The role of performance measurement accounting essay

Business, Accounting

CHAPTER 2

LITERATURE REVIEW

2. 1 Introduction

This chapter will cover the literature on performance measurement, strategy map, balance scorecard and its role in aligning organizational goals to the strategy. By studying related literature on BSC, it is seen that BSC really plays a significant role in the success of an organization and that it helps to measure the success of the strategy (Kaplan and Norton, 2001). Schneiderman (1999) stated that balanced scorecards that did not have a sound foundation would fail. Therefore, this chapter will summarize the positive and negative effects of BSC collected from many studies and elaborate hypotheses to predict the effects of BSC in practice of a specific organization. Additionally, it is learnt from this chapter that the four perspectives of BSC are inter-related, and that even though financial results are very important, delivering long term value and success will require a focus on non-financial factors including high performing people, efficient processes and effective customer services (Kaplan and Norton, 1996). The following part is related conceptualization on the research content.

2. 2 Performance Measurement

2. 2. 1 Definition

Performance measurement is defined by Lebas (1995) as a system by which a company monitors its daily operations and evaluates whether it is attaining its objectives. Meanwhile, Lichiello and Turnock (1999) define it as the selection and use of quantitative measures of capacities, processes, and outcomes to develop information about critical aspects of activities, including their effect on the public. Basically, it is considered part of a performance management system (Sanayei et al., 2011) and is set aligned with the organization's strategy. According to Hronec (1993), performance measurement system is a tool for balancing multiple measures (cost, quality, and time) across multiple levels (organization, processes and people). While it was suggested by Green et al. (1991) to " target the value-added activities of the company", Kaplan (1991) suggested that an effective performance measurement system " should provide timely, accurate feedback on the efficiency and effectiveness of operations". In fact, organizations always plan to build an effective tool to help them manage the performance and well achieve the targets.

2. 2. 2 The role of performance measurement

According to Christian C. Johnson (2007), it is important to understand why measuring an organization's performance is both necessary and vital…. An organization operating without a performance measurement system is like an airplane flying without a compass, a Formula One race car driver guiding his car blindfolded, or a CEO operating a company without a strategic plan… The purpose of measuring performance is not only to know how a business is performing but also to enable it to perform better. The ultimate aim of implementing a performance measurement system is to improve the performance of an organization so that it may better serve its customers, employees, owners, and stakeholders. Basically, a performance measurement system enables an enterprise to plan, measure, and control its performance according to a pre-defined strategy (Johnson, 2007). Many authors including Atkinson and McCrindell (1997), De Toni and Tonchia (2001), as cited in Pongatichat and Johnston (2008), have identified its benefits as a tool to (i) communicate the organization's strategic direction, strategic priorities, (ii) create a shared understanding, (iii) monitor and track the implementation of strategy, (iv) align short-term actions with long-term strategy, (v) make clear the links between performance of individuals and sub-units, and sub-units and overall organizational performance, (vi) promote integration among various organizational processes, (vii) focus change efforts, and (viii) facilitate organizational learning.

2. 2. 3 Different performance measurement models

Many researches on banking performance measurement used traditional measures like statistical analysis (Arshadi & Lawrence, 1987; Devlin & Gerrard, 2005), structural equation models (SEM) (Collier, 1995), multi-criteria classification methodology (PARCLAS) (Kosmidou et al., 2006) and DEA (Giokas, 2008). In the meantime, Wu et al. (2011), Chen et al. (2008), and Meyer and Markiewicz (1997) chose to adopt the four BSC perspectives, including both financial and non-financial indicators. In their 1992 work, Kaplan and Norton also described performance measurement as a way to review an organization's financial and non-financial goals. Figure 2. 1 summarizes the selection indicators of banking performance measurement that have been investigated in several important studies, along with their main analytical methods (Wu et al., 2011). According to Weber et al. (2001) and Bible et al. (2006), traditional measures no longer worked effectively because those measures relied so strongly on financial indicators and did not sufficiently cover other critical factors like skills, competencies, and motivation of employees; customer and supplier relationships; innovative product development; databases and information technologies; efficient and responsive operating processes; innovation in products and services; customer loyalty and relationships; and political, regulatory, and societal approval. Meanwhile, the BSC can cover all these measures in a more specific and appropriate way that supports management in implementing organizational goals. Furthermore, amongst some major models listed out by Johnson (2007) in performance measurement including Activity-based Costing and Management, Economic Value Added, Quality Management, Customer Relationship Management and Balanced Scorecard, BSC seems to be most widely used. It differs from other tools as it first begins with the question: " What is the strategy?" When answering this question, a strategic map is used, that is " a logical and comprehensive architecture for describing strategy" (Kaplan and Norton, 2001 as cited in Kocakulah and Austillm, 2007). Literature on strategy map will be articulated in the following part after the theories on BSC.

