THE BALANCED SCORECARD (BSC) METHOD:  
FROM THEORY TO PRACTICE

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Abstract

Performance management has become a legislative requirement for the private and local sectors. Unfortunately, not many tools exist to measure and monitor public and private service delivery effectively. Managers require accurate information to ensure that their decisions are not based on emotions and assumptions, but that the information with regard to service delivery is accurate and relevant. In modern business models, intangible assets such as employee skills and knowledge levels, customer and supplier relationships, and an innovative culture are critical in providing the much-needed cutting-edge to the organization. This is where tools like the balanced scorecard method hold relevance for the enterprise. Developed by Robert Kaplan and David Norton, the balanced scorecard method translates an organization’s strategy into performance objectives, measures, targets and initiatives. It is based on four balanced perspectives, and links them together with the concept of cause and effect. A proper balanced scorecard can predict the effectiveness of an organization’s strategy through a series of linked performance measures based on four perspectives including:

Keywords: balanced scorecard, strategy maps, performance measurement

Introduction

Balanced scorecard is a management system that enables organizations to translate the vision and strategy into action. This system provides feedback on internal business processes and external outcomes to continually improve organizational performance and results. Robert Kaplan and David Norton created the balanced scorecard approach in the early 1990s. Most traditional management systems focus on the financial performance of an organization. According to those who support the balanced scorecard, the financial approach is unbalanced and has major limitations:
1. Financial data typically reflect an organization’s past performance. Therefore, they may not accurately represent the current state of the organization or what is likely to happen to the organization in the future.
2. It is not uncommon for the current market value of an organization to exceed the market value of its assets. There are financial ratios that reflect the value of a company’s assets relative to its market value. The difference between the market value of
an organization and the current market value of the organization’s assets is often referred to as intangible assets. Traditional financial measures do not cover these intangible assets. The main purpose of this article is to analyze the Balanced Scorecard method theory and practice. The article seeks to analyze this three matters:
1. origins of the Balanced Scorecard method,
2. evaluate this method in private and public sectors
3. analyse the strategy mapping process.

1. Origins of the Balance Scorecard Method

The Balanced Scorecard was developed by Robert Kaplan and David Norton (1992). In 1990, Kaplan and Norton led a research study of a lot of companies with the purpose of exploring the new methods of performance measurement. The importance of the study was a growing belief that financial measures of performance were ineffective for the modern business enterprise. Representatives of the study companies, along with Kaplan and Norton, were convinced that reliance on financial measures of performance had an affect on their ability to create value. The group discussed a number of possible alternatives but settled on the idea of a scorecard, featuring performance measures capturing activities from throughout the organization—customer issues, internal business processes, employee activities, and of course shareholder concerns. Kaplan and Norton introduced the new tool the Balanced Scorecard and later summarized the concept in the first of three Harvard Business Review articles, “The Balanced Scorecard—Measures That Drive Performance.”

The Balanced Scorecard has been translated and effectively implemented in both the nonprofit and public sectors. Success stories are beginning to accumulate and studies suggest the Balanced Scorecard is of great benefit to both these organization types. The BSC was originally created primarily as a measurement system and as an answer to a criticism concerning the unilateral measurement of the performance ability of a company. It was organized through four different perspectives:

a. The financial perspective: to succeed financially, how should we appear to our shareholders? Examples of this perspective include financial ratios and various cash flow measures.
b. The customer perspective: to achieve our vision, how should we appear to our customers? Examples of this perspective include the amount of time spent on customer calls and customer survey data.
c. The internal perspective: to satisfy our shareholders and customers, what business processes must we excel at? The internal business processes that are often classified as mission oriented and support oriented. Examples of this perspective include the length of time spent prospecting and the amount of rework required.
d. The learning perspective: to achieve our vision, how will we sustain our ability to change and improve? Includes employee training and organizational attitudes related to both employee and organizational improvement.

Examples of this perspective include the amount of revenue that comes from new ideas and measures of the types and length of time spent training staff.
There are many benefits and challenges to the balanced scorecard. The primary benefit is that it helps organizations translate strategy into action. By defining and communicating performance metrics related to the overall strategy of the company, the balanced scorecard brings the strategy to life. It also enables employees at all levels of the organization to focus on important business drivers.
The main challenge of this system is that it can be difficult and time-consuming to implement. Kaplan and Norton originally estimated that it would take an organization a little more than two years to fully implement the system throughout the organization. Some organizations implement it quicker, for some it takes longer. The bottom line is that the balanced scorecard requires a sustained, long-term commitment at all levels in the organization for it to be effective.

