"BALANCED SCORECARD" TOOL FOR STRATEGIC PLANNING

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ABSTRACT

Evaluation of the performance of an organization is essential for its sustainable development. Various measures have been evolved over a period of time for the purpose. However, most of these measures concentrate on only one of the facets of the organization. It is recognized that while an organization might be performing well in one area, it might be ill-performing in some other area. Consequently, balanced sustainable development of the organization becomes a difficult objective. The concept of Balanced Scorecard, developed by Robert Kaplan and David Norton in 1992, tries to overcome this limitation of the traditional techniques of performance evaluation. A Balanced Scorecard brings together, in a single management report, many of the seemingly disparate elements of a company's competitive agenda. It provides an organization the necessary tools for performance measurement and monitoring, directly addressing multiple aspects that support the overall vision and strategy by developing indicators for different factors. Once the use of the Balanced Scorecard filters down in the organization, the lower level employees are able to see the link between what they do and its impact on the company's bottom line goals (e.g., results benchmarks like profit). And the scorecard becomes a management tool where employees receive feedback that is timely enough to impact current or future performance. Unfortunately, the logic lying behind the scorecard approach to performance measurement can go away when measures are put to use in the face of practical contingencies affecting an organization. While there are good reasons to measure multiple dimensions of performance, there are also strong pressures to appraise performance along one dimension: better or worse. The Balanced Scorecard concept has intrinsic executive appeal, though for success the Balanced Scorecard must be viewed as the tip of the improvement iceberg. Processes within the organization are less visible, but equally essential to assure that the scorecard contained the right components and support systems. Adding simply more non-financial measures can result in a loss of organizational focus and a dilution of effort. This paper critically evaluates the concept of Balanced Scorecard as a tool for performance measurement of an organization. Apart from the need for such a technique, the shortcomings are also discussed to understand why adoption of Balanced Scorecard technique is difficult in practice.

KEYWORDS: Balanced Scorecard, Performance Evaluation, Contingencies

INTRODUCTION:

The traditional performance measurement systems for organization featured an overwhelming reliance on financial metrics. However, such financial metrics were ill suited to meet demands of modern business world characterized by value creation stemming from intangible assets such as employee know-how, strong customer relationship and cultures capable of innovation and change. The notion was simple, but the ramifications profound. As a remedy, the organizations around the world began to embrace the Balanced Scorecard system.

The concept of the Balanced Scorecard (BSC) was first introduced by Robert Kaplan and David Norton in 1992. Since its inception, the concept has been hailed as one of the most influential business ideas of the twentieth century. Thousands of organizations, spanning every conceivable type and size across the globe, have relied upon it. However, when it comes to practical application, organizations find it quite difficult to evaluate performance through a Balanced Scorecard, mainly due to the existence of various contingencies. Consequently, what appears to be an excellent tool for performance measurement turns out to be inefficient when applied in practice. This paper is intended at bringing out both strengths and weaknesses of Balanced Scorecard approach to performance evaluation of an organization.

The paper is divided into four sections in all. Section II brings out the significance of intangible assets for an organization and the need for Balanced Scorecard as a tool to evaluate performance. Section III discusses the contingencies, which render the use of Balanced Scorecard impractical and irrelevant, while restricting the inclusion of innovations and flexibility in it. Section IV discusses the flip side of the Balanced Scorecard approach due to the contingencies, while section V concludes.

II. MEASUREMENT OF INTANGIBLE ASSETS:

In the contemporary economic environment, factors like employee knowledge, relationship with the customers and the culture of innovation and changes generates success for an organization. In other words, the intangible assets are the key to long-term success in today's world. The power of intangibles manifest in the valuations is seen in modern organizations. According to Blair, the ordinary accounting techniques can measure only the physical assets of the companies.

However, these physical assets account for less than one fourth of the value of the corporate sector. This implies that more than 75 per cent of the sources of value inside an organization are ignored and not measured or reported in their books. Just about two decades ago, the values of intangible assets in a typical organization were estimated at around 38 per cent. This value has virtually doubled in the past two decades. Kaplan and Norton have recommended broadening the scope of the performance evaluation measures to include four areas of an organizational functioning:

a. Financial Performance
b. Customer Knowledge
c. Internal Business Processes
d. Learning and growth Mechanism

This allows the monitoring of present performance of the organization. Not only that, but also this method tries to capture information about how well the organization is positioned to perform in the future.