2. 3 Balanced Scorecard

2. 3. 1 Definition

As mentioned by Kaplan and Norton in their 1992 work, BSC is an integrated set of performance measures comprising both current performance indicators and drivers of future performance, and financial as well as non-financial measures. It is considered a strategic performance management system that links performance to strategy using a multi dimensional set of financial and non-financial performance measures. In addition, it helps companies improve corporate governance (Dye, 2003) through the management of business performance and achievement of strategic goals. The concept of BSC was then extended into a management tool for describing, communicating and implementing strategy (Kaplan, 2010). As highlighted by Sharma (2009), BSC is unique in two ways compared to the traditional performance measurement tools: (1) it considers the financial indices as well as the non-financial ones in determining the corporate performance level and (2) it is not just a performance measurement tool, but also a performance management system. According to Tseng (2010), BSC is a multi-criteria evaluation concept that highlights the importance of performance measurement. For managers of organizations, the function of the BSC is to provide a view of what is happening both inside and outside the organization, involving identifying the key components of operations, setting goals for them, and then exploring ways to measure progress toward achieving those goals (Luu and Venkatesh, 2010). The term " balanced" reflects the balanced consideration given to long and short term objectives, financial and non-financial measures, leading and lagging indicators, and external and internal performance perspectives, said Kaplan and Norton (1996a). Many studies, as mentioned in Gates (1999), Lingle and Schiemann (1996), proved that organizations managing through ‘ balanced’ performance measurement systems perform better than those that are not. The BSC’s key characteristic is that the included measures are linked to the entity’s mission and strategy, and are explicitly designed to inform and motivate continuous efforts toward their attainment (Hoffecker, 1994; Kaplan & Norton, 1996a, 1996b, Kurtzman, 1997; Maisel, 1992). Meanwhile, Bible et al. (2006) said that a major characteristic of a BSC is that it combines long-range strategic financial goals with day to day operations and that it is a useful tool in helping companies focus on the future. As such, the BSC is an integral part of the strategic planning process, and not just a system for tracking performance after the fact (Kocakulah and Austill, 2007). An effective balanced scorecard generally includes a mix of outcome measures and performance drivers. Furthermore, an effective balanced scorecard embodies a balance between diagnostic measures and strategic measures. Gumbus et al. (2003) found that it measures outcomes and focuses on continuous improvement. The balanced scorecard articulates a theory, or model, of the organization's causal chain of performance drivers and outcomes. At the organizational level, developing the balanced scorecard involves identifying several key components of operations, establishing goals for these and then selecting measures to track progress toward these goals. In a research by Morisawa (2002), the five essences of BSC are described as (i) achieving a balance among short-term, medium and long term management objectives through a diverse measurement of performances; (ii) creating a sense of understanding by establishing non-financial quantitative indicators other than financial indicators; (iii) eliminating vagueness by keeping to quantitative indicators; (iv) promoting organizational learning through a repeated cycle of hypothesis verification and knowledge management for organizational achievement; (v) providing a common strategic communication platform linking the heads and members of the organization. With applying the BSC conceptualization to the case of HSBC, the author would like to propose the following hypothesis.

H1: Balanced Scorecard is an effective performance measurement tool.

