

Balance score card as a performance



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Leading organizations has been successfully using performance measurement to gain insight into the organization and the effectiveness and efficiency of its programs, processes, and people. However, they do not stop at collecting and analysis of data rather, these organizations use performance measurement to force improvements and successfully transform strategy into action. Therefore, they use performance measurement for managing their organizations.

The balanced scorecard (BSC) is the most widely applied performance management system today. The BSC was originally developed as a performance measurement system in 1992 by Dr. Robert Kaplan and Dr. David Norton at the Harvard Business School. Unlike earlier performance measurement systems, the BSC measures performance across a number of different perspectives-a financial, a customer, an internal business process, and an innovation and learning perspective. BSC was introduced at a time when businesses were evaluating performance only through a financial scope and the different perspectives added a new dimension to the performance management concept.

However over the years a number of alternatives have been introduced to replace BSC such as Applied Information Economics (AIE), Performance Prism, Results based management Model etc. This is mainly due to the changes in the environment which is beyond the four quadrants of BSC and basic implementation issues experienced in BSC. The Balanced Score Card has to go through a transformation in order to survive and revive itself as powerful performance management tool.

Balance Score Card – Introduction

The field of performance management in today's day and age is vital to any organization. This importance can be defined through John E Jones quote “ What gets measured gets done, what gets measured and fed back gets done well, what gets rewarded gets repeated.”

- John E. Jones. Performance Management can be of two main aspects. In one view, the performance of the company as a whole and further the effectiveness of the management of their capabilities of running the business successfully are looked at while in another view performance management system of evaluating employees to help them reach their respective goals and thereby ensure that the company meets the company's overall objectives.

When the word “ measurement” comes to our mind, it has always been through a financial scope. There by performance of an entity was always measured through measures such as Return on Investment (ROI), Earnings Per Share (EPS), Gearing Ratio, Net Profit After Tax (NPAT), and Sales Turnover etc. However when the environment became gradually more competitive and complex there were more stakeholders involved in a business. The customers were one of the main stakeholders interested in the activities in the organization. Their demand evolved and along with that how they perceive performance also too dramatic change. They were no more content with only financial evaluation of the organization; measures such as market share, customer satisfaction, productivity, and innovation etc were more appealing.

It was during this transition, the balance score card was introduced by Dr. Robert Kaplan (Harvard Business School) and David Norton as a performance measurement framework that added strategic non-financial performance measures to traditional financial metrics to give a more balanced view of organizational performance.

The balanced scorecard is a strategic management tool used for translating an organization's strategic objectives into a set of performance indicators distributed among four quadrants. Some of these indicators are maintained to measure an organization's advancement towards its vision and other indicators are maintained to measure the long term drivers of success. Through the balanced scorecard, an organization monitors both its current performance and its efforts to improve processes, motivate and educate employees.

Balance Score Card – History

The balance score card has been known to be created by Kaplan and Norton however there is a historical twist to this as for my findings on www.wikipedia.com. The first balance scorecard was created by an independent consultant called Art Schneiderman in 1987. He participated in a research study in 1990 led by Dr. Robert S. Kaplan and was able to describe his work on balanced score card. Subsequently, Kaplan and David P. Norton included anonymous details of this use of balanced scorecard in their 1992 article on Balanced Scorecard. Kaplan and Norton's article wasn't the only paper on the topic published in early 1992 but the 1992 Kaplan and Norton paper was a popular success, and was quickly followed by a second in 1993. The balanced score card was widely spoken of only through their articles and <https://assignbuster.com/balance-score-card-as-a-performance/>

journals. Kaplan and Norton researched on BSC through a project involving 12 companies. Thereby BSC became Kaplan & Norton Balance Score Card and they were identified as the creators. Balanced Scorecard has been awarded a prize by the American Accounting Association as the “ best theoretical contribution in 1997”.

Balance Sore Card – Perspectives

As explained earlier BSC is a tool which monitors organizational strategies by using a combination of financial and non financial measures. It is designed to interpret strategy in to objectives and measure it across four balanced perspectives, namely Financial, Customer, Internal Business Process and Learning and Growth. The BSC directs to develop metrics, collect data and analyze as for these for quadrants in order to have an overall perspective.

The pictorial view of the perspectives is as follows:

The Financial Perspective

This perspective reviews if the strategies of the company contribute towards the bottom line of the company. The virtue of Balance Score Card (BSC) is that it represents both leading and lagging performance measures.

Traditional lagging indicators include financial measures, such as revenue growth and profitability. As it implies financial data is mostly historical data and organizations are measured based on its past performance. This perspective clearly describes how the organization looks to the shareholders.

