Balanced Scorecard: From the Inclusion of Non-Financial Performance Measures towards the Strategic Managerial System

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Introduction

This article deals with the Balanced Scorecard that is conceived as a platform for incorporating the traditional financial measures with the reemerging non-financial perspective of customers, internal processes and learning and growth. The Balanced Scorecard was introduced by two internationally well-known figures – Robert S. Kaplan and David P. Norton – and till today has influenced a number of works and thoughts of others, and though the future is always uncertain, it is more than likely that the Balanced Scorecard will accompany us – management, researchers and possible stakeholders in relevant companies – in the bright future to come.

But to support the preceding statement, let us first start at the beginnings of the whole conception and establish the fundamental blocks that over the time assisted in transforming the original idea into almost a classic. Then we will focus on several of the main features which underwent noticeable changes during the initial period of 1992 to 1996 – outlined by publication of the first article: *The Balanced Scorecard: Measures That Drive Performance*; and completed with the first monograph on the BSC: *The Balanced Scorecard: Translating Strategy Into Action*. The current state of affairs will be discussed in the following section with the emphasis on the associated current and possible future research in the wake of the availability of data for archival research.

To provide the reader with as much of an objective and unbiased picture as possible, the opinions of others who are questioning the originality, possibility of implementation and usefulness of the BSC are provided as well. At the end, there is a summary of the whole article that evaluates the chances for further survival of the original idea.

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Inception of the original idea

In ‘The Balanced Scorecard Links Performance Measures’ (Kaplan – Norton, 1992) the authors introduced the idea of composing a matrix of four perspectives: financial, customer, internal business and innovation and learning. For every perspective, the authors raised a basic question (How do we look to shareholders? How do customers see us? What must we excel at? Can we continue to improve and create value?), and set goals and measures to control the progress towards the goals.

However, rather than describing the idea itself, it might prove more important to realize the circumstances surrounding companies in the late eighties and early nineties. The ‘industrial age’ was slowly but steadily coming to its end and the new type of companies were emerging throughout the more and more competitive international markets (Kaplan – Norton, 1992). These companies were ‘poor’ in the previously established standards – lacking in physical assets, plants and machines, typical for the previous era – and, on the other hand, ‘rich’ in intangibles and human capital – a necessary precondition of success in the Information Age: ‘The strategies for information age organizations, however, cannot be this linear or this stable’ (Kaplan – Norton, 1996b, p. 16).

At the same time, the trend was moving from the culture of ‘many of the same’ (mass production of standard products) – taking advantage of the economies of scale and scope – towards ‘few and customized’. That brought a need for a new way of looking at the activities of a company: ‘Activity Based Costing’ was one of the results of the upcoming shift in perception and Kaplan significantly contributed to this stream of literature (e.g. Cooper – Kaplan, 1991). Therefore, quite soon the attention toward a ‘well-specified activity-based cost model’ and its ‘cost drivers’ was complemented, because ‘No cost system, including Activity Based Costing, can measure the value of what an organization does for its customers’ (Kaplan – Norton, 2001, p. 378) by ‘measuring the factors that create current and future revenues’ and so called ‘value drivers.’ So that the company could predict ‘both its [organization’s] cost and its revenue-generating functions.’ (2000, page 30).

Although the BSC was first introduced in *Harvard Business Review* in 1992, we must not consider it was as a purely academic exercise; on the contrary, the Scorecard was compiled while consulting the needs of CEOs of real companies for about a year: “Nolant Norton Institute, the research arm of KPMG, sponsored a one-year multicompany study, ‘Measuring

Performance in the Organization of the Future'" (Kaplan – Norton, 1996b, p. 7). The main reasons are, first, the unreliability of financial measures – a critique reaching from short-term myopia and portraying only a one-dimensional history of a firm towards earnings management (Kaplan – Norton, 1992; Assiri – Zajdi, M. – Eid., 2006) – and second, the inability to curtail the newly emerging set of indicators chalking up to one or even two dozens of measures (Kaplan – Norton, 1996b). The need for a framework providing a holistic view was painfully apparent.