2. 3. 2 Four perspectives of BSC

According to Smith and Kim (2005), implementation of a balanced scorecard usually starts with senior management who defines the organization’s mission and strategy. This strategy is then translated into objectives for departments and individuals (Bible et al., 2006). These objectives are aligned with the overall corporate strategy and converted into four diverse perspectives: financial, customer, internal business processes, and learning and growth (Kaplan and Norton, 1992) as illustrated in Figure 2. 2 below. Figure 2. 2: Four perspectives of Balanced Scorecard (Source: Kaplan and Norton, 1992)With Financial perspective, it indicates how well the organization is translating its operational results into financial well being (Kaplan and Norton, 1992). The objective of every organization is to deliver maximum value to stakeholders (Pangarkar and Kirkwood, 2008). Measures are operating income, revenue growth, return on capital, and economic value added. In addition, Cohen (2003) as cited in Smith and Kim (2005) highlighted that since the scorecard includes both financial and other measures, management can see how decisions will affect not only the financial measures, but also the general health of the company. With Customer perspective, it reveals how well the organization is meeting the expectations of its customers. It includes objectives for desired customer-related outcomes, such as to acquire, satisfy, and retain targeted customers (Kaplan and Norton, 1992). As customers are the source of business profits, satisfying customer needs is the ultimate objective of enterprises (Prahalad and Ramaswamy, 2004). According to Smith and Kim (2005), most companies are interested in customer satisfaction, customer retention, new customer acquisition, market position and market share in target segments. They can acquire this information in various ways, such as customer satisfaction surveys, focus groups, and market analyses (Quick MBA, 2004), and then work out specific targets to be incorporated into the balanced scorecard. With Internal Processing perspective, it focuses on the internal processes that the entity must perform well if it is to meet customers' expectations and financial objectives for productivity improvements (Kaplan and Norton, 1992). Internal business processes are the mechanisms through which performance expectations are achieved (United States Department of Energy, 2004). With Learning and Growth perspective, it is vital to focus on employee skills that drive improvements and successes with respect to the other perspectives (Kaplan and Norton, 1992). Objectives are to describe the goals for employees, information systems, and organizational alignment. The measures here are commonly employee-related and include data on turnover, lost time accidents, productivity, training hours, certifications, career and leadership development, and job satisfaction. According to Smith and Kim (2005), learning and innovation perspective is much more than just the training of employees. It includes cultivating an environment where mentoring and tutoring of employees by other employees is part of the corporate culture (The Balanced Scorecard Institute, 2004) and where help is readily available for anyone in the organization who needs it. It also includes making information available to everyone in the company. Figure 2. 3 gives a sample of generic measurements of the 4 perspectives with classification of financial and non-financial, short term and long term, leading and lagging, internal and external factors (Martin, 2012).

2. 3. 3 The positive effects of BSC

BSC is commented by many authors to have many good points which are mentioned below. According to Waal et al. (2009), the more complete the BSC system implementation is, the more positive effects an organization will have and, in other words, the more it will benefit from this system.

Clarification and translation of the organization’s vision and strategy

According to Kaplan and Norton (1996, 2001), balanced scorecard, when correctly understood and properly implemented, clearly communicates the organization’s strategy to its employees. Kaplan and Norton (2007) emphasized that the scorecard lets managers communicate their strategy up and down the organization and link it to departmental and individual objectives. It provides executives with a comprehensive framework that can translate the company’s vision and strategy into a coherent and linked set of performance measures (Kaplan, 2010). In addition, Johnson (2007) agreed that the scorecard helps to translate the organizational strategies into more easily understood operational metrics and goals. In the meantime, translating a bank’s strategies into actions was listed by Hung-Yi Wu (2012) as one of the benefits of using the BSC for banks.

Alignment between business strategic goals and operation plans

Kocakulah and Austill (2007) agreed that it combines long-range strategic financial goals with day-to-day operations and enables companies to integrate their business and financial plans. According to Sorenson and Sullivan (2005), a good BSC system makes the organization and its departments focus on fulfilling the mission through the linking of objectives, initiatives and measures to an organization's strategy. This will allow management to align the business and service units, teams, and individuals around strategic goals to implement and achieve corporate strategies successfully (Bible, et al., 2006). Furthermore, it improves alignment among divisional (or individual) goals and the organization's goal and strategies. It also aligns annual or short-term operating plans and performance-evaluation measurement with long-term strategies (Pineno & Cristini, 2003).