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Figure 1. The methodology of the Balanced Scorecard
### Table 1. Comparison of Balanced Scorecards in the Private and Public Sectors

<table>
<thead>
<tr>
<th>Features</th>
<th>Private Sector</th>
<th>Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Focus</td>
<td>Shareholder value</td>
<td>Mission effectiveness</td>
</tr>
<tr>
<td>Financial goals</td>
<td>Profit; market share growth; innovation; creativity</td>
<td>Cost reduction; efficiency; accountability to the public</td>
</tr>
<tr>
<td>Efficiency concerns of clients</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Desired outcome</td>
<td>Customer satisfaction</td>
<td>Stakeholder satisfaction</td>
</tr>
<tr>
<td>Stakeholders</td>
<td>Stockholders; bondholders</td>
<td>taxpayers; legislators; inspectors</td>
</tr>
<tr>
<td>Who defines budget priorities</td>
<td>Customer demand</td>
<td>Leadership; legislators; funding agencies</td>
</tr>
<tr>
<td>Key success factors</td>
<td>Uniqueness; advanced technology</td>
<td>Sameness; economies of scale; standardized technology</td>
</tr>
</tbody>
</table>

2. **Comparing the Balanced Scorecard between private and public sectors**

Using the same performance metrics in the public sector as the private sector is likely to be ineffective since public sector goals differ drastically from those of the private sector. Private sector focus is primarily on *shareholder value: the bottomline*. Funding comes from various sources, and as long as shareholder financial needs are met, the company can function as it pleases (see Table 1). The public sector faces a quite different environment. Public sector funding comes, in most cases, from the taxpayers it is servicing. The measure of success is not shareholder value or profit but rather *how well the agency is meeting the mission* given to them by congressional statute or executive order. Although the agency can oftentimes perform this mission in whatever way it sees fit, it is still bound by the directive of the mission. Thus, strategic value comes in the form of fulfilling the mission, and fulfilling the mission comes down to customer satisfaction with the agency’s service. However, defining customer needs is a bit more complex. A second difference evolves through the number of customers or stakeholders that a public sector organization must serve.

The Balanced Scorecard can be effective in the public, if and only if, the current perspectives are rearranged (see Figure 3). The four perspectives of the current version of the Balanced Scorecard can still be applied in government organizations as long as they are rearranged according to governmental priorities. Therefore, it is clear that above considerations seem to have considerable impact on the ability of the Balanced Scorecard in ensuring best customer satisfaction. These considerations, if positively dealt with, may contribute to employee satisfaction, superior employee performance, sound internal business process and in turn, may lead to efficient stewardship of taxpayers’ money.
Furthermore, the best possible use of taxpayers’ money may eventually lead to achieving the bottom-line objective - absolute customer satisfaction. In the light of the above observations, it is clear that some modifications are needed to the current version of the Balanced Scorecard for its use in the government sector as an effective performance measurement and management tool. Although significant research has taken place and various modifications to the current version of the Balanced Scorecard have been suggested by the researchers for the private sector, no studies have been found recommending a modified Balanced Scorecard model for the government sector. The following diagram (Figure 3) is suggested for the government sector, keeping in mind that “Customer” perspective is the bottom line of government sector. The Balanced Scorecard Institute has compared the different strategic objectives of the public and private Sectors. Table 2 shows the differences in each strategic level:

Figure 3. Is it meaningful to measure performance in public sector?
Table 2. Comparison of Private and Public Sector Strategies

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Private Sector</th>
<th>Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>common target</td>
<td>competitive</td>
<td>achievement of mission</td>
</tr>
<tr>
<td>financial target</td>
<td>profit, growth, increasing market share</td>
<td>cost reduction, effectiveness</td>
</tr>
<tr>
<td>values</td>
<td>innovation, creativity, acceptance</td>
<td>responsibility to the public, equity, integrity</td>
</tr>
<tr>
<td>desired result</td>
<td>customer satisfaction</td>
<td>customer satisfaction</td>
</tr>
<tr>
<td>stakeholder</td>
<td>founder, market, stockholder</td>
<td>tax payer, legislator, auditor</td>
</tr>
<tr>
<td>prioritisation of budget</td>
<td>customer demand</td>
<td>management, legislator</td>
</tr>
<tr>
<td>orientation in terms of security</td>
<td>securing intellectual property</td>
<td>national security</td>
</tr>
<tr>
<td>critical factors for success</td>
<td>growthrate, revenue, market share, uniqueness, superior technology</td>
<td>best management practices, consistency, standardised technology</td>
</tr>
</tbody>
</table>

A special requirement for adoption is needed for the financial perspective. Even though the Balanced Scorecard seems to be balanced all perspectives and measures are aligned to the financial success and profitability of the organization.

