



Integrated Performance Management: A Guide to Strategy Implementation

Performance Management from a Control Perspective: Introducing the Balanced Scorecard

Contributors: Werner Bruggeman

Edited by: Kurt Verweire & Lutgart Van den Berghe

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Performance Management from a Control Perspective: Introducing the Balanced Scorecard

WernerBruggeman

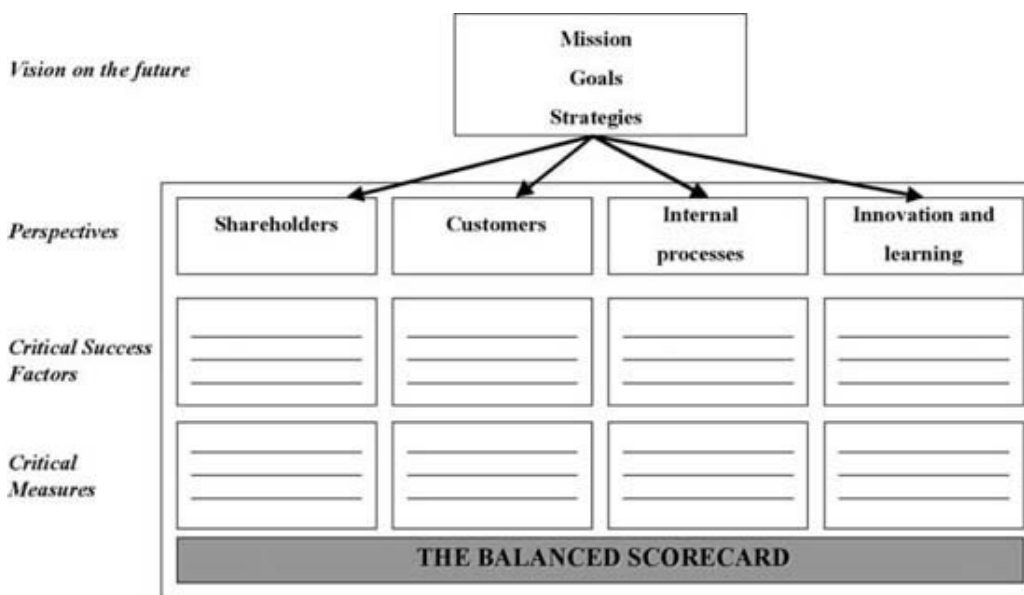
The 1990s literature on performance measurement created the awareness that most companies' performance measurement and reporting systems focus too much on financial performance. On a corporate and business unit level many executives now understand that traditional financial accounting measures (like return on investment (ROI), earnings per share and unit cost per product) can give misleading signals for continuous improvement, innovation and competence-building activities. They feel a need to improve financial control systems and to supplement them with *strategic performance measures*. To be effective these measures must be aligned with the company's mission, goals and strategy.

In order to be able to better align performance measures to strategy Robert Kaplan and David Norton developed the Balanced Scorecard. This chapter describes the basic concepts and techniques in developing a Balanced Scorecard. It also shows how a company can use the Balanced Scorecard as a central element in its performance management process to become a *Strategy-Focused Organization*. In the final section of this chapter, we compare the Balanced Scorecard with some other accounting and control frameworks.

Defining the Balanced Scorecard

The Balanced Scorecard, a framework introduced by Kaplan and Norton, offers a methodology to develop a set of measures that gives top managers a fast but comprehensive view of the business (Kaplan and Norton, 1992, 1993, 1996a, 1996b, 2000, 2001). It helps managers translate the company's mission, goals and strategies into measures. It complements the financial measures with operational measures on customer satisfaction, internal processes and the organization's innovation, learning and improvement activities - operational measures that are the drivers of future financial performance (see [Figure 3.1](#)). The Balanced Scorecard provides a framework to describe, communicate and manage the strategy in a consistent and explicit way.

Figure 3.1 The Balanced Scorecard linking measurement to strategy



Source: Adapted from Kaplan and Norton (1992)

The four perspectives of the scorecard permit a balance between short-term and long-term objectives, between desired outcomes and the performance drivers of those outcomes, and between hard objective measures and softer, more subjective measures. The Balanced Scorecard distinguishes between four main performance measures (Kaplan and Norton, 1992).