Efficiency improvement and better strategic planning

According to Kocakulah and Austill (2007), it is a successful tracking record of efficiency improvement and better strategic planning. Lovell et al. (2002) and Tapinos et al. (2005) agreed with that, whereas Pieper (2005) said that BSC provides a snapshot of the organizational performance that is easy to understand, and it can enhance communication with key stakeholder groups from customers to employees. A case study of Ahn (2001) showed that, in fact, the BSC contributed to clarify and describe strategy, of a business unit, into clear elements that are easily understandable by all people: " A clear strength of the Balanced Scorecard was that of being an easily understood concept" (Ahn, 2001). The results of the research of Geuser et al. (2009)

showed that the BSC helps to clarify strategy at the operational level. On the other hand, it makes employees understand the value of their work and how it relates to the organization's strategic objectives (Inamdar and Kaplan, 2002). Hung-Yi Wu (2012) pointed out that BSC provides a way to measure and monitor the performance of key performance drivers that can lead to the successful execution of a bank's strategies, whereas Frigo et al. (2000) said it is an effective tool to ensure continuous improvement in the systems and processes of banks. Dumond (1994) and Sandt et al. (2001) suggest that using balanced performance measurement systems improves the decision-making performance of managers and employees. Lawson et al. (2003) and Dumond (1994) found that using performance measurement systems and linking scorecards to compensation significantly increased employee satisfaction, whereas Ittner et al. (2003b) presented evidence to the contrary.

Enhancement of strategic feedback and learning throughout the organization

According to Salterio and Webb (2003), BSC makes it possible for strategic learning and feedback. It is to provide guidance and feedback toward the desired outcomes. It can provide motivation and direction, give feedback on the effectiveness of plans and their execution, and help in strategy formulation and revision (Weng, 2011). It enhances employee's learning and continuous improvement by measuring and providing feedback on their actions (Kaplan and Norton, 2001). It speeds up the pace of learning because the actual results are compared to predictions (Inamdar & Kaplan, 2002).

The below Figure 2. 4 summarizes some key good points of BSC and lists the literature sources in which they were found.

No.

Positive effects of BSC

Literature sources

1Clearly communicates the organization's strategy to its employeesKaplan & Norton (1996, 2001); Pieper (2005)2Links strategy to departmental and individual objectivesKaplan & Norton (2007); Bible et al. (2006)3Translates strategy into more easily understood operational metrics and goalsJohnson (2007); Hung-Yi Wu (2012); Geuser et al. (2009)4Combines long-range strategic financial goals with day-to-day operationsKocakulah & Austill (2007); Pineno & Cristini (2003)5Gives a clear focus for the organization and its departments on achieving targets and fulfilling the missionSorenson & Sullivan (2005)6Gives a tracking record of performance, efficiency improvement and better strategic planningKocakulah & Austill (2007); Lovell et al. (2002) & Tapinos et al. (2005) ; Hung-Yi Wu (2012)7Makes employees understand the value of their work and how it relates to the organization's strategic objectivesInamdar & Kaplan (2002)8Increases employee satisfactionLawson et al. (2003) and Dumond (1994)9Encourages strategic feedback, continuous improvement and learning and development throughout the organizationSalterio & Webb (2003); Frigo et al. (2000)It is seen that all the above positive effects are just mentioned in theory and may differ in different types of organizations. Kocakulah and Austill (2007) saw that as entities and industries differ, scorecards may differ. In reality in an organization like HSBC in Vietnam these good points need to be authenticated through getting feedback from as many employees as possible to ensure accuracy and suitability. Accordingly, the research is to check whether the benefits of implementing BSC at HSBC Vietnam are in line with those statements indicated by other authors. Those listed in the table are used as criteria to evaluate the effectiveness of BSC in HSBC in Vietnam. According, the following hypothesis is proposed.

H2: There are relatively positive impacts of BSC in HSBC.