The Public Sector’s financial perspective is mainly adjusted to budget targets, saving potentials, securing the basis for taxes, sustainment of credit worthiness and similar.

Some of the facts which are especially important for adoption of the Balanced Scorecard approach in public sector are:

- The closeness to political interests needs a special thoughtfulness and sensibility.
- It is important to explain employees and representatives the Balanced Scorecard’s usefulness.

The implementation of a Balanced Scorecard requires an effective controlling system which assembles measures, values and other significant reporting data. Public sector still needs to catch up here. Accordingly from the beginning this should be allowed for.

- A balance between a tight schedule and adequate time for practice, communication and feedback during strategy discussion has to be found. To keep motivation high the rollout should be kept short. Adoption needs dynamics, especially in the Public Sector.
3. Strategy mapping

The strategy map has turned out to be as important an innovation as the original Balanced Scorecard itself. Executives find the visual representation of strategy both natural and powerful. Strategy maps provide increased granularity for executives to describe and manage strategy at an operational level of detail. A strategy map provides a visual framework for an organization’s strategy – how it intends to create value. Specifically, a good strategy map will link together:

1. The desired productivity and growth outcomes.
2. The customer value proposition which will be needed.
3. Outstanding performance in internal processes.
4. The capabilities required from intangible assets.

In effect, a strategy map captures the organization’s strategy in visual form so that managers can better execute their desired strategy. Strategy maps are built around the structure of these four perspectives. They ensure that the organization’s objectives in each of these perspectives are consistent and internally aligned. That alignment, in turn, means the organization is focused and performing at an optimal level rather than having the actions of one part of the organization impact on the results achieved by another part (Hers, 1998). Strategy maps clarify all cause-and-effect relationships so that an effective strategy can be developed and then optimized over time. They are the interface between strategy and the Balanced Scorecard. Conceptually, a strategy map links the high-level goals of the organization – its mission, values and vision – with meaningful and actionable steps each an employee can take. Strategy maps also provide balance between the various competing dynamics every organization faces:

- Whether to invest in intangible assets that will generate strong long-term revenue growth or focus on cutting costs more aggressively so as to boost short-term results.
- How to differentiate your organization from your competitors by clarifying your value strategy – which usually involves one of the four different approaches already mentioned:
  1. Offering the lowest total cost to customers
  2. Product leadership – always offering superior products
  3. Making available complete customer solutions
  4. Locking-in customers so that it would be hard to switch to other vendors:
     a) Which internal processes to focus on and optimize and which to outsource.
     b) How to balance the allocation of resources between the various internal processes in such a way that different benefits are delivered at various points of time.
     c) How to align everything the organization does in such a way that the efforts of one part of the company do not have a negative impact on the results achieved elsewhere.
     d) How to make good management decisions about investments in intangible assets as the drivers of organizational growth in the future (Du Mee, 1996).

A company or other organization creates value by producing goods and services that can be sold for profit. At one time, it was suggested that managing these processes was the most important duty of management. In today’s competitive environment, however, operational excellence alone is not sufficient to provide a sustainable competitive edge. A strategy map (see Figure 4) helps ensure internal processes are well executed and properly aligned with intangible assets and the customer value proposition.
The four key internal processes by which organizations create value according to (Kaplan, Norton, 2002) are:
- Operations management processes;
- Customer management processes;
- Innovation processes;
- Regulatory and social processes;

In the operations management area, organizations are:
- Attempting to develop deeper relationships with suppliers with the goal of lowering the total cost of procuring all the materials needed to products the customer is offered. Generally, this involves simplifying ordering and accounting functions to lower administrative costs as far as possible.
- Looking for new ways to actually produce the products and services as efficiently as possible through continuous improvement of processes and enhanced efficiency initiatives.
- Attempting to lower the costs of distribution and delivery in any way possible.
- Trying to get a better idea of the risks involved in doing business and then finding effective ways to offset and minimize those risks to a better effect.

Figure 4. A simplified strategy map (source Kaplan, Norton, 2002)

By focusing on operations management, organizations attempt to inject key features into their value proposition:

1. Competitive prices
2. High levels of quality
3. Speedy delivery of the goods purchased
4. A comprehensive solution to customer problems.

A well thought out and integrated strategy map provides strategic focus to these key internal processes. Or, put differently, a strategy map helps link process improvement programs to
important organizational outcomes. Strategy maps help organizations improve the right things, not just the more obvious things. Strategy maps are also useful where organizations have embarked on quality management programs such as Total Quality Management (TQM), Six Sigma or Activity-based Management (ABM). The strategy map helps embed these quality management efforts within a strategic framework that will provide cause-and-effect accountability and measurement metrics.

