Balanced Scorecard: A Paradigm Measure Of Business Strategy And Firm Performance

Asa Romeo Asa, Navneel Shalendra Prasad, Maw Maw Htay

Abstract: - Due to intensity of characteristics comprised in today's globalized markets whereby companies face fierce competition on a global scale which compel them to drive strategy to achieve firm performance objectives such as long-term profitability and customer loyalty. Balanced scorecard has become increasingly important strategic management tool that translates visions into profitable actions, particularly focusing on intangible assets such innovation, value chain, employee skills and knowledge levels, customer and supplier relationships, which are critical in providing the much-needed cutting-edge to an organizational setting. Therefore, this theoretical paper attempts to ascertain whether the implementation of a balanced scorecard as a paradigm measurement tool contributes to the improvement and synergy of business strategy and firm performance.

Keywords: - Balanced Scorecard, Business Strategy, Firm Performance, Innovation, Knowledge, Competitive Advantage, Profitability

1 INTRODUCTION

Balanced Scorecard (BSC) is a strategic tool that enables organizations to bridge the gap between strategy and actions. It incorporates financial and non-financial elements from a variety of perspectives into a single framework that is used extensively in business and industry, government, and non-profit organizations worldwide to align business activities to the vision and strategy of the organization, aimed at improving internal and external communications, and monitor firm performance against strategic objectives. Organizations face great challenges to achieve a competitive edge and to retain customers, the solution to this challenge is to constantly innovative to satisfy the ever changing needs of their customers. Achieving customers' satisfaction through innovation can strengthen the financial position of the organization [21]. BSC as a tool helps organizations to focus on areas relevant to organization's success; it seeks to clarify achieved firm performance relative to the business strategy undertaken. Hence, organizations should develop and monitor sound strategies to capitalize and maintain sounding financial positions. Evans, [5] stated that strategies may be well drawn and presented, but the problem is that strategy is not well communicated to people involved in the execution process. Strategy execution is everyone's business in the organization [2].

- *Asa Romeo Asa is currently pursuing doctoral degree program in management science and engineering in Wuhan University of Technology, P.R, China, PH:+8615071474543. E-mail: romeoassa@gmail.com*
- *Navneel Shalendra Prasad is currently pursuing doctoral degree program in management science and engineering in Wuhan University of Technology, P.R, China, PH:+8618707149491. E-mail: navi_7237@hotmail.com*
- *Maw Maw Htay is currently pursuing doctoral degree in Industrial Engineering in Wuhan University of Technology, P.R, China, PH:+8613720263612, E-mail: maw041@gmail.com*

In many organizations the formulation of strategy is done at top management hierarchy whilst the execution part occurs at bottom up process. According to Anand [1] four barriers are responsible for strategy implementation: vision barrier: few people in the organization understand the strategy of their organization; people barrier: the objectives of most workers are not linked to the organization's strategy; resource barrier: misallocation of time, energy, and money to processes that are critical to the organization; lastly is the management barrier: management allocates little time to strategy, and much time to short-term tactical decision-making. Moreover, Kaplan and Norton [12] argued that most companies fail to execute strategies, is because: only 5% of the workforce understands their company's strategy; only 25% of managers have incentives linked to strategy; 60% of organizations don't link budgets to strategy; 86% of executive teams spend less than one hour per month discussing strategy. Thus, a well implemented strategy should be ensured that these barriers are bridged if it were to achieve goals.

2 THE FUNDAMENTAL OF BALANCED SCORECARD

Developed by Robert Kaplan and David Norton in 1992, the balanced scorecard model translates an organization's strategy into performance objectives, measures, targets and initiatives. It is based on four balanced perspectives which an organization must focus on, and links them together with the cause and effect concept. A balanced scorecard that is properly implemented can measure the effectiveness of an organization's strategy through a series of linked performance measures based on four perspectives including customers, finance, internal processes, employee learning and growth. The BSC study came to existence on the premise that traditional performance measurement systems, that are based on financial accounting measures were no longer sufficient indicators of performance in today's rapidly changing business environment [13]. Such traditional measurement systems do not take into account the value of intangible and intellectual assets, which are increasingly important in our knowledge-based economy. It is evident in a knowledge based business environment that the traditional tangible assets become less important as compared to intangible assets that create value for organizations. Innovation that competitors find difficult to copy has become increasingly crucial for organizations in a knowledge based economy, which also makes this type of innovation an unmanageable to measure with traditional financial accounting systems. Therefore, a need is created to find a different measure to the increasing importance of intangible assets.The aim of the Balanced Scorecard is to clarify and communicate a company's vision and strategy into action. The balanced scorecard framework is founded on four perspectives that are briefly discussed below:

2.1 The Customer Perspective

The aim of the customer perspective is to ascertain the needs of the customers, and then devise appropriate the value the company wants to apply to the end-user that will potentially satisfy their needs taking into account the measure of quality and perceived value of the products or services that are supplied to the customer. According to Kaplan and Norton [10], customers are primarily concerned with time, quality, performance and service, and costs. For a company to attain its customer satisfaction and retention ought to deliver on time, offer innovative products/services and technological excellence that will render the company's offering at a satisfactory cost, because if customers are not satisfied, they will seek products and services elsewhere. Customer measures are considered leading indicators of future performance.

