Balanced Scorecard

What is the balanced scorecard?

The balanced scorecard (BSC) is a tool to execute and monitor the organizational strategy by using a combination of financial and non financial measures. It is designed to translate vision and strategy into objectives and measures across four balanced perspectives: financial, customers, internal business process and learning and growth. It gives a framework ensuring that the strategy is translated into a coherent set of performance measures.

Original methodology

The earliest balanced scorecards comprised simple tables broken into four sections – typically these "perspectives" were labeled "Financial", "Customer", "Internal Business Processes", and "Learning & Growth". Designing the balanced scorecard required selecting five or six good measures for each perspective.
Many authors have since suggested alternative headings for these perspectives, and also suggested using either additional or fewer perspectives. These suggestions were notably triggered by a recognition that different but equivalent headings would yield alternative sets of measures. The major design challenge faced with this type of Balanced Scorecard is justifying the choice of measures made. "Of all the measures you could have chosen, why did you choose these?" This common question is hard to ask using this type of design process. If users are not confident that the measures within the Balanced Scorecard are well chosen, they will have less confidence in the information it provides. Although less common, these early-style Balanced Scorecards are still designed and used today.

In short, early-style Balanced Scorecards are hard to design in a way to build confidence that they are well designed. Because of this, many are abandoned soon after completion.

Improved methodology

In the mid 1990s, an improved design method emerged. In the new method, measures are selected based on a set of "strategic objectives" plotted on a "strategic linkage model" or "strategy map". With this modified approach, the strategic objectives are typically distributed across a similar set of "perspectives", as is found in the earlier designs, but the design question becomes slightly less abstract.

Managers have to identify five or six goals within each of the perspectives, and then demonstrate some interlinking between these goals by plotting causal links on the diagram. Having reached some consensus about the objectives and how they inter-relate, the Balanced Scorecard is devised by choosing suitable measures for each objective. This type of approach provides greater contextual justification for the measures chosen, and is generally easier for managers to work through.

The four perspectives

The grouping of performance measures in general categories (perspectives) is seen to aid in the gathering and selection of the appropriate performance measures for the enterprise. Four general perspectives have been proposed by the Balanced Scorecard:

The financial perspective examines if the company's implementation and execution of its strategy are contributing to the bottom-line improvement of the company. It represents the long-term strategic objectives of the organization and thus it incorporates the tangible outcomes of the strategy in traditional financial terms. The three possible stages as described by Kaplan and Norton (1996) are rapid growth, sustain and harvest. Financial objectives and measures for the growth stage will stem from the development and growth of the organization which will lead to increased sales volumes, acquisition of new customers, growth in revenues, etc. The sustain stage on the other hand will be characterized by measures that evaluate the effectiveness of the organization to manage its operations and costs, by calculating the return on investment, the return on capital employed, etc. Finally, the harvest stage will be based on cash flow analysis with measures such as payback periods and revenue volume. Some of the most common financial measures that are incorporated in the financial perspective are revenue growth, costs, profit margins, cash flow, net operating income, etc.

The customer perspective defines the value proposition that the organization will apply in order to satisfy customers and thus generate more sales to the most desired (i. e. the most profitable) customer groups. The measures that are selected for the customer perspective should measure both the value that is delivered to the customer (value position) which may involve time, quality, performance and service and cost and the outcomes that come as a result of this value proposition (e. g., customer satisfaction, market share). The value proposition can be centered on one of the three: operational excellence, customer intimacy or product leadership, while maintaining threshold levels at the other two.

The internal process perspective is concerned with the processes that create and deliver the customer value proposition. It focuses on all the activities and key processes required in order for the company to excel at providing the value expected by the customers both productively and efficiently. These can include both short-term and long-term objectives as well as incorporating innovative process development in order to stimulate improvement. In order to identify the measures that correspond to the internal process perspective, Kaplan and Norton propose using certain clusters that group similar value creating processes in an organization. The clusters for the internal process perspective are operations management (by improving asset utilization, supply chain management, etc.), customer management (by expanding and deepening relations), innovation (by new products and services) and regulatory & social (by establishing good relations with the external stakeholders).

The learning and growth perspective is the foundation of any strategy and focuses on the intangible assets of an organization, mainly on the internal skills and capabilities that are required to support the value-creating internal processes. The learning and growth perspective is concerned with the jobs (human capital), the systems (information capital), and the climate (organization capital) of the enterprise. These three factors relate to what Kaplan and Norton claim is the infrastructure that is needed in order to enable ambitious objectives in the other three perspectives to be achieved. This of course will be in the long term, since an improvement in the learning and growth perspective will require certain expenditures that may decrease short-term financial results, whilst contributing to long-term success.

How to go about it?

Implementing Balanced Scorecards typically includes the following steps:

1) Formulate mission, vision and strategic goal of the organization.
2) Develop the balanced scorecard matrix:
   a) Break down the strategic goal into objectives and activities within the given dimensions.
   b) Select strategic initiatives/activities (goal, action, indicator).
3) Club initiatives into strategic projects.
4) Implement strategic projects (clear assignment of responsibilities!).
5) Communicate the planned activities and results by means of a reporting scorecard.

The balanced scorecard matrix

Vision and strategy				
	Objectives	Measures	Targets	Initiatives
Financial perspective				
Customer perspective				
Internal Process perspective				
Learning and growth perspective				

Key performance indicators (KPIs)

According to each perspective of the Balanced Scorecard, a number of KPIs can be used such as:

Financial: Cash flow, Return on Investment (ROI), Financial Result, Return on capital employed, Return on equity

Customer: Delivery Performance to Customer – by Date, Delivery Performance to Customer – by Quality, Customer satisfaction rate, Customer Loyalty, Customer retention

Internal Business Processes: Number of Activities, Opportunity Success Rate, Accident Ratios, Overall Equipment Effectiveness

Learning & Growth: Investment Rate, Illness Rate, Internal Promotions %, Employee Turnover, Gender/Racial Ratios

Further lists of general and industry-specific KPIs can be found in the case studies and methodological articles and books presented in the references section.