HOW BALANCED IS THE PERFORMANCE MEASUREMENT THROUGH THE BALANCED SCORE CARD

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1.INTRODUCTION

In the global knowledge economy, creation, sustenance and application of knowledge has become the key differentiator of success. Many companies have realized that management of knowledge and the knowledge workers act as a critical source of competitive edge than the traditional effective physical asset management.An important fall out of this thinking is rapid changes in the way the performance of an organization and its people is measured.Traditionally corporate performance is most often measured periodically using some variant of historical accounting e.g. Net Profit, EPS or some measures based on the accounting income e.g. ROI / ROCE.Traditional Financial ratios have worked as important tools of measuring organizational performance in the bygone years. It has however been felt that the leading indicators of business performance cannot be found in the financial data alone (Eccles, 1991).There has been growing criticism of financial measures in performance evaluation of a system in post-reform India as they are historic in nature rather than futuristic. Their relevance in the information age, in the context of companies building internal assets and capabilities is questioned. The situation may worsen when the firm is compelled to pursue short-term goals at the cost of the organization's long-term objectives (Anand, Sahay, & Saha, 2005).Measuring corporate performance has been a critical as well as time honored area of research. As practicing managers and academicians try to remedy the inadequacies of existing performance measurement systems focused around the traditional financial measures, variety of measures surfaced –while some have concentrated on traditional financial measures more relevant, few others have suggested non-financial measures. The rapidly growing literature on performance measures in the last two decades is a clear indictor of this phenomenon. The Economic Profit, Residual Income, Economic Value Added, Balanced Score Card, Activity Based Costing, Cash Value added, Shareholder Value Added, Total Shareholder Return, Cash Flow Return On investment are but to name a few among the most popular ones.This paper attempts to evaluate how balanced is the Balanced Score Card performance measurement system developed by Kaplan & Norton as an alternative-among others-to the traditional financial measures of performance.

2.WHAT IS BALANCED SCORE CARD?

Kaplan and Norton (1992) define the "Balanced Score Card" as a set of measures that gives top managers a fast but comprehensive view of the business. The balanced scorecard includes financial measures that tell the results of actions already taken. And it complements the financial measures with operational measures on customer satisfaction, internal processes, and the organization's innovation and improvement activities-operational measures that are the drivers of future financial performance.The balanced scorecard includes financial measures that tell the results of actions already taken. And it complements the financial measures with operational measures on customer satisfaction, internal processes, and the organization's innovation and improvement activities-operational measures that are the drivers of future financial performance.

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The balanced scorecard allows managers to look at the business from four important perspectives through four basic questions:

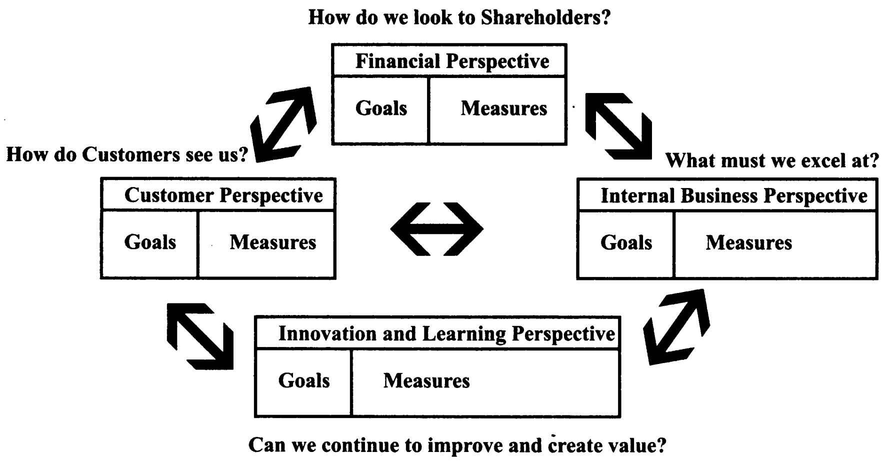
1.How do customers see us? (Customer perspective).

2.What must we excel at? (Internal business perspective).

3.Can we continue to improve and create value? (Innovation and learning perspective).

4.How do we look to shareholders? (Financial Perspective)

Figure 1: The Four Perspective of Balanced Score Card



Source: Kaplan & Norton (1992), The Balanced Score Card-Measures that drive Performance, HBR

Customer Perspective

The customer perspective will help the company address the important concerns of the customers and build their continued patronage. Customers' concerns tend to fall into four categories: time, quality, performance and service, and cost.