2.2 The Financial Perspective

The financial perspective is to evaluate whether the company's strategies are translating into bottom-line improvements of the company. Financial measures tend to be historical, and do not reveal the present situation of the business environment and the prospects of the future performance. However, financial measures are still important because there is no guarantee that improved operating performance will indeed lead to financial success [10]. The financial performance such as profitability of an organization is significant to its success, therefore cannot be dismissed. According to Kaplan & Norton [10], operational improvements that do not lead to financial success indicate that the implementation of the strategy of an organization needs to be revisited. However, trying to capture the success strategy using the traditional financial indicators requires the selection of financial measures that will most effective suited by the product life cycle stage. There are three possible stages described by Kaplan and Norton [13], that is rapid growth, sustain, and harvest. For the growth stage, companies will probably use measures such as increased sales volumes, acquisition of new customers, and growth in revenues that can evaluate the growth and development of the company. In the sustain stage Financial measures will be return on investment (ROI) and the return on capital employed, measures on this stage are purposely directed to evaluate the effectiveness of the organization. Finally, the harvest stage, measures are payback periods and revenue volume aimed to reap the rewards of the strategy that will potentially be based on different cash flow analysis that attempt to evaluate the company's success in harvesting profits from maturing products or services.

2.3 The Internal Business Perspective

The purpose of the internal business perspective is to determine the key business processes that create and deliver the goods and services of the company to the customers whilst develop measures to ensure that these processes are working well. By focusing on the activities and key processes required, it enhances the company's efforts to excel at providing the value expected by the customers, hence that the measures in the customer perspective will be supported. The processes in the in the internal business perspective have impact on the financial perspectives, whereas well implemented measures that attain smaller lead-times or better quality may result in greater profit margins. Contrary, poor performance in critical business processes can lead to a decline in customer satisfaction and ultimately in profit margins. These measures serve as focal guidelines for managers to focus on the important internal operations that will aid them meet customers' expectations. According to Kaplan & Norton [10], companies should focus on business processes that have the most significant impact on customer satisfaction and are required to excel and compete in their industry. Measures in the internal business perspective could be innovation rates, service measures, lead-time, quality measures, efficiency measures, costs reductions.

2.4 The Innovation and Learning Perspective

The purpose of the innovation and learning perspective is to determine the ability of the company to continually improve and innovate. This is the foundation of any strategy and centers on the human and intangible assets of the company. As discussed earlier, intangible assets are increasingly important in today's globalized economy as business success lies on it. Thus, the focus is mainly on the internal skills and capabilities that are required to support the value creation, which includes the areas of individual and corporate self-improvement and technological support and tools. This perspective tries to define the human and developmental requirements of the company that will enable ambitious objectives in the other three perspectives to be achieved. To increase shareholder value a firm must constantly able to innovate, learn and improve which will result in firm growth. Theoretically, through increased improvement, businesses are able to improve their internal processes, leading to greater customer satisfaction, corporate growth, and increased profits [21]. The possible measures in this perspective are illness rates, employee turnover and education and development.

3THE BALANCED SCORECARD AND BUSINESS STRATEGY

The balanced scorecard results are only useful if the management reviews them and openly passed on to employees dealing with the execution phase. Communication is the essence in the process of converting visions and strategies into action. Communication can be an effective tool for motivating employees involved in change [16]. Appropriate communications provide employees with feedback and reinforcement during the change [19], which enables them to make better decisions and prepares them for the advantages and disadvantages of change [20]. A well formulated balanced scorecard depends on how well an organization manages strategy if it is to achieve its purpose. Figure 1 and 2 below shows the process of translating the vision into operational terms that provide useful guides to action at the operational level. A link exist between the balanaced scorecard and strategy management to attain firm performance. Firm peformance can be long-term profit, customer rention and loyalty and so on. *Therefore,*

Balanced scorecard + Managed strategy = Firm perfomance

For people to act on the vision and strategy statements, those statements must be expressed as an integrated set of objectives and measures, agreed upon by all senior executives, that describe the long-term drivers of success [14]. The communicating and linking process allows managers to communicate the strategy across the organization and link it to departmental and individual objectives. The scorecard gives managers a way of ensuring that all levels of the organization understand the long-term strategy and that both departmental and individual objectives are aligned with it. While the business planning process enables companies to integrate their business and financial plans by using the balanced scorecard measures as the basis for allocating resources and setting priorities, they can opt and align the initiatives that prompt them toward long-term strategic goals. Finally, feedback and learning process gives companies the capacity to compare the budgeted to the actual financial goals. It serves as a reflection and learning process.

