Performance Measurement - The Balanced Scorecard Perspective

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Abstract: The transition from the industrial to the informational age sets new rules of competition. The competitive success is based more and more on the intangible assets like skills, systems and values. Companies are finding that performance measurement systems that worked in the past are not effective in this new context. There is a need for performance measurement systems linked to the strategy that combines financial indicators of the past performance with the drivers of future success. The Balanced Scorecard translates a firm’s strategy in a comprehensive set of performance measures in four perspectives: financial, customer, internal processes, learning and growth.

Keywords: performance measurement, Balanced Scorecard.

Introduction

The old adage “You can’t improve what you can’t measure” is certainly true for firms. A report by the Conference Board of Strategic Performance Management in 1998 found that companies using performance measurement were more likely to achieve leadership positions in their industry and were almost twice as likely to handle a major change successfully (B. L. Adams, 2003). Firms need to develop an entire system of meaningful performance measures to become and then remain competitive (Wisner et al., 2005, pg.433).

Peter Drucker (in Niven, 2002), suggests that few factors are as important to the performance of an organization as measurement, and measurement is among the weakest areas in management today. In today’s highly competitive environment and due to the rapid changes that occur, organizations need to devote significant time, energy, and human and financial resources to measuring their performance in achieving strategic goals.

Although measuring performance requires the substantial effort and high costs, a 2001 survey by the American Institute of Certified Public Accountants and Lawrence S. Maisel, found that only 35 percent of respondents rated their performance measurement systems as effective or very effective.

Increasingly, organizations are reaching the conclusion that while measurement is more crucial than ever, their systems for capturing, monitoring, and sharing performance information are critically flawed. While the methods of modern business have transformed dramatically over the past decades, the systems of measurement have remained firmly mired in the past.
Most performance measures used by firms today continue to be the traditional cost-based and financial statistics reported to IRS and to shareholders in the form of annual report, balance sheet and income statement data. These systems were perfectly suited in the industrial era, but they are ill-equipped to capture the value creating mechanisms of today’s modern business organization. Intangible assets such as employee knowledge, customer and supplier relationships, and innovative cultures are the key to producing value in today’s economy. According to a survey implemented by the Institute of Management Accountants’ Cost Management Group, only 6 percent of its members were using customer satisfaction as an organizational performance measure (Wisner et al., 2005, pg.433).

**The Characteristics of an Effective Performance Measurement System**

The role of strategy is more important today than it has ever been. The necessity of effectively executing strategy is crucial in an era of globalization, customer knowledge, and rapid change. But the sobering fact is that about 9 out of 10 organizations fail to implement their strategies.

What is needed is a measurement system that balances the historical accuracy and integrity of financial numbers with today’s drivers of economic success, and in so doing allows the organization to beat the odds of executing strategy.

Performance measurement provides the link between strategies and action. Inappropriate measures lead to actions incongruent with strategies, however well formulated and communicated. Appropriate measures should provide and strengthen this link, and both lead to attainment of strategic goals and impact on the goals and strategies needed to achieve them (Dixon et al., 1990). Effective performance measurement systems link current operating characteristics to these long-term strategies and objectives (Wisner et al., 2005, pg.433).

As many of the world’s businesses respond to increased competitive pressures by attempting to develop and maintain a distinctive competitive advantage, the need to develop effective performance measurement systems linking firm strategy to operating decisions increases. Performance criteria that guide a firm’s decision making to achieve strategic objectives must be easy to implement, understand, and measure; they must be flexible and consistent with the firm’s objectives; and they must be implemented in areas that are viewed as critical to the success of the firm. Thus, an effective performance measurement system should consist of the traditional financial information for external reporting purposes along with tactical-level performance criteria used to assess the firm’s competitive capabilities while directing its efforts to attain other desired capabilities. Finally, a good performance measurement system should include measure of what is important to customers. These measures will vary by company and through time as strategic changes occur to the firm, its products.

Creating an effective performance measurement system involves the following steps (Nicholas, J., M., 1998; Wisner & Fawcett, 1991):
- identify the firm’s strategic objectives;
- develop an understanding of each functional area’s role in the required capabilities for achieving the strategic objectives;
- identify internal and external trends likely to affect the firm and its performance over time;
- for each functional area, develop performance measures that describe each capabilities;
- document current performance measures and identify changes that must be implemented;
- assure the compatibility and strategic focus of the performance measures to be used;
- implement the new performance system;
- periodically reevaluate the firm’s performance system as competitive strategies change.

A feature of the leading organizations is that they successfully use performance measurement not only to obtain information and to make judgments about the organization and the effectiveness and efficiency of its programs, processes, and people, but also they use performance measurement to drive improvements and successfully translate strategy into action (The Procurement Executives’ Association, 2006, pg.3).

Various groups including the National Partnership for Reinventing Government and the Center for Advanced Purchasing Studies suggest the following attributes of a successful performance measurement and management systems (The Procurement Executives’ Association, 2006, pg.6-8):

- **A conceptual framework is needed for the performance measurement and management system.** Every organization needs a clear and cohesive performance measurement framework that is understood by all levels of the organization and that supports objectives and the collection of results.

- **Effective internal and external communications are the keys to successful performance measurement.** Effective communication with employees, process owners, customers, and stakeholders is vital to the successful development and deployment of performance measurement and management systems.

- **Accountability for results must be clearly assigned and well-understood.** High-performance organizations clearly identify what it takes to determine success and make sure that all managers and employees understand what they are responsible for in achieving organizational goals.