The first big step was taken when companies abandoned the dominance of inherently backward-looking financial measures and incorporated forward-looking and value-creating non-financial measures. But the second, and perhaps more vital step, was to perceive the Scorecard not as a controlling mechanism, a set of independent measures, but as a translation of a company's vision and strategy into specific interconnected measures. This was the main theme of the transformation, as we will see in the next section; but we can trace it back to the article: 'Putting the Balanced Scorecard to Work' (Kaplan – Norton, 1993).

Mature Stage Transformation

Once the concept was established among the academics, and moreover, among the practitioners who implemented it within several influential companies – e.g. Rockwater, Apple Computer, and Advanced Micro Devices (Kaplan – Norton, 1993) – the initial 'persuasive rhetoric' (Johanson – Skoog – Backlund – Almqvist, 2006) had to be changed. From the first emphasis on using the BSC as a tool for a rapid breakthrough to new niches while exploiting the advantage of being focused in a direction articulated by the Balanced Scorecard, the authors focused more on using the BSC as a Strategic Management System in a steady state – it is not completely clear how successful they were (see Further sections 5 for more details).

And in order to achieve greater proliferation of their idea Kaplan and Norton first, supplemented the initial chart ('Translating Vision and Strategy: four perspectives, Kaplan – Norton, 1996a) by:

- adding 'Vision and Strategy' explicitly into the center of the whole chart,
- connecting the center to every perspective,
- introducing detailed structure of every perspective, and

- substituting ‘Innovation and Learning’ with ‘Learning and Growth’.

As later critics have pointed out (Johanson – Skoog – Backlund – Almqvist, 2006), the BSC did not evade the trap of putting the Financial Perspective at the top of the whole framework. But should we consider that as a flaw? If we believe what the authors claim, then it might, on the contrary, be seen as a great advantage. Because the financial measures are what matters when ‘push comes to shove’ – ‘*Ultimately, casual paths from all the measures on a Scorecard should be linked to financial objectives’* (Kaplan – Norton, 1996c, p. 67, author’s emphasis) – their position at the top is fully deserved.

However, that would not have been enough because ‘today's information age organizations operate in more turbulent environments, senior managers need to receive feedback about more complicated strategies.’ The BSC came with ‘double-loop learning’ which consists in questioning the underlying assumptions and adjusting them according to current ‘evidence, observations, and experience’ (Kaplan – Norton, 1996b, pp. 16-17). This second change was perhaps vital for the further existence of the BSC. It put it into a center of a four-spike chart describing the process of the BSC implementation. Companies were to understand the whole process as a long-term employment with the initiative gradually trickling down from the top-management to the employees of a company and their Personal Scorecard (more details about the top-down approach in the further sections). The end of the repetitive, but at the same progressive, processes was introduction of a system for running the company in the future.

The Managing Strategy revolving around the implementation of the BSC is based on four processes that are repeated as many times as necessary:

- Translating the Vision: clarifying the vision, gaining consensus.
- Communicating and Linking: communicating and educating, setting goals, linking rewards to performance measures.
- Business Planning: setting targets, aligning strategic initiatives, allocating resources, establishing milestones.
- Feedback and Learning: articulating the shared vision, supplying strategic feedback, facilitating strategy review and learning.

The BSC as described is derived from the main feature: Balance between:

- short-and long-term objectives,
- financial and non-financial measures,
- external and internal perspectives,
- hard objective measures and softer, more subjective measures,
- outcomes desired and the performance drivers of those outcomes, and
- lagging and leading indicators (Kaplan – Norton, 1996b, p. viii., 10, 25, 32).

The last two items are especially vital for the alleged differentiation of BSC from other previously known management systems, particularly the Tableaux de Bord (Kaplan – Norton, 1996c, Epstein – Mazzoni 1998 – see further sections for greater details). For a company to forsake myopic concentration on short-term goals it has to measure the result of its current actions on future performance. Therefore, it has to identify the drivers of the changes as the leading indicators and the expected outcomes as the lagging indicators.

Usually the non-financial improvements are more difficult to identify and measure and will serve primarily as the leading indicators, while financial measures will be at the very end as the lagging indicators and the ultimate goal (Kaplan – Norton, 1996c). The other possible distinction is to divide the indicators within each perspective itself. Thus we get generic – profitability, market share, customer satisfaction – and unique measures: generic measures tend to be lag indicators and unique measures are the lead indicators, the drivers. Therefore, '*A good Balanced Scorecard should have an appropriate mix of outcomes (lagging indicators) and performance drivers (leading indicators) that have been customized to the business unit's strategy*' (Kaplan, Norton, 1996b, p. 150, author's emphasis).