- According to Kaplan and Norton, *financial performance measures* define the long-term objectives of the business unit. Apart from profitability measures (see [Chapter 2](#)), other financial measures are possible, such as sales growth, cash flow, cost reduction measures, etc.
- In the *customer perspective*, managers identify the customer and market segments in which the business unit competes and the measures of the business unit's performance in these targeted segments. Generic outcome measures include: customer satisfaction, customer retention, new customer acquisition and customer profitability. More specific measures should focus on the different value propositions that are offered to the customer, such as convenience, uniqueness, functionality, price, quality, service level, etc.
- In the *internal business process perspective*, managers identify the critical internal processes in which the organization must excel. Internal processes should deliver the value propositions for the customers, and this should be done in the most efficient and effective way. Managers should not only look at the existing processes, but identify new processes if necessary. (Operational) innovation is a crucial point, and should be measured.
- *Learning and growth* is the fourth Balanced Scorecard dimension and identifies the infrastructure that organizations must build to create long-term growth and improvement. The organizational learning and growth come from three principal resources: people, systems and procedures. For each of these different resources, appropriate measures need to be developed, in line with the strategic objectives of the firm. Reskilling employees, developing appropriate information technology and systems, and aligning organizational procedures should help companies to cope with a fast-changing environment.

These four perspectives of the Balanced Scorecard should be considered as a template, not as a 'straitjacket'. No mathematical theorem exists to prove that four perspectives are both necessary and sufficient (Simons, 2000). But the perspectives identified by Kaplan and Norton make sense for many companies: shareholders, customers and employees are very important stakeholders in each and every company.¹ Depending on industry circumstances and the strategy, one or more additional perspectives may be needed to incorporate the interests of other important stakeholders (e.g., suppliers, the community, the environment).

[Figure 3.2](#) shows the Balanced Scorecard of a company where the ambition of the management is to become the market leader and to be an excellent company for the shareholders by implementing a strategy of high-quality products, on-time delivery and lean manufacturing in an organization with strong employee involvement.

Figure 3.2 The Balanced Scorecard - an example

Long-term goals: become the market leader; be an excellent company for our shareholders.

Strategy: high-quality products, on-time delivery and lean manufacturing

Organization: create a working environment stimulating employee involvement

CRITICAL SUCCESS FACTORS	STRATEGIC OBJECTIVES	MEASURES
Financial Market leadership Excellence for the shareholder	Increase market share Create more shareholder value	Market share EVA® increase
Customer High-quality products On-time delivery	Improve quality Improve delivery reliability	Number of complaints Percentage of orders on time
Processes Lean manufacturing	Shorten cycle time Reduce work in process	Cycle time Days work in process
Innovations and learning Employee involvement	Improve employee involvement	Number of suggestions