Kaplan and Norton (1992, 1996) developed the Balanced Scorecard concept to address the perceived shortcomings in financially oriented performance measurement systems. The Balanced Scorecard approach supplements traditional financial measures with non-financial measures focused on at least three other perspectives – customers, internal business processes, and learning and growth. Kaplan and Norton contend that the Balanced Scorecard provides a number of mechanisms for linking long-term strategic objectives with short-term actions.

First, development of the Balanced Scorecard forces managers to develop consensus around the firm's vision and strategy. By requiring the vision and strategy to be expressed in terms of an integrated set of objectives and measures, senior executives must agree on how broad strategic objectives can be translated into operational measures that guide lower-level managers' actions.

Second, the Balanced Scorecard allows managers to communicate the firm's strategy throughout the organization, helping to ensure that employees understand the long-term strategy, the relations among the various strategic objectives, and the association between the employees' actions and the chosen strategic goals.

Third, by integrating strategic and financial plans, the Balanced Scorecard helps firms to allocate resources and set priorities based on the contribution of various initiatives to long-term strategic objectives. Corporate executives can learn the extent of investment needed in human resources, systems and procedures to improve future performance.

Fourth, by incorporating non-financial indicators of the drivers of strategic and financial success, the Balanced Scorecard provides strategic feedback and promotes learning through the monitoring of short-term strategic results, thereby allowing firms to modify objectives or strategies before financial results turn down. In fact, Balanced Scorecard puts strategy at the center of the management process. It also acts as the "operating system" for a new management process.

Fifth, a Balanced Scorecard complements measures of past performance, that is, the lagging indicators, with the future performance drivers, that is, the leading indicators. In this sense, a Balanced Scorecard is not only a tool to evaluate performance of an organization, but it is also a link between the past performance and future strategic actions of the organization. Such linkages are necessary to

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realize the performance objectives more efficiently.

Although Kaplan and Norton (1996) argue that the proper role of the Balanced Scorecard in determining compensation is not yet clear, a recent survey of scorecard implementations found that 70 percent of the respondents already used the Balanced Scorecard or some variant of it for compensation purposes. 17 percent are actively considering its use for this purpose (Towers Perrin, 1996). Similarly, research by Ittner et al. (1997) indicates that 36 percent of U.S. firms now use both financial and non-financial measures in the annual bonus contracts of their chief executive officers, with significant weightage assigned to a function of strategic objectives of the organization.

III. INTEGRATION OF CONTINGENCIES IN PERFORMANCE EVALUATION:

The role of BSC is to identify different measures, which are significant in determining performance by assigning appropriate weightage to all such measures. A BSC method of performance evaluation involves linking strategy to action. It provides a framework that helps in solving its short-term operational problems with alignment to the long-term strategy. As the BSC practice became more widely adopted, more evidence became available to test its universal effects.

Interestingly, the evidence also explains variation in the effectiveness of the BSC practice as the measure of performance evaluation. So, while designing a BSC, these contingent factors become essential to consider. Several contingencies have been found to be important in studying the effectiveness of the practices. These include

1. Environmental uncertainty
2. Organizational structure
3. Size of the organization
4. Technology

Uncertainty associated with contingencies presents the organization with difficulties in planning the future as events cannot be identified or impact of events on operations is unknown. Evaluating performance becomes difficult as performance of the managers depends on events over which they have little control. Evaluating performance becomes difficult as performance of the managers depends on events over which they have little control.

Moreover, if the performance measurement criteria of the organization keep changing frequently, due to the changes taking place within the organization and outside the organization, it becomes difficult for the organization to frame the BSC. In this case, the organization needs to frame the BSC frequently to accommodate the changing criteria of performance evaluation. And it is always difficult to make changes in performance drivers, as they are not just performance indicators, but organizational strategy has to be formulated on its basis. So with the change in the performance indicators, a need arises to change the long-term and short-term strategy of the organization.