Last but definitely not least, let us just briefly mention the connection between the BSC and compensation (see further sections for additional information). Many companies were facing the basic problem of trying to achieve A while rewarding for B. One possible solution was to connect bonuses to the BSC measures. Although it is next to impossible to 'conjure' a specific formula that would fit most of the companies, at least we know this : ''The only generalizable finding from all of the company experiences in linking compensation and reward to Balanced Scorecards is that they do it.' (Kaplan – Norton, 2001, p. 265)'

This stage was concluded by, *The Balanced Scorecard: Translating Strategy into Action*, published by Harvard Business School Press in 1996. In this title, the BSC is presented with all the previously mentioned details, and apart from discussing the individual perspectives on their own, strong emphasis is placed on linking and constructing an imaginary 'Map of performances' (Kaplan – Norton, 1996b).

However, the longer you stick your head over the crowd the bigger the chance that somebody will try to chop it off. Thus after couple of unsuccessful implementations (McCunn, 1998), and, moreover, after contrasting the BSC with European schools of thought (esp. Epstein – Manzoni 1998), the bright future might not have outlasted the initial stage. As evident, if only from the existence of this article, the BSC survived and established itself rather firmly within the canon of management literature. The next section discusses the current state defined primarily by the second monograph: *The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment* (Harvard Business School Press, 2001) and the interest of experimental researchers.

Current State of Affairs

'We are confident … that innovating companies … will expand the structure and use of the scorecard even further. So perhaps in a few years readers can look forward to the sequel' (Kaplan – Norton, 1996b).

The forecast was fulfilled in 2001 by the first and the last, as far as I can judge, sequel for a considerable amount of time. The concept of the book is based on two main drivers: first, a substantial shift in the philosophy of 'modern successful companies towards the Strategy-Focused Organization' (of course, with the help of BSC – using five more strategy oriented perspectives: Mobilize Change through Executive Leadership, Translate the Strategy to Operational Terms, Align the Organization to the Strategy, Make Strategy Everyone's Everyday Job, Make Strategy a Continual Process – as described in Kaplan, Norton, 2001); and, secondly, a reliance on rich variety of a new real-world examples spanning from large profit organization to small-and-medium sized companies and non-profit organizations.

However, it is not so clear that there is anything like the 'one-size-fits-all' BSC (see esp. Johanson – Skoog – Backlund – Almqvist, 2006). In the preface, the authors claim that: 'Adopters throughout the world include large and small, manufacturing and service, mature and rapid-growth, public and private, and for-profit and not-for-profit organisations.' (Kaplan – Norton, 2001 p. vii.). Even though they provide us with several examples of success, it does not necessarily imply that it is suitable or rather practicable for other sectors – we need at least consider certain modifications to the BSC before implementing it into the SME or not-for-profit organisations (see next section for details).

To solve this dispute, researchers – Hoque and James (2000) – did, in order to provide 'hard evidence', use the empirical data already available. In their paper: Linking Balanced Scorecard Measures to Size and Market Factors: Impact on Organizational Performance, they examined the relationship between organization site, product life-cycle stage, market position, BSC usage and organizational performance. The research design consisted in a questionnaire sent to the chief financial controllers of 188 Australian manufacturing firms. The model used is as follows:

$$\begin{aligned} BSC\,Usage = \alpha_0 + \beta_1 \cdot Size + \beta_2 \cdot Product\ Life\ Cycle\ Stage \\ + \beta_1 \cdot Market\ Position + e, \end{aligned} \qquad (1)$$

Only Market Position was found not to be significantly correlated with BSC usage, which might be due to some research limitations. The coefficient for size and product life-cycle stage are both positive and significant, supporting the hypothesis that greater BSC usage is associated with larger organization size and business with products at the early / growth stage. Therefore, we can conclude that implementation of the BSC is too expensive or difficult for SME – or perhaps, the concept is not yet followed through for this type of companies – and seemingly unnecessary for companies in steady state.