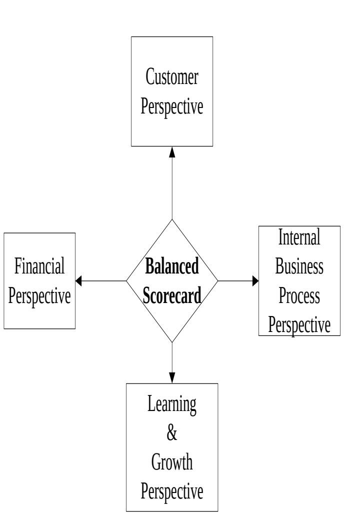

Fig. 1: Balanced Scorecard Framework

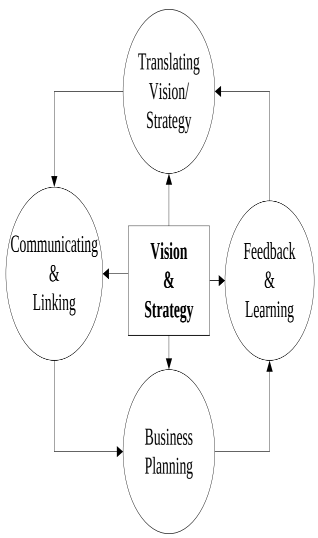

Fig. 2: Four Processes of Managing Strategy

4 Employee Performance Standard

People are sort to be utmost important assets of any organizations, hence having skilled, knowledgeable and courageous/willing workforce is crucial for organizational performance. For the balanced scorecard to function; it is fundamental to assess and measure the employee performance because the people formulating, implementing and executing the balanced scorecard should be competent enough in directing strategy to attain desired results. For this premise we propose a new theoretical measure called the Employee Performance Standard (EPS), with its fundamental focus circled on employees. It analyses the facets that are significant for employees to be competent and perform accordingly.

Employee Performance Standard (EPS) = f (Skill + Knowledge + Courage)

Skill is the capability of an employee to perform and complete assigned tasks timely, relevantly and some sense of accuracy. This can be acquired through training and experience. While, knowledge is the uniqueness of an individual in carrying out strategy and tasks directed to attain desired output. It includes formal learning and intuition. It is significant for making informed and also prompt decisions where necessary. Intuitive can be regarded as the cause of creativity and innovation, which is important aspect of intangible assets that drive the modern economy to success. Courage is the willingness of an employee to succeed. It arises from internal and external aspiration of employee bounds; it includes motivation, confidence, coaching, and satisfaction.

5 THE BALANCED SCORECARD AND LONG-TERM PERFORMANCE

The By using the balanced scorecard to focus on long-term performance, rather than on short-term gains, the authors aim to assess through prior studies whether companies that have adopted the balanced scorecard are more successful in the long run. Specifically, finding out whether there's a correlation between the implementation of a scorecard and increased long-term perfomance of an organization. Chwan-Yi & Lin [3] attempted to develop an integrated framework by merging the concepts of the BSC and the Data Envelopment Analysis (DEA), whereby an auto company and a commercial bank were employed for empirical investigations. The study revealed that the synergy of the BSC and the DEA translates the appropriate performance indices into managerial implications. Fu-Hsiang Chen, et al, [6] used a balanced scorecard approach to establish a performance evaluation and relationship model for hot spring hotels based on a hybrid MCDM model combining DEMATEL and ANP This effective performance evaluation model developed by applying the hybrid MCDM enables business managers to understand the appropriate actions and achieve a competitive advantage. Zhang & Li [24] believe that performance management is an important aspect of banking business management. In their study they proposed the BSC as a tool to improve the performance of commercial banks in China. Harold [8], applied the BSC to develop a comprehensive performance measurement and a management tool for the IT in the banking sector in India. The author clarified how a cascade of balanced scoreboards can be useful in the technology effectiveness of commercial banks in India to guarantee better performance management. Taiji [22] conducted a research on the role of balanced scorecard for improvement of management systems in Japanese companies. The results of the study includes an examination of cases where BSC was introduced into a Japanese companies, the researcher found that while the reasons for introducing it varied, however the BSC typically played these roles; firstly, it made the strategy tangible, secondly, it improved and created a capability within an organization, and lastly, it enhanced the strategic mindset in employees, thereby resolving management issues. These roles highlighted the shortcomings in the management system of Japanese companies and enabled them to resolve these issues. Through BSC guidelines, Huang and Lin [9] examined the performance system of five commercial banks in China. Through investigations and evaluations of the current performance systems of the sample banks, the authors were able to design a new performance evaluation system based on the BSC. There are many evidences in literature on BSC success in achieving firm performance in variety improvements that result in long-term profits; however the ones discussed in this paper serve as validity for this theoretical analysis on BSC linking to performance.