A BSC created as mechanistic nature of integrated performance may restrict innovation and flexibility, which are important for any organization in this changing world. The technology adopted by an organization presents varying degree of complexities. These complexities can lead to more complex business modeling with the large number of casual connections between strategy and operations. Such a model can result in a wide diversity of measures that can cause information overload. An attempt to manage performance against the measures exceeding the information processing capabilities of managers at the extreme level could result in a deteriorating performance.

Thus, in highly detailed and comprehensive business modeling, the associated performance measures will be ineffective if the conditions affecting the models are changing in unpredictable ways. Balanced Scorecard also involves detailed and complex business modeling due to its generic measures, cause-and-effect relationships, which create problems in strategy linkage. Contingency approach sees that organizations change their performance measures over time to accommodate their changing circumstances, while attempting to maintain effectiveness of operations while designing their Balanced Scorecards (Donaldson, 2001).

IV. BALANCED SCORECARD – AN INTERMEDIATE SOLUTION:

Ittner et al. (2003) found that financial firms using a BSC to reward managers had the potential to counter many of the criticisms of short-term accounting-based reward system. However the weights assigned to each performance measure used in the BSC differed from manager to manager and organization to organization. While undertaking evaluations and awarding bonuses, some measures were neglected, although these measures were the leading indicators of the strategic objectives of financial performance and customer growth.

Ittner and Larcker (1998a) report that scorecards assisted only a minority of managers in understanding goals and strategies or in relating their jobs to business objectives. They established that managers made little attempt to link non-financial performance measures to advance their chosen strategies. Most remarkably only 23 per cent of these managers were able to show that they built casual models and most of the managers could not validate the casual links. In an experimental study, Lipe and Salterio (2000) demonstrated that managers had cognitive difficulties working with measures to evaluate performance that were specific to a situation.

One difficulty in studying BSC is that the precise nature of an organization's scorecard is often not identified. There is a wide variation in the nature of Balanced Scorecard ranging from combinations of financial and non-financial measures to more comprehensive systems linking operations to various perspectives and to strategy (Ittner and Larcker 1998a; Hoque and James 2000; Ittner and Larcker 2003; Ittner et al. 2003). With a highly diverse set of measures managers must decide how they will spread their efforts over the different areas. So it is difficult for the manager to decide upon a balanced set of measures, which in turn makes designing a BSC difficult in practice.

In the situations of technological complexity, uncertainty and interdependence, it is possible to use probabilistic and subjective measures. However, some research works have shown that these softer measures tend to be manipulated by senior management. It may also happen that the range of measurement is compressed, which may lead to lesser differentiation in assessing the performance of the employees and an overall perception of unfairness (Predegast and Topel, 1993; Moers, 2005).

Ittner and Larcker (1998a) report that more than a third of respondents to a survey by the consulting firm Towers Perrin found it difficult to implant BSC for lower levels. In some organizations, more complex hierarchical structures may contribute to the difficulty of identifying as to how the implied business model translates across the organizational structure. And for effective implementation of BSC, organizations require structures that are sufficiently open and flexible to ensure that employees are empowered to search for alternatives to respond to strategic, uncertainties and that these are discussed regularly in face-to-face meetings (Simon 1995, 2000).

Moreover, Balanced Scorecard is expensive to design and implement. The size of the organization is an important factor that determines the extent to which the organization might have resources to experiment with the performance measurement systems.

V. CONCLUSION:

While financial aspects alone appear to be inefficient tool for performance evaluation of an organization, Balanced Scorecard technique appears to be a more comprehensive and more efficient tool for the purpose. Evidence suggests that many organizations have been able to generate better strategic links between short-term and the long-term objectives based on this technique. However, various contingencies inherent to the functioning of an organization make it difficult to implement this method effectively. Not only that the contingencies make practical implementation of the BSC technique a little difficult, but also different organizations face a wide variety and different sets of contingencies. Hence, it is almost impossible to build a single, common BSC for all organizations even within one business sector. Further, different BSCs may be required to assess the performance of a single organization over a period of time. Consequently, comparing different organizations on the basis of a BSC may become an even more complicated task.

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