Strategy maps can be used dynamically to create an action plan rather than passively as snapshots of corporate intent. To use a strategy map and Balanced Scorecard together effectively in this way is a six-step process:

1. **Establish and define what the current value gap is for shareholders**; or in other words, set the financial objectives, measures, and targets. Determine how much long-term revenue growth and short-term productivity improvements you will work towards achieving. These should be stretch targets that will challenge the organization.

2. **Reconcile your current value proposition**; by identifying your current target customer segments, clarifying the value proposition you now use, selecting your measures and reconciling your customer objectives to the goals of financial growth. You might also decide on a new customer proposition that will generate the growth you desire.

3. **Establish your projected timeline**; how quickly you anticipate your new internal processes and themes can begin to generate the kinds of financial results required. This should indicate which goals are achievable and which goals may need further adjustment.

4. **Identify your key strategic themes**; those critical few internal processes which will have the greatest impact on the customer value proposition. You also highlight which internal processes are the drivers for those targets and create some linked objectives, measures, and targets.

5. **Identify and align your intangible assets**; by assessing the level of strategic readiness of each intangible asset. You then set targets on how to increase each asset’s level of readiness individually.

6. **Specify and fund the strategic initiatives required to execute the strategy**; so there is clarity about the level and sources of funding required. The cause-and-effect linkage of the strategy map, Balanced Scorecard, and action plan should help visualize the logic involved. These steps mean that passive statements of intent are given substance and relevance. For example, a strategic objective to “Reduce the typical product development cycle” is appealing but also open to individual interpretation. When it is transformed into something like “Reduce the product development cycle from three years to nine months”, everyone in the organization realizes this will require some breakthrough, outside-the-box thinking rather than minor enhancements (Marco, 2006).

**Conclusions**

The Balanced Scorecard was developed, between others, by Robert Kaplan and David Norton. It was originally created primarily as a measurement...
The Balanced Scorecard provides the cornerstone for a new strategic management system. The scorecard enables organizations to introduce new governance and renew process focusing on strategy. It does not rely on short-term financial measures as the sole indicators of performance but it does the following additional functions (Ghosh, Mukherjee, 2006):

1. Translate strategy to action, making strategy everyone’s job.
2. Manage the intangible assets e.g. customer loyalty, innovation, employee capabilities.
3. Leverage cross functionality without changing the structure of the business.
4. Measure what matters the critical few vs. the important many in real time, not just after the facts.
5. Create a daily management system for the day-to-day navigation of the business.

A Balanced Scorecard, however, suffers from some major drawbacks. The most important among these are (Ghosh, Mukherjee, 2006):

1. The Balanced Scorecard decomposes the organization’s primary objectives (financial perspective) into customer, internal process and learning and growth objectives (operating perspectives) in a way that is reminiscent of the way that the Dupont formula decomposed the return on capital employed metric into front-line operational measures.
2. To make scorecard useful, it should be prepared in conformity with the overall business strategies. Thus, companies may bias their scorecards to the dimensions that closely support their strategic direction.
3. It is difficult to integrate a company’s scorecard into its planning, budgeting and resource allocation process; especially when scorecard metrics are changed.
4. In order to make the scorecard more useful and practical it is necessary to assign weights to different measures (both financial and non-financial) on the basis of their importance to the organization for specifying trade-off between financial and nonfinancial measures.
5. To make the scorecard more efficient and useful it should include a large number of both financial and non-financial measures and these should be continually modified on the basis of measurement feedback.
6. There are some organizations like investment companies to which Balanced Scorecards have little value as they are interested in improving financial performance only.
7. The creditors, debenture holders and even shareholders of an organization are interested in financial performance rather than operating performance which compels the management to give much emphasis on financial perspective of the organization making the scorecard imbalanced.

Creating the balanced scorecard is a critical step in the strategic process. So many organizations create a strategic plan and then dutifully ignore it because day-to-day issues / firefighting tends to take precedence. The scorecard periodically reminds the organization what the critical strategic issues are and gives the necessary feedback on the progress toward achieving them.
It is important that the scorecard is like a scale. The role of the scale when you are on a diet is not to make you lose weight. The scale merely provides you with feedback on how you are doing. In the same way, building a balanced scorecard will not improve organizational performance. It will simply give you feedback to know how well you are achieving your strategic direction.

The real strength of the linkages between the strategy map, Balanced Scorecard and action plan is consistency. Instead of a fragmented approach where one part of the organization pursues a different agenda from another part, everyone uses the same overall strategy. The vision is consistent with the strategy to get there. People can be inspired to act because they see that it is feasible to get to where the management wants to head.

References