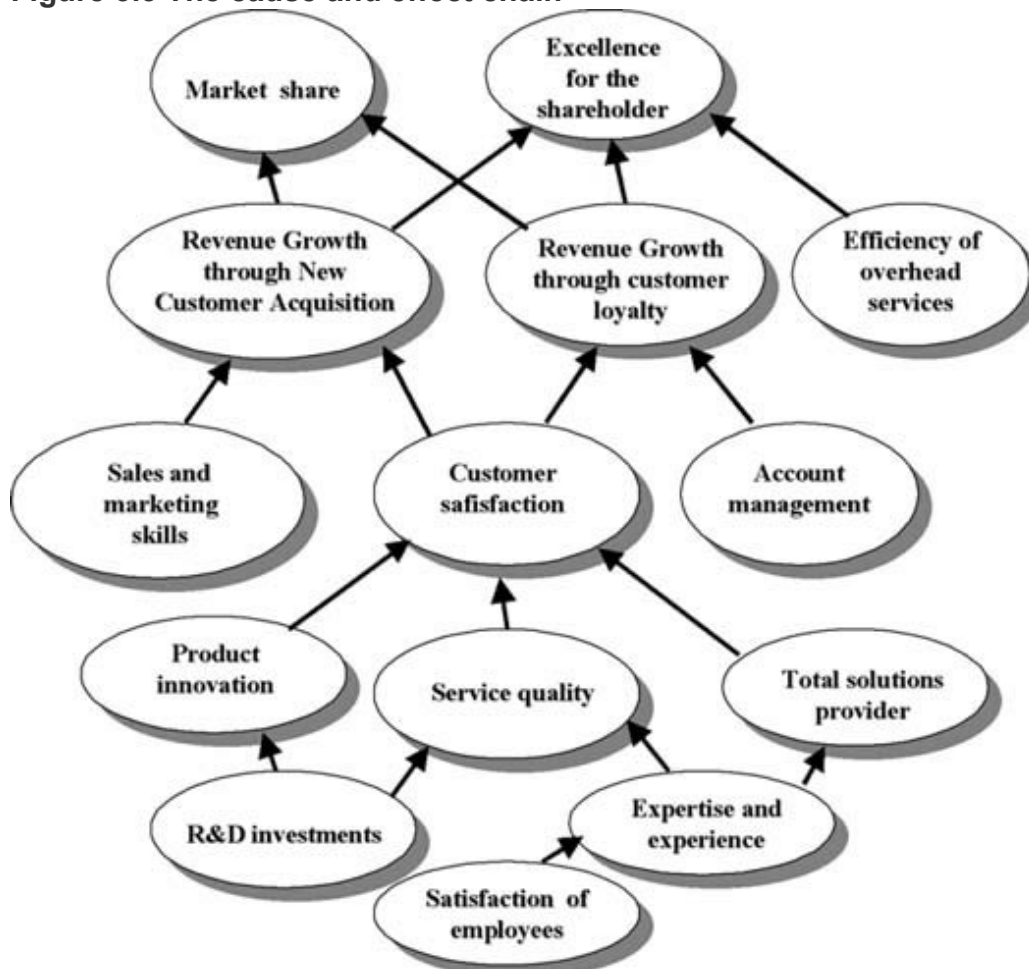
Although the Balanced Scorecard was originally devised as a measure to 'tell the story of the business unit's strategy', it can be implemented at the corporate and the functional levels, and on the level of corporate support functions and shared services as well. A functional scorecard translates the functional strategy (e.g., marketing, manufacturing, Human Resources, ICT strategy) into a coherent set of performance measures. A Balanced Scorecard of a corporate or a shared service links the performance measures of the service unit with its mission, its goals and its strategies and aligns them with the corporate strategy in order to offset the problems of facing different or even conflicting goals and strategies on the different organizational levels.

Important steps in developing a Balanced Scorecard are: clarification of the mission, goals and strategy of the entity under focus, identification of the critical success factors (or the strategic objectives), translating the critical success factors into measures, designing the necessary data collection systems and channelling the right data into each of the four quadrants of the scorecard. In some cases the Balanced Scorecard requires the implementation of a data warehouse.

From Vision to Strategy Maps

In many companies or business units and organizational units, the mission, the goals and the strategies are not clearly defined. In this case the management team should spend more time in clarifying their *strategic vision*. That is, the management team should clearly indicate where the organization (or the unit of analysis) wants to go. To make this process more effective, Kaplan and Norton offer an analytical framework, called the *strategy map*, which is a logical and comprehensive architecture for describing the strategy. When building a strategy map a management team should first make explicit its long-term performance goals. Then one reflects on the hypothesized key drivers of the future performance. [Figure 3.3](#) shows an example of a strategy map of a Divisional Balanced Scorecard.

Figure 3.3 The cause and effect chain



The long-term goals are to become the market leader and to be an excellent company for the shareholder. The perceived key driver of these performances is new customer acquisition, customer loyalty and overhead cost management. The drivers of new customer acquisition are sales and marketing skills and customer satisfaction. Customer satisfaction is driven by product innovation, service quality and the delivery of total problem solutions. Total solutions delivery is driven by experience and expertise, which is determined by employee satisfaction. The strategy map shows the causal relationships between the critical success factors. For each factor one can determine one or more performance indicators and fit them into a Balanced Scorecard (see [Figure 3.4](#)).