In regarding point number 7 in the table above, there is a relationship between employees having a good understanding of the organization's strategic objectives with a well-performing organization. According to Stewart (1999), a well-performing organization should have at least 67% employees having a good understanding of overall organization goals. This research will then conduct a survey amongst HSBC's employees to examine if they know and understand its objectives and if HSBC is considered well performing in accordance with Steward's (1999) point of view. Another hypothesis is given below:

H3: There is a positive relationship between a well performing organization and its employees' understanding of its objectives.

2. 3. 4 Negative impacts of BSC

While there are a large number of advantages of the BSC indicated in previous studies, few possible negative aspects of its use have been discussed. According to Bourne et al. (2000) and Neely et al. (2000), much work has been carried out on the design and deployment of measurement systems, but relatively little on their impact.

Lack of communication

According to Kocakulah and Austillm (2007), there is a lack of communication within the organization about the use and purpose of the BSC. This lack of communication can have serious implications on the BSC’s effectiveness, and it is one of the main ways in which problems occur when the BSC is not utilized properly. Rousseau and Rousseau (2000) characterize this problem as the " executive toy syndrome." Balanced scorecards that fail to involve every employee’s understanding and commitment are destined to fail. As such, it is necessary to get to know if BSC’s purposes are effectively communicated and if employees well understand the organizational goals and objectives through the execution of BSC.

Imbalance between the four perspectives

If the BSC is not properly built, meaning one of the four perspectives is not receiving due attention and focus, the impacts can be negative and not measurable. Todinov (2006) gave an example that failures in internal processing system may cause high losses, for instance in operational loss, customer loss, reputation loss, low quality, low productivity, etc. On the other hand, Smith and Kim (2005) figured out that insufficient focus on learning, innovation and growth results in negative impacts on other perspectives and the business goals eventually. They said, the reason why learning and growth is the one that businesses tend to overlook the most amongst the four perspectives is because the links between innovation, learning, and growth are not visibly tied to bottom-line results in short term. Meanwhile, learning and growth are pointed out by Martinsons (2002) as a motivation factor to employees, directly impacting employees' satisfaction and retention. Yet for many years, as Kaplan (2010) described it, the learning and growth perspective was " the black hole of the Balanced Scorecard." As such, it is necessary to look into the case of HSBC to see if this kind of issue is existent and how to overcome it.

Adaptability to strategy changes

Kocakulah and Austill (2007) raised their concern about the adaptability of BSC to strategy changes. According to Niven (2002), in some changes, objectives, measures and targets might remain in place unmodified, whereas in some other changes, there might be the need to be replaced with new ones consistent with the updated strategy. In practice, in many organizations, BSC may not be properly updated in line with the changes in strategy. It can be due to the reason that changing a BSC can be very time-consuming (Weng, 2011), including working on a list of relevant objectives and measures that reflect the changes, then communicating the changes down to all levels across the organization, allocating resources, evaluating and feedback and adjustment. It can also be due to the missing of management's due attention to the role and significance of the BSC to the achievement of organizational goals. This issue will be taken into consideration when doing the research on the case study of HSBC in Vietnam. By and large, although there are not many negative impacts found in recent studies, all the above mentioned issues will be authenticated in the following Chapter. In addition, there remain a lot of issues to be identified and addressed from the case of BSC implementation of HSBC in Vietnam. It is believed that the study will churn out some interesting facts and findings to support the following hypotheses.

H4: There are relatively negative impacts of BSC in HSBC.

H5: Of the four perspectives of HSBC's BSC, learning and growth is the weakest point.