To put the balanced scorecard to work, companies should articulate goals for time, quality, and performance and service and then translate these goals into specific measures. In addition to measures of time, quality, and performance and service, companies must remain sensitive to the cost of their products. (Kaplan & Norton, 1992).

Internal Business Perspective

The Internal Business perspective aims at identification and improvement of critical internal business processes that yield competitive edge and result in greater customer satisfaction.The internal business measures in the scorecard should be taken from those processes that with the highest impact on customer satisfaction, profitability, core competencies. In each of these areas, the processes need to be decomposed into measureable components and linked to employee actions & skills.

Innovation and Learning Perspective

Innovation has become a key driver in the knowledge economy. Global competitiveness demands an ability to innovate continually and bring about value enhancements in internal business processes, external product markets.A company's ability to innovate, improve, and learn ties directly to the *company*'s value. That is, only through the ability to launch new products, create more value for customers, and by improving operating efficiencies continually can a company penetrate new markets and increase revenues and margins – in short, grow and thereby increase shareholder value (Kaplan & Norton, 1992)

Financial Perspective

Financial perspective brings in the more direct relationship between actions and results.Financial performance measures primarily reveal whether a company's strategy is resulting in the earnings improvement. The financial goals include those of profitability, sales growth, market value of the firm, liquidity etc.,

3.THE STRATEGY AND BALANCED SCORE CARD

The Balanced Score Card is well suited to the companies in the global knowledge economy. The score card puts strategy and vision at the core. It establishes goals but leaves the behaviors and actions necessary to arrive at those goals to be decided by the individuals themselves. Kaplan and Norton (1996) outline the four important processes in linking the strategy and the Balanced Score Card.

Translating the Vision

The top management of the organization will come out with a clear vision and will try to develop consensus among the top layers of management. They would explicitly agree on the revenue projections in each of the products and services the company offers, identify most desirable customer segments and so on. Finally the top management would translate their vision into such term that are easily understood by those (middle and lower level managers) who ultimately execute the vision.

Communicating and Linking

The objective measures and targets that are devolved in the first process (translating vision) will be further refined and expressed at the business unit level. The role of each business unit in translating the vision is spelt out and clearly communicated to all levels down the hierarchy. Further, a personal score card is developed synchronizing the individual targets with those of corporate objectives. At this stage some companies might opt to link the financial compensation to performance.

Business Planning

Unlike the traditional business planning that is hardly synchronized with the organizational budget, the Balanced Score Card empathizes with and forces the companies to integrate the strategic planning and budgeting processes. Measures of progress from all the four (customer, internal processes, innovation & learning and financial) perspectives are selected and targets are set.

Business Planning also helps in linking strategy to actions by specifying the short-term targets for the Balanced Score Card measures.

Feedback and Learning

While the first three processes of translating the vision, communicating and linking, and business planning are very critical for the successful implementation of organization strategy, they will not yield the desired result without an able feedback and learning mechanism.The Balanced Score Card supplies three elements that are essential to strategic learning. First, it articulates the company's shared vision, defining in clear and operational terms the results that the company, as a team, is trying to achieve. Second, the score card supplies the essential strategic feedback system that is able to test, validate, and modify the hypotheses embedded in a business unit's strategy. Third, the score card facilitates the strategy review that is essential to strategic learning.

4.THE ADVANTAGES & APPLICATION OF BALANCED SCORE CARD

The scorecard serves several management requirements. It pulls together, all important elements of a company's competitive agenda. Through this, the top management can better understand the internal trade offs-whether the value addition in one area is achieved at the cost of another. By combining the financial, customer, internal process and innovation, and organizational learning perspectives, the Balanced Score Card helps managers understand, at least implicitly, many interrelationships. This understanding can help managers transcend traditional functional barriers and ultimately lead to improved decision making and problem solving. The Balanced Score Card keeps companies looking and moving forward instead of backward (Kaplan & Norton, 1992)The very attractive feature off the Balanced Score Card system is the inbuilt provision of feedback to the mangers and employees. This will help us take timely actions and put the strategy in track.A properly constructed Balanced Score Card can provide management with the ideal tool in reacting to the turbulent business environment and helping the organization correct the course of action (Guptha, Sarkar, & Samantha, 2004).About 60 percent of the fortune 1,000 companies in the United States have had experience with the Balanced Score Card (Silk, 1998) .In India, there are about 45.28 per cent companies that are using the Balanced Score Card. Initiating the change process in the organization (50%), broadening of the performance measures (45.8%), and facilitating the integration of business plans with the financial plans (45.8%) are the major motivations for the implementation of the Balanced Scorecard in corporate India. The other management motivations include translating corporate vision and strategy into integrated set of objectives and measures, benchmarking, and making visible trade-off between long-term growth and short-term improvements (Anand, Sahay, & Saha, 2005).