Figure 3.4 Critical success factors derived from the example Strategy Map

CRITICAL SUCCESS FACTORS	MEASURES
Financial	
Market share	Revenue growth rate
Excellence for the shareholder	EVA®
Growth through new customer acquisition	Revenue from new customers
Growth through customer loyalty	Revenue from existing customers
Customer	
Customer satisfaction	Customer satisfaction index
Total solution provider	Number of complaints
	Percentage of revenue from total solution projects
Service quality	Percentage of due dates met
Processes	
Account management	Percentage of revenue under account management
Lean overhead services	Overhead costs/revenue
Innovations and learning	
Sales and marketing skills	Number of days training
Expertise and experience	Average number of years seniority of employees
Satisfaction employees	Satisfaction index (survey)
Product innovation	Number of free leaves
	Percentage of revenue from products < 3 years
R&D investment	R&D budget

This can also be done for various functional levels within organizations. As such, Balanced Scorecards and strategy maps can also be developed for the HR department, for the IT department, and so on.

Integrating Sustainability Goals into the Balanced Scorecard

Most strategy maps focus on shareholder value creation, growth and market share as the main long-term company goals. Some authors argue that the Balanced Scorecard implicitly considers the shareholder as the only stakeholder (Otley, 1999). The financial perspective measures shareholder value creation; the customer, the internal and the learning and growth perspective contain measures of the drivers of future financial performance. This is a typical example of an instrumental stakeholder approach, as defined in [Chapter 2](#).

Some people argue that following an instrumental stakeholder approach, one might not consider the needs of other stakeholders, such as employees and their families, the national and international society at large, local communities, suppliers and the future generations. Modern performance management pays more and more attention to sustainability management and defines goals and strategies in the area of social responsibility and ecological sustainability (see also [Chapter 2](#)). In implementing the Balanced Scorecard one can take full advantage of the opportunity to develop a performance measurement system that contains measures linked to the key sustainability goals and strategies. Thus the Balanced Scorecard may contain measures of environmental performance and satisfaction measures of regulators, communities and suppliers. In this case the Balanced Scorecard becomes an all-stakeholder model of performance measurement.

Benefits of Using the Balanced Scorecard

The Balanced Scorecard helps companies to design an integrated performance measurement system. The Balanced Scorecard project invites top management to develop a clear strategy and build a consensus around it. The process of translating the strategy into measures also

gives middle managers a clear understanding of what the strategy really means for them. As such the scorecard project helps to communicate the strategy throughout the company, align unit and individual goals with the company strategy, link strategic objectives to long-term targets and identify cause-and-effect relationships between performance measures.

For the (corporate) staff functions, shared services and coordination centres, the Balanced Scorecard contributes to the alignment of the goals, the strategies and the actions of the corporate centres with the corporate and the business unit strategies. With the scorecard, top and functional management have a tool to monitor continuously the degree to which strategies are implemented. The use of the Balanced Scorecard strongly affects the behaviour of managers. They show a stronger motivation to implement the organization's strategy. Recall the statement: 'What you get is what you measure.'

From a Measurement to a Management Instrument: Towards a Strategy-Focused Organization

In the introductory chapter, we described that the use of the Balanced Scorecard has evolved over time. For some years, the Balanced Scorecard has been considered a performance measurement instrument; nowadays, Kaplan and Norton (2001) see the Balanced Scorecard as the central element in a 'new approach to implementing strategy'. Unlike traditional management programmes, which link performance to financial frameworks, budgets or even new shareholder value approaches, companies which successfully implement Balanced Scorecards reinvent part of their management systems to focus on strategy.

A number of companies (Mobil Oil, Cigna Insurance, and the former Chemical Retail Bank) have shown remarkable performance improvements only three years after the introduction of the Balanced Scorecard. According to Kaplan and Norton, the success of these companies was due to the successful implementation of their strategy: 'these executive teams successfully executed their strategies when the majority of their colleagues could not' (2001: 13).

Strategy must be understood and executed by everyone. The organization must be aligned around its strategy, and performance management systems help create that alignment. Herein lies one of the major causes of poor strategic management. Most performance management systems are designed around the annual budget and operating plan. They promote short-term, incremental, tactical behavior. While this is a necessary part of management, it is not enough. You cannot manage strategy with a system designed for tactics. It is our belief that it is this need—the need for strategic enterprise management—that has been driving the widespread adoption of the Balanced Scorecard.