- **Performance measurement systems must provide intelligence for decision makers, not just compile data.** Performance measures should be limited to those that relate to strategic organizational goals and objectives, and that provide timely, relevant, and concise information for use by decision makers—at all levels—to assess progress toward achieving predetermined goals. These measures should produce information on the efficiency with which resources are transformed into goods and services, on how well results compare to a program’s intended purpose, and on the effectiveness of organizational activities and operations in terms of their specific contribution to program objectives.

1. **Compensation, rewards, and recognition should be linked to performance measurements.** Performance evaluations and rewards need to be tied to specific measures of success, by linking financial and nonfinancial incentives directly to performance. Such a linkage sends a clear and unambiguous message to the organization as to what’s important.

2. **Performance measurement systems should be positive, not punitive.** The most successful performance measurement systems are learning systems that help the organization identify what works—and what does not—so as to continue with and improve on what is working and repair or replace what is not working.
3. Results and progress toward program commitments should be openly shared with employees, customers, and stakeholders. Performance measurement system information should be openly and widely shared with an organization’s employees, customers, stakeholders, vendors, and suppliers.

The Balanced Scorecard and the Measurement of Performance

Developed by Robert Kaplan and David Norton, the Balanced Scorecard allows an organization to translate its vision and strategies by providing a new framework, one that tells the story of the organization’s strategy through the objectives and measures chosen. Rather than focusing on financial control devices that provide little in the way of guidance for long-term employee decision making, the Scorecard uses measurement as a new language to describe the key elements in the achievement of the strategy. The use of measurement is critical to the achievement of strategy.

In his book, Making Strategy Work, Timothy Galpin notes “measurable goals and objectives” as one of the key success factors of making strategy work. While the Scorecard retains financial measures, it complements them with three other, distinct perspectives: Customer, Internal Processes, and Learning and Growth.

Organizations around the globe have rapidly embraced the Balanced Scorecard and reaped swift benefits from its commonsense principles: increased financial returns, greater employee alignment to overall goals, improved collaboration, and unrelenting focus on strategy, to name just a few. To reap those rewards, however, an organization must possess the tools necessary to craft an effective Balanced Scorecard.

The concept of balance is central to this system, specifically relating to three areas (Niven, 2002, pg 22- 23):

1. Balance between financial and nonfinancial indicators of success. The Balanced Scorecard was conceived to overcome the deficiencies of a reliance on financial measures of performance by balancing them with the drivers of future performance.

2. Balance between internal and external constituents of the organization. Shareholders and customers represent the external constituents expressed in the Balanced Scorecard while employees and internal processes represent internal constituents. The Balanced Scorecard recognizes the importance of balancing the occasionally contradictory needs of all these groups in effectively implementing strategy.

3. Balance between lag and lead indicators of performance. Lag indicators generally represent past performance (customer satisfaction, revenue) that are objective and accessible but lack predictive power. Lead indicators are the performance drivers that lead to the achievement of the lag indicators. They often include the measurement of processes and activities. On-time delivery might represent a leading indicator for the lagging measure of customer satisfaction. A Scorecard should include a mix of lead and lag indicators. Lag indicators without leading measures do not communicate how targets will be achieved. Conversely, leading indicators without lag measures may demonstrate short-term improvements but don’t show whether these improvements have led to improved results for customers and ultimately shareholders.

Kaplan and Norton (Kaplan and Norton, 1996) describe the steps in the design of a balanced performance management system:
1. **Translate strategy into action** – the top management team has to translate the strategy into specific objectives. Financial objectives must be set and then customer, internal processes and core competences necessary to achieve those objectives have to be established. After a consensus on the long-run objectives is obtained, specific operational measures should be selected.

2. **Select linked measures** – every measure selected should be linked to a strategy. There should be a cause-and-effect relationship in the chain from learning and growth, to processes, to customers and to financial performance.

3. **Link financial objectives to life cycle** – the design of a scorecard must begin with the identification of the organization’s life cycle as the financial objectives differ depending on the stage of this life cycle.

4. **Select a mix of customer measures** – to be successful, companies must focus on customer needs, so they have to select a mix of generic and custom measures. The generic measures mostly used by companies are: market share, customer retention, customer acquisition, customer satisfaction, customer profitability. The custom measures should focus on product/service attributes, customer relationship, and image and reputation.

5. **Focus internal processes on meeting expectations** – the focus should be on customers and shareholders not on making incremental improvement to current operations.

6. **Focus on investments for the future** – to achieve long-term success on the financial, customer and internal processes of the BSC, firms must invest in people, systems and procedures. Regarding the employees, firms measure employee satisfaction, employee retention, employee productivity, and employee skills. Firms must invest in systems to ensure that employees have all the information about customers. Procedures must ensure a positive organizational climate that motivates employees to act in the best interest of the firm.

**Conclusion**

In an era of globalization, customer knowledge, and rapid change, the successful implementation of strategy plays a crucial role. A performance measurement system is needed to link the strategy with the action and it must include a balanced set of measures linked to the organization’s strategy.

A sustainable competitive advantage, in the new economy, is based more on the intangible assets like skills, systems and values than on physical and financial capital. The Balanced Scorecard provides managers with the instrumentation they need to navigate to future competitive success. It translates the organization’s mission and strategy into a comprehensive set of performance measures. The BSC complements financial measures of past performance with the measures of drivers of future performance.

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