Another keystone of BSC is the translation of business strategy into performance measures. There are two basic findings in this sphere: first, evaluations of performance depend on measures that are common within the whole business rather than on ones that are unique to individual business units (Lipe – Salterio, 2000); second, that the linkage between performance measure and business strategy can influence performance evaluation (Banker – Potter – Schroeder, 2001).

If the strategic information was of no use for the evaluation of performance, then the BSC would be a waste of time and money. Thus Baker, Chang and Pizzini conducted an experiment in which half of the participants were provided additional information on Strategic Business Unit strategies and the other half had no such information. The results published in *The Accounting Review*, 'The Balanced Scorecard – Judgemental Effects of Performance Measures Linked to Strategy' (2004), show that 'strategically linked measures have a significantly greater impact on evaluations than non-linked measures' and, moreover, that 'strategically linked unique measures *also* have a significantly greater impact on evaluations than common non-linked measures' (p. 3, emphasis added).

One of the most important building blocks of the BSC is the relation between non-financial measures and financial performance. As stated in previous sections, the authors relied on the expected 'Cause and Effect Relationships' (Kaplan – Norton, 1996b) and the possibility of identifying the leading and lagging indicators. These intuitively sound hypotheses – 'if-then statements' – were in the beginning not entirely supported by the empirical evidence (Ittner – Larcker, 1998) or were not tested at all.

Therefore Banker, Potter and Srinivasan collected time-series data from eighteen hotels for seventy-two months and asked two basic research questions: first, are non-financial measures (customer satisfaction) significantly associated with future financial performance; and second, whether the adoption of an incentive compensation plan that includes non-financial performance measures improves both non-financial and financial performance. The results are to be found in the article in *The Accounting Review*: 'An Empirical Investigation of an Incentive Plan that Includes Nonfinancial Performance Measures' (2000).

The study does confirm the association between customer-satisfaction measures and future financial performance, as well as the improvement of the future results by the implementation of the incentive plan that included non-financial measures. However, the biggest challenge now lies in an estimation of an average lag between non-financial measure and future financial performance. The result – an average lag of six months – is unfortunately relevant only to certain types of businesses – service industries with frequent visits of customers – and might not be generalizable to other industries. Therefore, the future of the BSC is dependent upon 'the understanding of the timing and magnitude of the link between the levers managers control and future financial performance' (Banker et at., 2000, p. 90).

Contemporary Comments and Critiques

It is perhaps not surprising that the main disputes are voiced from across the ocean and especially from countries with socialist histories –

France and Sweden. That the concept of BSC might and will be disputed was obvious from its very beginning because we are dealing with a theoretical construct, not a hard theory. ‘No mathematical theorem exists that four perspectives are both necessary and sufficient,’ and therefore, even the very foundation of the whole idea, the four perspectives ‘should be considered a template, not a strait jacket’ (Kaplan – Norton, 2001, p. 34). Therefore, never-ending arguments can be held about the peculiar advantages of including one slightly different perspective; I will, on the other hand, try to provide a more conceptual look connecting the beginnings with the possible future.

The whole issue revolves around the basic problem that we get what we measure. A possible solution to the fallacies of financial measures was developed by process engineers in France several decades ago – a ‘dashboard: a Tableau de Bord’ (Epsten, Manzoni, 1998) – in order to better understand cause-effect relationships (between actions and process performance). This process was lately applied also at the top management level.

We can see that, contrary to Kaplan and Norton’s claim (1996b and 1996c), the Tableau de Bord was not only a collection of key indicators. ‘[T]here should be one Tableau de Bord for each sub-unit. These ‘dashboards’ should be integrated in a nested structure’ (Epsten, Manzoni, 1998, p. 191). The whole sequence starts with Vision and Mission (instead of strategy) and goes over Objectives and Key Success Factors toward a series of quantitative Key Performance Indicators.

$$\text{Vision and Mission} \Rightarrow \text{Objectives} \Rightarrow \text{KSF} \Rightarrow \text{KPI} \qquad (2)$$

What are then the main correspondences and more importantly contributions of BSC? Both ‘Balanced Scorecards and Tableaux de Bord group a small set of selected indicators on a single, succinct document’ (Epsten, Manzoni, 1998, p. 194), So the holistic view holds for both; however, because Tableaux de Bord was invented by engineers, the key factors were usually measured as physical variables (Kaplan – Norton, 1996c, p. 64); on the other hand, Epsten and Manzoni claim that the Bord tends to over-emphasize financial measures. Interconnected is also the fact that the measures for the Bord were usually collected within the firm, rather than externally – customer perspective.