(Kaplan and Norton, 2001: 12—13)

This alignment and focus on the strategy of the organization can create breakthrough performance. Recall from [Chapter 1](#) that 'alignment' and 'focus' are two central concepts in the performance management literature. This is the main message from Kaplan and Norton's most recent book, *The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment* (2001). In this book, they argue that successful organizations create a performance management programme that puts strategy at the centre of its management processes. They detected five principles that permit organizations to become strategy-focused, enabling them to execute their strategies rapidly and effectively.

Mobilize Change through Executive Leadership

Balanced Scorecard programmes are not about metrics, but about change. Therefore, the single most important condition for success is the ownership and active involvement of the executive team. As strategy must be understood and executed by everyone in the organization, change must come from every part of the organization. If those at the top are not energetic leaders of the process, change will not take place and the opportunity will be missed. In order to run the change project successfully, it is necessary to establish a sense of urgency and to create the leadership team. Establishing a sense of urgency is about creating mobilization and creating momentum. Once the organization is mobilized, the process must be governed, with emphasis on fluid, team-based approaches to deal with the unstructured nature of the transition to a new performance management model. According to Kaplan and Norton, the creation of a shared vision and strategy was an effective way to build an executive leadership team (in contrast to a collection of individual business unit heads who met periodically to discuss business issues).

Translate Strategy into Operating Terms

The Balanced Scorecard approach can only be successful if the mission, the vision, the goals of the company and the strategy (i.e., how the vision and goals can be achieved) are clearly defined. Unfortunately, there are no standards for strategy-making. *Developing and crafting* a strategy remain an art, says Mintzberg (1987). However, there is nothing 'arty' about *describing* the strategy. Nevertheless, describing the strategy is of utmost importance.

Kaplan and Norton argue that the Balanced Scorecard provides the discipline for describing the strategy of the organization reliably and consistently. In addition to building scorecards, the Balanced Scorecard approach helps executive teams to better understand and articulate their strategies. The foundation of the design is the 'Strategy Map', which we described earlier in this chapter. Strategy scorecards, along with their graphical representations on Strategy Maps, should provide a logical and comprehensive tool to describe strategy. It communicates clearly the organization's desired outcomes and its hypotheses about how these outcomes can be achieved (Kaplan and Norton, 2001: 9—11).

Align the Organization with the Strategy

The Balanced Scorecard is a powerful tool to describe a business unit's strategy. But organizations consist of numerous sectors, business units and specialized departments, each with its own operations and often its own strategy. In order to be really successful, synergies should be created and the strategies across these units should be coordinated.

Kaplan and Norton are convinced that the Balanced Scorecard can and should be used to define the strategic linkages that integrate the performance of multiple organizations. In this way, individual strategies are linked and integrated. It requires that the goals and strategies at the corporate level are clearly formulated and articulated. The high-level strategic themes should then be translated to the business unit level. As such, the Corporate Scorecard provides the communication and coordination mechanisms across business unit scorecards. Beyond aligning the business units, organizations must also align their staff functions and shared service units, such as Human Resources, IT, finance, etc.

Make Strategy Everyone's Everyday Job

Strategy cannot be limited to a few people at the top of an organization. This is especially the case in 'modern firms', where decision-making is increasingly being moved lower in the organization and where self-directed teams rather than individual managers now make decisions. Kaplan and Norton showed that successful Balanced Scorecard users took steps to ensure that everyone in the organization understood the strategy, was aligned with it, and was capable of executing it.

This was done in several ways. Communication is clearly one of the most important processes in this respect. Organizational alignment can only be achieved if the programme is conveyed in all communication media and if it is reinforced by the personal behaviour of executives. Some companies developed personal scorecards, to align individuals with the company's strategy.² Another major instrument to bring down the strategy to the individual level is to link incentive compensation to targeted scorecard measures. This is often done at the managerial level. Rewarding managers on the basis of the Balanced Scorecard is consistent with the goal of creating a better 'strategic alignment'. Kaplan and Norton (2000) refer to a study of the Hay Group which stipulates that of 15 companies using the Balanced Scorecard 13 have linked their remuneration system to the Balanced Scorecard, which they call '*the Balanced Paycheck*'. They describe a number of case studies and already give a few practical recommendations for implementation. Their experience is that:

- It might be a good idea to link the remuneration of managers not too quickly to the Balanced Scorecard, due to the fact that the first scorecards are only preliminary and the reported performance data are still insufficiently reliable in a first phase;
- It might be a good idea to base the remuneration of managers especially on objective (output) measures instead of subjective (behavioural) measures;
- Some companies link the remuneration of their managers to a limited number of Balanced Scorecard measures;
- A balance needs to be found between measures for individual performance and team performance;
- It is difficult to link remuneration to the Balanced Scorecard if the measures need to be frequently adapted in a fast-changing environment.