5.THE BALANCED SCORE CARD: THE LIMITATIONS

The major limitation of the Balanced Score Card is that it promotes multiple objectives. If we choose multiple objectives, we are faced with a serious problem. A theory developed around multiple objectives of equal weight will create quandaries when it comes to making decisions (Damodaran, 2000).Assume that a firm chooses two objectives; maximizing market share and maximizing profits. If an investment increases both market share and profits, the firm will encounter no problems; the firm makes the investment. What if the investment increases market share while reducing profits? The firm should not make this investment if the profit maximization objective is considered, but it should make the investment based on the market share objective.

Other important criticism on the Balanced Score Card approach is that of difficulty involved in balancing the financial and non-financial measures. The whole exercise becomes fruitless when the firms are not successful in this balancing act. As a performance measurement system, the Balanced Scorecard will lead to confusion, conflict, inefficiency, and lack of focus.

This is bound to happen as operating managers guess at what the tradeoffs might be between each of the dimensions of performance (Jensen, 2001).Even an excellent set of Balanced Score Card measures does not guarantee a winning strategy. The Balanced Score Card can only translate a company's strategy into specific measurable objectives. A failure to convert improved operational performance, as measured in the score card, into improved financial performance should send executives back to their drawing boards to rethink the company's strategy or its implementation plans (Kaplan & Norton, 1992).Ittner and Larcker (2003) argue that only few companies realize the benefits of using non financial performance measures (such as Balanced Score Card) as they fail to identify, analyze, and act on the right non-financial measures. Through a field study of 60 companies supplemented with survey responses from 297 senior executives, Ittner and Larcker discovered that most of the companies have made little attempt to identify areas of non-financial performance that might advance their chosen strategy.

Nor have they demonstrated a cause and effect link between improvements in those non-financial areas and in cash flow, profit, or stock price. They have identified four common mistakes companies make when trying to measure non financial performance.

1.Not linking Measures to Strategy
2.Not Validating the Links
3.Not setting the right performance targets
4.Measuring incorrectly

There are four principles that CFOs can rely on to keep themselves—and their companies—on track, while they implement the modern performance systems like Balanced Score Card (Koller & Peacock, 2002)

1.Understanding how the company creates Value.
2.Integrating financial and operational measures.
3.Keeping the measurement system transparent and uniform.
4.Focusing on the dialogue.

(Jalbert & Landry, 2003) summarizes the advantages and disadvantages of Balanced Score Card (Figure 2)

Figure 2 Advantages and Disadvantages of Balanced Score Card

Advantages	Disadvantages
.Considers both financial and non-financial factors	. Not a market driven performance measure
.Well designed for compensating lower-level employees	. May not align perfectly with a shareholder wealth maximization goal
.Provides details of firm performance beyond that obtained from market determined measures	

6. CONCLUSION

Today, there exists a wide array of performance systems viz., VBM (Value Based Management), EVA (Economic Value Added), Balanced Score Card, CFROI (Cash Flow Return on Investment), and a flurry of others. Most of these ideas are in fact largely common sense and definitely none of them has a magic wand that would make performance improvement instant. The hard work of designing and implementing a successful planning and performance management approach is about developing a method that works for the specific company. Even the most sophisticated financial measures that aren't adapted to specific situation will fail; a less sophisticated approach can create significant value if it is tailored to ones industry and needs (Koller & Peacock, 2002). Most of the papers and research on balanced Score Card had been conceptual and the Use of Balanced Score Card with a much broader utility of linking strategy and translating vision into actions are yet to be empirically established Despite the criticism, the Balanced Score Card continues to be an important tool of performance measurement all over the globe barring the difficulty in balancing the different perspectives of an organization.

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