Few of the measures that can be used are :

- Return on Capital Employed (ROCE)
- Return on Investment (ROI)

- Market Share
- Revenue Growth
- Profitability
- Economic Value Added (EVA)

The Customer Perspective

This aspect reviews how customers perceive the organization. And today, the buzz word in the corporate world is customer service. The importance given to this concept is immense due to the competitiveness and the buyer bargaining power. Therefore customer focus, customer satisfaction, on time delivery etc are leading indicators. Poor Performance from this perspective is a leading indicator of downfall in future business even if the financial indicators are healthy.

In developing metrics for satisfaction, customers should be analyzed in terms of kinds of customers and the kinds of processes for which we are providing a product or service to those customer groups. Metrics for the customer perspective could include:

- No. of Complaints
- On Time Deliveries
- Repeat Purchases
- Customer Acquisition
- Customer Retention

The Internal Business Process Perspective

This assesses the quality of people and processes. This perspective refers to internal business processes which the company should improve in order to achieve its objectives and give customers both satisfaction and productivity.

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Traditional methods only looked at improving existing systems however the balanced scorecard has the ability to identify entirely new processes that the business should succeed, in order to achieve customer satisfaction. The measures for this have to be developed very carefully as understanding the business process is crucial. The measures should focus on internal processes that will have the greatest impact on customer satisfaction and achieving business objectives.

Potential measures for the internal perspective include:

- Amount of reworking
- Increase in productivity
- % of defects
- Increase in capacity utilization

The Learning & Growth Perspective

This perspective concentrates on the areas an organization must improve, on continuous improvement, and creating value in the future. The focus is on the intangible assets of the organization. The future of any organization today lies on how innovative and evolving it is, thereby this perspective encourages this aspect. Further the perspective includes employee training and corporate cultural attitudes related to both individual and corporate self-improvement.

The following metrics could be used to measure success in relation to the innovation and learning perspective:

- No of New Products introduced
- No of Trainings done per period

- Research & Development as a % of Sales
- Employee suggestion which were implemented

Critical Evaluation of the Balance Score Card

An organization without a performance management system is like a ship in the deep blue sea without a compass, not knowing if the direction it sails is correct nor knowing how to improve its direction. Therefore the purpose of measuring performance is not only to know how the entity is performing but also to enable it to perform better. The Balanced Scorecard concept measures whether the companies are aligned with its larger-scale objectives in terms of vision and strategy. It focuses not only on financial outcomes but also on the human aspect as explained earlier under the introduction and the perspectives area. Thereby the BSC provides an overall view of the organization and the business. This is contrasting to the traditional method of being only financial oriented only. The measurements used in the separate perspectives are explained in the earlier section.

The balanced scorecard is not only a measurement system but is a management system as well. It enables organizations to clarify their vision and strategy to its employees and translate them in to operational goals or action plans. The evolution of BSC from its simple performance measurement framework to a strategic planning and management system is gradual.

Further the BSC is also useful to communicate the expectations expected from the employees. This can be done through clearly defining the measures or KPI's to be achieved by individual or department. To elaborate this in order to achieve overall objectives of the organization of Sales growth by <https://assignbuster.com/balance-score-card-as-a-performance/>

10%, Employee A, B & C of Production Department can contribute by keeping the lead time of goods 98% as expected or better than customer expectation. Employee D & E of Sales team can target to ensure customer complaints are attended to within 24hours which is an industry norm. As explained in this, the Sales growth of 10% is expected to come through attending to customer order on time (lead time) and customer service (handling complaints). Cascading the organizational objectives to the lowest level employee will pave the way for success.

As explained the balance scorecard has evolved over the years to be identified as a “ strategic linkage model” or a strategy map. The strategy map enables organizations to clarify their strategy and assist organizations with creating their BSC framework and measures. A generic corporate strategy map is provided below to illustrate the “ Strategy Map” concept.

The balance score card has the ability to identify the key areas which can make a huge impact in an organization. The critical success factors of each perspective can be identified through the well defined measurement criteria. As for the results of the KPI's the management has the ability to identify the superior and weaker link of the organization and take action to correct the situation. A business might be performing well with increased sales, however the production team might have a ratio of increased defect rates. This might not reflect in the top line as the production team ensures the sales are not slowed down by covering up with increased production. If the internal process is not reviewed properly the production defect rates will not highlighted. This is where the BSC becomes a critical tool to identify critical success factors.

The balanced scorecard approach can be used and applied at both the individual and the organizational level. It provides a balanced approach to evaluate the employees' performance in a comprehensive manner.

Traditionally, measuring the employee performance refers to only the comparing of their action plans and behaviors with the standards set.

However the BSC actually measures the results of their actions like profits, increasing market share. It considers the progress towards achieving the goals and objectives of the organization and the effectiveness of the process. Thereby, the balanced scorecard gives the full view of the employees and the organizational performance and it helps to align the employee performance plans with the organizational goals.