Linking remuneration and reward systems to the Balanced Scorecard is, however, a delicate and complicated issue. It is not only important to determine which performance measures to use as the basis for the reward system, but also to decide how the performance targets are set. The target-setting literature suggests that performance control should be based on challenging but attainable targets. The performance targets set by the Balanced Scorecard are sometimes considered 'unattainable'. Thus, the motivation impact of Balanced Scorecard-based variable remuneration should not be overestimated. This finding was also supported by academic research. One study examined how the introduction of a Balanced Scorecard affected the motivation of managers of a manufacturing division of a Danish petrochemical company (Bruggeman et al., 2001). The general idea was that the managers perceived that the implementation of the Balanced Scorecard had positively affected their motivation. However, the positive motivational effect had mainly come from the *visioning process* and from the design and the use of the Balanced Scorecard as a tool to monitor the implementation of strategy and to measure the departmental progress. The effect of linking the variable pay system to the Balanced Scorecard had only a minor impact—and in some cases even a negative one—on the motivation of the operating managers. On the one hand, when the performance targets were met, they considered it as fair to receive a bonus but, as stated

before, the variable pay was not their major source of motivation. Some managers felt that the percentage of variable pay was set too low. However, not paying the bonus when targets were not met was considered as unfair and caused significant demotivation and frustration. In such cases the following reasons were mentioned:

- Some performance measures in the Balanced Scorecard were not precise measures of the objectives to be realized;
- Some important performance measures in the Balanced Scorecard could hardly be influenced by the managers.

Make Formulating Strategy a Continual Process

Just like change projects, Balanced Scorecard projects should become continual processes. Kaplan and Norton propose to use the Balanced Scorecard as the central element in management meetings, instead of the traditional budget and operating plans: 'Companies with the Balanced Scorecard adopt a new "double-loop process". The process integrates the management of tactics with the management of strategy' (Kaplan and Norton, 2001: 13—15). This is done in three ways.

Strategy-Focused Organizations should link the strategy to the budgeting process. The Balanced Scorecard is used as a screen for evaluating potential investments and initiatives. Strategy budgets are introduced. These strategy budgets are used to fund all types of strategic innovation initiative, which should guarantee the long-term performance of the organization. The Balanced Scorecard has also become the instrument on which management meetings are based. Management meetings are scheduled on a monthly or quarterly basis to discuss the Balanced Scorecard: are performance targets reached? Are strategic initiatives implemented properly and timely? According to Kaplan and Norton, the process creates a focus on strategy that did not exist before.

Finally, a process for learning and adapting the strategy evolved. The Balanced Scorecard and the strategy maps make the strategy explicit and formulate hypotheses and links between different value drivers, which ultimately result in long-term financial success. As the scorecard is put into action and feedback systems begin their reporting on actual results, an organization can test the hypotheses of its strategy to see whether its strategy is working. This is where organizational learning can begin.

The Balanced Scorecard and Other Performance Measurement Models

Without any doubt the Balanced Scorecard has been the most popular performance management framework that originated from the accounting and control world. However, many other initiatives were undertaken to develop new tools and frameworks for performance measurement and management. In this section, we briefly introduce some other well-known frameworks.

All these frameworks aim to address some of the weaknesses of traditional performance measurement approaches (just like the Balanced Scorecard did):

- The cost focus of traditional performance measures gives little indication of future performance and encourages short-termism (Bruns, 1998). The traditional methods of performance measurement review results instead of the causes for those results.
- Traditional performance measures fail to reflect changes in the competitive circumstances

and strategies of modern organizations (Johnson and Kaplan, 1987; Kennerley and Neely, 2002).

- There is too much focus on financial measures, which leads to an unbalanced performance measurement system.