6 WEIGHTING OF MEASURES ALONG THE BALANCED SCORECARD

Theoretical analysis of this paper does not necessarily writing off the use of accounting financial measures. However, it is important for organizations to balance the financial measures to non-financial measures. Theoretically, a company with a balanced approach to measurement should have better performance than an organization with a higher focus on one of the two measures. According to study conducted by Ernst & Young [4] presents that nonfinancial criteria constitute, on average, 35 percent of the investment decisions by buyers, The study also found that research analysts use non-financial data when evaluating companies and recommending buy/sell decisions, and that the more non-financial measures analysts used, the more accurate the earnings forecasts were. Hence, a grasp of know-how on nonfinancial by companies can aid in the value growth of the their business undertakings. Consistence in measuring intagible assets such as innovation is critical for long-term performance. It is not enough to implement a BSC without tracking the impact of it on firm performance such as long-term profitability. The use of other tools such as innovation index by OSLO manual [18] and Tobin's Q ratio are all necessary in tracking the impact of BSC in an organization at a period of time. The formulas are given below; The two innovation performance indicators, following the OSLO manual [18], namely the ratio of innovation sales and the innovation rate, to represent the economic significance of innovation calculated in percentage.

$$\textit{Ratio of Innovation Sales} = \frac{\text{new product sales}}{\text{total product sales}}$$

$$\textit{(or) Innovation Rate} = \frac{\text{number of new products}}{\text{total number of products}}$$

Tobin's Q aids a company to examine whether it had experienced increased long-term profitability as a result of BSC implementation.

$$\textit{Tobin's Q Ratio} = \frac{\text{total market value of firm}}{\text{total asset value of firm}}$$

7 BENEFITS AND SHORTCOMINGS OF BALANCED SCORECARD

To begin with the optimistic aspects of a balanced scorecard is evident among prior studies that it has several benefits due to its centrality on intangible assets. The use of the balanced scorecard makes it easier for many organizations to establish mechanism that transforms strategic vision into tangible goals and measures. The BSC provides management and employees with a comprehensive picture of business operations to undertake and aids in aligning key performance measures with strategy at all levels of an organization. With BSC in place, organizations that embrace a participatory working environment benefits from increased creativity and intuitive leading to unique competitive advantage, improved decisions and better solutions. The critics of the BSC argue that while a balanced scorecard might be simplistic in theoretical form, obviously it cannot implement itself which pose remains a challenge for many organizations to implement. Particularly, the ability to define and execute their unique strategy has proven as the main challenge for organizations [17]. Reporting is a critical part of the balanced scorecard system. Without reports, it is impossible to utilize the scorecard as a tool to analyze performance and make decisions for improvement. However, the reporting process fails at times, and information is lost. Two major reasons why the reporting process does not work for scorecards are difficulty in designing reports that are useful to management, and difficulty in choosing an appropriate reporting tool. Managers require different reports for different reasons. It is challenging to find a balance between the amount of detail that managers want, and the right reports to capture that information. Timing of reports is critical; information that is too late is not useful [23].

8 STRATEGIC IMPLICATIONS

For managers finding it difficult to implement a BSC into their organisations; we recommend them to adapt to Kotter's 8-steps of leading change to successfully transform business implementation namely create a sense of urgency, recruit powerful change leaders, build a vision and effectively communicate it, remove obstacles, create quick wins, build on your momentum and institutionalize the new approaches. Managers that follow these steps can help make the change part of their organizational culture given the balanced scorecard.

9 CONCLUSION

To succeed, an organization must add value for all perspectives in both the short and long term and need to be able to balance both the financial and nonfinancial aspects of the business. If the employees have the right skills, knowledge, willingness and tools, and the right business processes are developed within the BSC, then customers will be satisfied, thus ensuring the continued success of the organization. Theoretical analysis in this paper brings us to the validity of BSC as tool that contributes to the synergy of strategy and firm performance and improvements in organizational goal attainment. However, for a BSC to be successful implemented it must be supported by various metrics, mechanisms and factors that are clearly discussed in this paper, if it is to achieve long-term profitability.

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