The Balanced Scorecard provides a stage for feedback and in turn a process for learning as well. Feedback about products, new learning's discoveries can be included in to the scorecard. Based on the measures employees can be given feedback and also training in order to improve the processes. This helps to refine the processes on a continuous basis with the use of the feedback. Thereby once a balanced scorecard system is in place, it allows for ongoing monitoring of goals and objectives.

BSC benefits to maximize co-operation between teams. Employee helps one another to achieve their respective overall KPI's. This helps to build the team culture in the organization. The BSC drives a performance drive in to the business with its set objectives and continuo's feedback. And if the objectives are linked to rewards, employees are very well motivated to achieve the set targets.

The BSC's ability to give a wide view of the business operations makes it a formidable tool in the business world. The four perspectives of the scorecard permit a balance between short term and long term objectives, between desired outcomes and the performance drivers of the outcome, between soft measures and hard measures.

However having gone through the positives of the Balanced Score Card, this tool has its negatives as well. The Balanced score card was introduced in the early 90's and now the business environment has seen many changes. Has the Balanced Score Card got all requirements to still qualify as good performance management tool in current context? , will be discussed in detail in the following section.

The organization through different elements in BSC analyzes the organization's performance and these measures are vital in creating a good balanced scorecard. Once the balance score card is implemented, you can not presume the business environment to be the same. In current context the volatility of the business environment is so rapid therefore the nature of your business can change in time, which means the BSC too has to be modified accordingly. It is a time consuming affair to maintain a scorecard but if it is not done properly the organization's ability to evaluate its employees will become an issue. The business should be able to give a considerable time to upkeep or maintain the scorecard, if not; it might not be a good solution for the business.

The balance scorecard attempts to involve employees from all levels in the organization by cascading the vision and strategies. Despite inherent

attempts to empower employees, the balanced scorecard is still seen to be based around a centralized, prescriptive model. Even though BSC focuses on dynamism and constant feedback it would still react slow to bottom level suggestions based on the organizational culture and background. In their book in 2007, Kaplan & Norton (2007) mentioned that implementing a BSC would take a minimum time line of 26 months.

Another weakness in BSC or a question which remains unanswered is how well the BSC will function in a dynamic environment. Organizations today are going through a paradigm shift. Internet and Information Technology as a whole has made the world a global market. Thereby the businesses also have to adapt to different environments, new changes in order to survive. Is BSC a model which is fast enough for this adaptation? , is a query in most people's mind. Currently any measurement tools have to be modified taking in to account the dynamic changes in the environment in order to make it a pervasive tool.

As discussed in the previous areas the BSC is designed to measure performance through four major perspectives. However questions are raised now whether these perspectives are sufficient to measure a business performance. As indicated in the BSC - History this model was introduced in the early 90's, however the organizations and the environments they perform in have moved much further and there are many other concepts which are significant for an organizations long term sustainability. As an example the Green concept was only a thought in the early 90's but today it's a way of life for organizations. Even customers are concerned in how respectful their brands are to the environment. Corporate Social

Responsibility is another indicator that organizations have stepped out of the traditional financial performance criteria, and they are actually weighed for the contribution they make to the society. It is used as a way of marketing too. These areas have a special place in the annual report and it is the pride of any organization to report their contribution to the society and the environment. Further ethical practices play a main role in reporting and in anything an organization does. After the Enron issue ethics have been discussed in the corporate tables and it does matter in blue chip companies to be ethical towards its stakeholders and shareholders. However these elements have not been touched upon on the balance score card.

Another observation on BSC is on the weight given on the four perspectives, the standard weight given may not be applicable to all organizations. It might vary from industry to industry and even internal divisions might have varied measures, thereby based on the importance of the perspective has to be reviewed before weights are assigned. Based on the research by Kaplan & Norton (2003) it has been found that using about 20 -25 measures is the usual recommended practice. Figure 3 drawn from an article written by Dr David Norton illustrates the weights assigned for each perspective, with greater emphasis on internal business process, as it is the primary source through which the strategy of the organization is implemented.

The balance score card weights should not be a pre defined and should be a management decision based on industry norms etc. At IFS which is an organization keen on research and development and learning, the emphasis on the internal process and learning and growth perspectives will be high. However if we take a bank, Financial stability, Customer service and the

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Internal Processes are all vital and require high weight. Thereby it is crucial on understanding the concept properly on assigning weights as it is a crucial part of BSC.

The stakeholders form the main category of any organization, because they are the group of people who will be affected from the decisions made by the organization. The customers perspectives have been included in to the Balanced score card however the other main categories which I felt lacking in BSC are the suppliers and the competitors. The suppliers are key to a company's source of raw materials and supplier management can bring monetary benefits to the organization. Organization should always keep a tab of its competitors and scores should be kept to follow up on direct competitors. As adding more perspectives will complicate the BSC, I have suggested a recommended way of handling this under recommendation section.