The performance measurement revolution in the 1980s and 1990s brought widespread acceptance of the need for organizations to take a more balanced approach to performance measurement. Many performance measurement frameworks emerged and a huge discussion started on what exactly 'balanced' meant. For example, Keegan, Eiler and Jones (1989) proposed a performance measurement matrix that categorized measures as being 'cost', 'non-cost', 'external' or 'internal'. They argued that the performance measurement system should consist of measures along all these dimensions. The SMART (Strategic Measurement and Reporting Technique), developed by Wang Laboratories (Lynch and Cross, 1991), also started from this idea and included internal and external performance measures. However, the notion of cascading measures down the organization was added so that the departments' objectives were aligned with the organization's objectives. This is an idea that we find was used in the Tableau de Bord, a tool that was developed in France in the early twentieth century (Kennerley and Neely, 2002)

Other researchers identified other dimensions of 'balance'. Fitzgerald and colleagues (1991) proposed a framework that distinguished between: measures that related to results and measures that focus on determinants of those results. This is an element that comes back in Kaplan and Norton's Balanced Scorecard as well. Brown (1996) developed the concept of linking measures through cause-and-effect relationships further. Kaplan and Norton's strategy maps clearly incorporate this particular aspect.

Identifying relevant performance measures is one thing, developing and implementing Integrated Performance Management Systems is another. But here again, there is a lot of material available in addition to Kaplan and Norton's work on the Balanced Scorecard. There is one publication that we thought was very useful because it provides concrete tools and techniques for setting up Integrated Performance Management systems. The Institute of Management Accountants and Arthur Andersen LLP (1998) published a document called *Tools and Techniques for Implementing Integrated Performance Measurement Systems: Statement on Management Accounting 4DD*, where they describe a three-phase approach to designing and implementing integrated performance management systems:

- The conceptual design phase is an analysis phase where attention is paid to understanding and identifying the organization's goals and strategies, and the way the organization operates. From these goals and strategies, critical success factors and key performance indicators are deducted. This phase consists of both top-down and bottom-up analyses, and of the creation of a steering team that has the (active) support of the top management team to develop consensus and assess the gaps between 'as is' and 'to be' environments.
- In the detailed design and implementation phase, the system is made operational and is integrated in the current management system. The costs and benefits of running the system are analysed, training and education is planned, and efforts are made to flesh out the details of the Integrated Performance Management System design, architecture and technology. This phase includes pilot projects and the ultimate system conversion.
- The ongoing support phase focuses on realizing the full benefits of implementation by supporting and fine-tuning the newly changed environment, and by facilitating continuous improvement in systems and performance (Institute of Management Accountants and

Arthur Andersen LLP, 1998).

Conclusion

This chapter illustrates how the Balanced Scorecard can be a basis for developing an effective performance measurement and management system. The Balanced Scorecard presents significant opportunities to develop, communicate and implement the strategy of the organization. Managers respond positively to the Balanced Scorecard and use it as a device to monitor strategy, to set targets, to benchmark and to plan strategic initiatives. Some remarkable examples have shown that the Balanced Scorecard can be used as a central tool in the strategy implementation process. These companies have realized breakthrough performance by organizing their management system around the Balanced Scorecard. However, more research is necessary to investigate exactly how the Balanced Scorecard can create this breakthrough performance. For example, recent research has shown that linking the Balanced Scorecard to the reward system does not always yield the expected results. We have also briefly presented some other accounting and control models that are very useful when setting up integrated performance management systems.

Notes

1 There has been some debate where to position employee-related items in the Balanced Scorecard: either in the internal business process perspective or in the learning and growth perspective. In our opinion, this is a meaningless debate. The Balanced Scorecard is a means to an end. The ultimate purpose is to track your performance along several dimensions. If employees are considered vital to the success of the company, then appropriate measures should be developed. Where you position them in the Balanced Scorecard is less relevant.

2 According to Kaplan and Norton (2001), the individual scorecards differ from the more traditional Management-by-Objectives approach. The objectives in an MBO system are established within the structure of the individual's organizational unit, reinforcing narrow, functional thinking. The individual objectives established within the framework of the Balanced Scorecard are cross-functional, longer-term and strategic.

- balanced scorecard
- performance measurement
- performance management system
- performance management
- measures of performance
- critical success factors
- remuneration

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