2. 3. 5 An ideal BSC model

The below model was mentioned by Norton (2000) as cited in Johnson (2007), articulating the need for balancing the number of measures in all four perspectives, with greater emphasis on process measures, because the process perspective is the primary domain through which organizational strategy is implemented. This model can be considered ' ideal' to many organizations, with a typical allocation across the four perspectives (Kaplan and Norton, 2000): financial – 22%customer – 22%internal – 34%learning and growth – 22%Best Practices LLC (1999) analyzed the scorecards of 22 organizations that had successfully implemented and found just about the same distribution of measures (Punniyamoorthy and Murali, 2008). However, Johnson (2007) believed that the number of metrics could vary due to the size of the company. Kocakulah and Austill (2007) also highlighted that organizations could tailor their BSCs to their own needs. The author agrees that weight of each perspective can depend on the organizational goals and departmental goals. For example, to a sales team, financial and customer perspectives can outweigh the other two and need to be more focused, whereas, to a service team, customer and internal process perspectives can outweigh. The result is to be authenticated after the survey is conducted in following chapters. Then the below hypothesis is born and pending for a confirmation.

H6: The execution of BSC in a specific organization in practice is different with an ideal BSC.

2. 4 Strategy map and potential relationships

2. 4. 1 Definition of strategy map

The strategy map is created from the causal linkages between BSC objectives and measures (Kaplan & Norton, 2000, 2001). It is the focus of a new strategic measurement system (Kocakulah and Austillm, 2007) and called a " value driver map" by Ittner and Larcker (2003). By defining strategy in such a way, organizations can establish an understandable direction for all their units and employees. Figure 2. 5 (Kaplan & Norton, 2004a) shows the current structure for a strategy map in which intangible assets and critical processes are linked to the value proposition and customer and financial outcomes. It helps transform intangible assets into tangible customer and financial outcomes. With the BSC, Kaplan and Norton have created a generic strategy map for different businesses, giving managers a starting place for describing strategy and improving the execution of processes to implement the outcomes. The firm will have a reliable foundation for the design of a management system to create a strategy focused organization (Kaplan and Norton, 2001).

2. 4. 2 Relationship between the four perspectives of BSC

Kaplan and Norton (1996a, 1996b) introduced three principles that link an organization’s BSC to its strategy: (1) cause and effect relationships, (2) performance drivers, and (3) linkage to financial goals. The chains of cause-and-effect connect all the factors (i. e., performance indicators) through the four perspectives of BSC, which reflect dynamically the change of strategies and indicate how an organization creates its value (Kaplan & Norton, 2004a, 2004b). Based on the BSC, the cause and effect relationships between the four perspectives have been created (Wong-On-Wing et al., 2007; Paul, 1998). Evans (2002) pointed out that not only does the BSC transform how the strategic plan is expressed, but it also pulls everything together, and counteract each other eventually (De Haas and Kleingeld, 1999). This is the so-called " cause and effect" relationship or linking of all elements together. For example, if you want strong financial results, you must have great customer service. If you want great customer service, you must have excellent processes in place (such as Customer Relations Management). If you want great processes, you must have the right people, knowledge, and systems (intellectual capital). Kaplan and Norton (1996) once said, BSC tells an organization the knowledge, skills and systems that its employees will need (learning and growth) to innovate and build the right strategic capabilities and efficiencies (internal processes) that deliver specific value to the market (customer) which will eventually lead to higher shareholder value (financial). Kaplan and Norton (2001) shared the same view. For example, investments in learning will lead to a better internal business process, which, in turn, is likely to improve a customer’s satisfaction and loyalty, and therefore result in a higher return on investments, which would satisfy shareholders. According to Smith and Kim (2005), as these four areas of strategic performance are based on cause-and-effect relationships, therefore, they can interact to serve as benchmarks for competitive success. The interaction of these areas also encourages all employees to consider the impact of their decisions on the financial performance of the company. As analyzed by Heskett, Sasser and Schlesinger (1997), learning and development drive performance and create customer profitability. Investments in employee training lead to improvements in service quality, better service quality leads to higher customer satisfaction, higher customer satisfaction leads to increased customer loyalty, increased customer loyalty generates increased revenues and margins. However, according to Sanayei et al. (2011), the relationships between Kaplan and Norton's (1996) perspectives are not cause and effect. Meanwhile, Norreklit (2003) thought that they are merely logic. Malmi (2001) also studied that employees' dissatisfaction was caused by lack of such causal relationships. Still, the researcher believes that there are cause and effect relationships between those components and will conduct on studying on this hypothesis.

H7: There are causal relationships between 4 perspectives of BSC in HSBC.