Still, the main difference can be seen in the application of both frameworks. While the Balanced Scorecard is supposed to be translated as far as to Personal Scorecard and then used all the year round, we talk about so called strategic measures (Kaplan – Norton, 1996c, p. 68). The Tableaux de Bord was used primarily 'as a device supporting management-from-a-distance and management-by-exception' (Epstein – Manzoni, 1998, p. 197) – so called diagnostic measures. To conclude, the Tableaux de Bord was rather similar in the theoretical realm but lacked the knowledge and financial support during the practical implementation, and therefore, 'often fell short in practice' (p. 200).

Various interesting points were raised by Johanson, Skoog, Bachlund and Almqvist in their collective effort to 'debate various critical issues in the implementation and use of the BSC as a management control tool' – 'Balancing dilemmas of the balanced scorecard' (2006). Unfortunately, as you can see, they, either intentionally or by mistake, decided to discuss the BSC as a management control tool rather than Management Strategic System, which would be more appropriate considering that '[o]ther measurement and control systems can establish diagnostic and compliance requirements far more effectively than the Balanced Scorecard' (Kaplan – Norton, 1996b, p. 35). Bearing this in mind, let us proceed further into the article.

The argument runs along three main axes (Johanson – Skoog – Backlund – Almqvist, 2006):

- Implementation problems – ranging from downright failure and the unsuccessful estimates of strong correlation towards consideration of a top-bottom approach and conceivable problems at the local level.
- Human nature – willingness 'to contribute to the firm's productivity with happiness and joy' and interconnected responsibility, flexibility, initiatives and creativity versus commands and order through a top-down process (failure to capture drivers like feelings, values, beliefs, relationships, fears and dreams).
- One-size-fits-all idea – from large profit-seeking firms toward public-sector organizations or small and medium-sized enterprises, or even firms under financial pressure – 'budget adherence tends to become an end in itself'.

In the section of Frequently Asked Questions (Kaplan – Norton, 2001, p. 369), the authors answer positively to the question about whether the BSC can be applied to small, new, and rapidly changing businesses. It started as a large companies' platform – 'since that time, we have seen many successful implementations in small divisions embedded in larger companies'. And that seems to be exactly the case. As was shown in the previous section (Hoque – James, 2000) and as is claimed by Tennnant and Tanoren (2005): 'SMEs are not aware of the BS and hence, the usage rate is very low compared to large companies.' We can conclude that SMEs are not excluded from using the BSC, but rather limited to small parts of larger businesses.

It does not mean that the BSC would not be useful for them. In the same study the authors found out that SMEs are mainly oriented toward 'day-to-day activities' without effective management of intangibles, nowadays a critical asset. Therefore, the recommendation is to implement the BSC that would be adapted according to for example the Japanese technique known as 'Hoshi Kanri' (Tennant – Tanoren, 2005).

The situation concerning the not-for-profit organizations is palpably different. Kaplan and Norton were aware of the inappropriateness of their initial conception, but at the same time, about the potential of BSC in this sphere: 'the opportunity for the scorecard to improve the management of governmental and not-for-profit enterprises is, if anything, even greater' (1996b, p. 179). It is therefore surprising that they devoted only a third of one subchapter to this topic in their monograph (1996). In 2001, there is one subchapter dealing primarily with 'Scorecards in Nonprofit, Government, and Health Care Organizations,' plus a number of additional examples from these types of companies throughout the rest of the book.

'When the BSC is implemented in non-profit organizations it is evident that the model originally proposed by Kaplan and Norton, with its four perspectives, lacks usefulness' (Johanson – Skoog – Backlund – Almqvist, 2006). Therefore, new variations are suggested by different authors – substituting Mission for Strategy and Vision at the centre; replacing shareholders with financial donors and putting them on the same level as customers (Kaplan – Norton, 2001, p. 135); reinterpretation of financial perspective as an owner or 'principal' perspective and expanding customer perspective to involve all the external interaction with society (Olve – Sjöstrand, 2002, p. 52).