Though the balanced score card could be reward the employees it is criticized when performance evaluation and incentives are related to it. It has been found that when rewards are linked to the scorecard directly, productivity drops considerably. This is mainly due to the fear by the employee that he/she maybe made responsible for factors which is beyond their control. Thereby they may tend to keep a margin or levy when agreeing upon targets in order to achieve the targets and get the incentives in a relaxed way. However this is not critic on the BSC concept, it is an issue with the implementation.

Another criticism is that the Balanced Scorecard does not provide a bottom line score. The scores are not assigned based on any proven economic or financial theory. The bottom line score does not give a unified view with clear recommendations. It acts only as a simple list of metrics and how they are interpreted will vary from organization and industry. Therefore the implementation and the management commitment and intelligence in interpreting the measures play a main role in the success of BSC.

Further to elaborate on this for BSC it is not usually sufficient to use generic measures used by other organizations. Each business should strive to identify the firm specific measures that are appropriate to implement their strategies and achieve the vision of the company. This relies upon the competency of the management. Further many companies use only lagging measures which shows results of a past event. For the balance score card to be successful the business should include leading measures as well, which will indicate the future of the business. Many managers get carried away with BSC by only including non financial measures however to reap the full benefit of BSC managers have to include future indicators (leading measures) as well. A research conducted by Claude Levy, a professor at the Free University of Amsterdam reported that the failure rate of BSC implementation is 70% and this is mainly due to the many number of metrics and employees not having an understanding of the metrics.

Due to its long duration in implementation many organizations use a balanced scorecard system. However this cost a lot of money in training time and additional money for any consultants that are needed during the

process. Therefore the initial cost in implementing the balanced scorecard is huge.

Balance Score Card – Recommended Improvements

Based on the evaluation above I suggest the following to improve the current balanced score card.

1. The main stakeholders such as competitors and suppliers should also be entered in to the BSC. As including another area will complicate the score card, I suggest these stakeholders are identified under internal business process however even 2-3 measures/KPI each has to be assigned for each stakeholder under this area. Many alternative tools have been designed based on the BSC framework and the “Performance Prism” is one such customized BSC framework which takes in to account five perspectives, which includes stakeholders as well.
2. The BSC design should be broader in order to accommodate the environmental aspect, Society and Ethics. However complicating the BSC with many perspectives will not serve the purpose either. Therefore the balanced score card should have an industry specific format with assigned measures. This standard could be used for the firm and customized if required. The measures used should be between 25-30 maximum with the newly included areas as well. Too many measures mean most of the time nothing gets measured at all.
3. The weights assigned to the perspectives should be decided based on the firm and the importance of the processes relevant to the business. I feel that it is hard to pre-define the weights in today’s context and it

should be a management decision, however in order to ensure order prevail they could get audit support on assigning weightage.

4. On implementation of the BSC it is of utmost importance that the objective of the concept is clearly communicated. Further if the measures/KPI's are discussed with line managers and staff before entering it to the scorecard the employees will feel ownership towards the KPI's. And thus can avoid any issues later arising when rewards are linked to KPI's. Linking incentives to the achievement of these KPI's is a motivator, and I feel should be an integral part of BSC.
5. The BSC will not be successful if it does not include leading measures as well as the lagging measures. At the end of the day it is all about improving your future. Thereby there should be a specification on BSC that out of the total measures even 40% should be leading measures and that there should be even one for each quadrant.
6. The balanced scorecard or any other performance management tool is driven by a well defined strategy of the organization. It is the understanding of the linkages between the objectives and metrics that is the foundation of the BSC. Thereby if the business is not equipped with a good strategy and competent management team, I feel the BSC is not the performance management tool for them.
7. The balance score card with its metrics should be an automated system. In present scenario, unnecessary issues can be resolved if a balanced scorecard software is installed. The organization should also give adequate time for training the staff.

Conclusion

The Balanced Score Card is the pioneer tool in focusing on a range of perspectives which included financial and non-financial factors. The tool is built to focus on past and future of the business with its lagging and leading measures. However in an ever evolving business environment, the BSC has failed to evolve with time. And the balance scorecard depends heavily upon how it is used or interpreted. Therefore the management commitment towards BSC is vital for its success.

The biggest critic for BSC is that its disability to be maintained in a dynamic environment. The industry specific BSC designs will be more applicable and more flexible. And these formats can include the perspectives relevant to that industry. For example for the power generation industry the environmental perspective should be mandatory. Further if the Balance Score card software is used the time factor for implementation can be reduced.

The weights assigned to each perspective should also be firm specific and the KPI's should be reviewed on a constant basis in order to ensure that they are real time KPI's.

The balance score card is still a popular tool among many mainly due to its simple to understand concept. All organizations are trying to gain an advantage over the other at all times, therefore if one organization takes the first step towards another performance management tool, the Balance scorecard will see a slow death.