However, even if the BSC is implemented upside-down (and/or inside-out) there is still an additional hitch within public-sector organizations since their goals and visions 'must be adapted to the outcome of political elections' (Johanson – Skoog – Backlund – Almqvist, 2006). And if, supposedly, we overcome even this hurdle as well, would not the eventual model be so dissimilar to any previous BSC that it raises doubts about 'the very existence of any useful BSC standard'?

One aspect almost utterly omitted from the scope of Kaplan and Norton's books is 'The E-Dimension' (Olve – Sjöstrand, 2002, p. 23). To function properly, the BSC 'has to be continually updated with current and operationally relevant information.' And though once the system is set up it might seem like a routine, the beginning obstacles might prove to be insurmountable. The basic questions are (Olve – Sjöstrand, 2002, p. 25):

- Should we use software at all?
- Should we use applications already implemented in our organization?
- Should we invest in a new application that fits our needs?

The proposed solution? 'It is often useful to rely on temporary solutions at the beginning of scorecard projects, until it is possible to predict how scorecards will look, who will use them, and how' (Olve – Sjöstrand, 2002, p. 23).

Thus even the BSC itself reached a stage where the diagrams and links are no longer tangible and visible with a naked eye, but rather a collection of 0s and 1s.

A Glance into the Future

'We can never say that the BSC has died or will die, nor that it will survive or has survived, since no single, uniform BSC exists' (Johanson – Skoog – Backlund – Almqvist, 2006).

Is it true? Was it all just a well-conducted sham on the general public as well as all the professionals? Were we all deceived into believing that there is something about the BSC?

The obvious answer is that if it were not real after the initial excitement, in the world of rational human beings, nobody would continue spending money on books or implementing the framework. However, the longer the initial idea has been in use all over the world, the more it was modified and adjusted and the more alternatives were found. Some of them are recognized and basically rejected by Kaplan and Norton themselves (2001, pp. 102-104) either as a step on a road towards BSC – 'Stakeholder (Constituent) Scorecards' missing the description of the drivers: *how* the outcome will be achieved – or as a 'dangerous illusion' – a KPI scorecard which basically reclassifies the many already existing measurements without adding any additional value.

Some of them are to be found in the works of others (such as Olve – Sjöstrand, 2002, pp. 13-23) 'As the basic format is quite simple, a number of variants soon developed, both in terms of how scorecards look and how they are used.' The variants ranging from the Scandinavian type – inclusion of an additional, fifth perspective: employee or human resources ("Stakeholder objectives, however, should not be appended to the scorecard via an isolated set of measures that managers must keep 'in control.'"; Kaplan – Norton, 1996b, p. 35) – or the previously mentioned stakeholder model to severely limited scorecards – concentrating only on a human resource perspective, customer perspective and financial perspective – and separated long-and short-term scorecards. Add the previously mentioned SME and not-for-profit modifications, plus an alternative bottom-up approach (Skandia), and the result is an abundant variety of options.

However, it seems that there are some defining features of BSC – primarily the drivers and their relationship to outcomes – which distinguish it from other systems and which allow the original authors to extend the idea way beyond the initial expectations. Thanks to that the courses dealing with the BSC are sold out months in advance and relevant publications are translated into dozens of foreign languages.

Conclusion

In this article, the reader was provided with a 'BSC' view of the Balanced Scorecard. I did not include too many details and left out considerations about particular perspectives. The intent was to paint a picture of an idea in a state of flux – causes and sometimes unexpectedly positive reactions – from the conception through its maturity toward its ending, either in further evolution or unavoidable extinction.

The author's view, as can be seen at the end of every section, leans toward the first possibility: the sound and valuable concept seams to be undergoing an ongoing evolution.

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ABSTRACT

This article deals with the issue of the Balanced Scorecard as a phenomenon that was introduced by two internationally acclaimed authors: Robert S. Kaplan and David P. Norton. The idea is first presented in several stages of its development undergone over several decades of the past century. Then we focus on the current state of affairs and mention the influence of data-dominated archival research. To provide the reader with an unbiased picture, we include a broad range of opposing views as well. In the end, the possible future for the already much evolved idea is briefly discussed.

Key words: Balanced Scorecard; Non-Financial Performance Measures; Strategic Managerial System.

JEL classification: M41.