

Performance Measurement and the Balanced Scorecard

Adding Value to your Services

I remember only too well the look my clients would give me as I explained their financial statements. It was as if those numbers had a hypnotic effect on them. I worked hard on those financial statements, and all I got was a blank look and seeming lack of interest.

It wasn't until later when I was on the other side of the table that I understood what was happening. For my client, last year's financial statements often lacked relevance to their current situation. Most of them already knew how they had done - they were now concerned about how to get where they wanted to go!

If you feel the way I do, what's the solution? Perhaps the accounting profession needs to evolve from its traditional role as after-the-fact scorekeeper into a partner in setting the strategic direction of its clients. I believe that performance measurement and the balanced scorecard is one way to do just that.

The Balanced Scorecard – How is it different?

By helping your clients implement performance measurement, and the balanced scorecard in particular, you can help them put strategy into action. The balanced scorecard is a management approach that translates strategy into measures that communicate the company's vision.

As accountants we tend to focus on the financial indicators. While these indicators are important, they tend to reflect on past performance rather than indicating future success. The balanced scorecard is fundamentally different. While it includes financial indicators, the scorecard targets leading indicators. In other words, the balanced scorecard focuses on the drivers of future rather than past profitability. The rationale for this is that if the leading indicators are good, then the financial measures will reflect this for future activity.

The underlying premise of all measurement systems is that measurement motivates. The problem with a measurement system dominated by financial measures is that in addition to reflecting on past decisions, it tends to motivate short-term behavior at the expense of the long-term view.

In this article, we want to give you a primer on the balanced scorecard and some ideas for implementing it into your practice. Whole books have been written about the balanced scorecard, and obviously these articles won't make you an expert. However, hopefully this article will pique your interest and give you a basis for learning more about this exciting area.

The Four Perspectives of the Balanced Scorecard

Just to make sure I don't confuse you, performance measurement and the balanced scorecard are not two different things. The balanced scorecard is an implementation of performance measurement. One of the things that distinguishes the balanced scorecard from other performance measurement systems is its different views of the organization. The balanced scorecard takes four different views or perspectives of a business. They are:

- **The financial perspective** - This perspective monitors the traditional monetary measures that we know and love so much - profitability, revenue growth, etc.
- **The customer perspective** – This view looks at the organization through the eyes of its customers. How do customers see the company? To determine how the customers see the organization we need to look at indicators like level of repeat business and satisfaction levels.
- **The internal perspective** – This view focuses on the performance of key internal processes which drive the business such as order processing and new product development. Indicators like service error rates, product development cycle and productivity measure this perspective.
- **The organizational and learning perspective** – This view deals with the basis of all future success, the organization's people and infrastructure. Indicators here might include items such as intellectual assets, market innovation and skills development.

The key is to identify indicators or measures in each of these areas and to select indicators linked to the company's strategic goals. The balance of measures across these four perspectives is what gives the balanced scorecard its name.

The measures that make up a scorecard do not exist in isolation from each other. They relate to a set of objectives that are themselves linked. A financial improvement is usually the end objective of the linked series of objectives. For example a company's objective of lower service error rate contributes to its objective of increased customer retention. And its objective of increased customer retention contributes to its objective of increased market share. And its objective of increased market share contributes to its objective of increase sales and greater net profit.

The Balanced Scorecard Tells the Story

A good balanced scorecard tells the story of the company's strategy through a set of related objectives and measures. For most clients their strategic goal will probably include "making more money". The question is - How can that be achieved? Here's a set of related objectives that might help them achieve that goal:

- A goal of improved profit (a financial perspective objective) could be related to increased revenue by increasing market share.
- That might be accomplished by achieving higher customer retention.
- Improved customer retention might be accomplished by improving customer satisfaction (a customer perspective objective).

- Increased customer satisfaction could be achieved by better customer service (an internal perspective objective).
- Better customer service could perhaps result from more motivated and satisfied employees (an organizational and learning perspective objective).

In this scenario every objective is part of a chain of cause and effect that relates to the strategy of “making more money”.

Once the set of related strategic objectives has been defined, the next challenges are:

- **Choosing metrics: What exactly should we measure?** We need to determine the metrics that best measure whether the objective is being met. We know how to measure our financial objectives, but we’re not as familiar at measuring other things. However, defining measures is usually straightforward. For example, to measure customer satisfaction the company may want to use customer surveys. To measure employee satisfaction, the measure might be trends in sickness and absentee rates. Keep in mind, there are no penalties for not choosing correctly the first time! Since the process should be a continuous process of evaluating results and making adjustments, the system can and will evolve and refine itself over time.
- **Setting goals: How will we define success?** For each measure, we need to set goals that can be achieved over time. In general, they should be stretch goals - difficult but not impossible to achieve.
- **Avoiding over commitment: How much can be achieved given the capacity of the organization?** This is probably where most organizations fail. It is better to start too small than to start too big. If company tries to accomplish too much, it runs the risk of failing and then abandoning the process completely.

In the fully implemented balanced scorecard system, the system would communicate to each part of the organization and potentially to each employee through separate scorecards the organizational strategy of the company. If that sounds too complicated, remember I said "the fully implemented balanced scorecard system". It seems to me that any business can benefit significantly from an executive level scorecard that can be easily implemented. Since one of the challenges of implementing any new system is over committing, it will generally be better to keep it simple in the beginning and let the system evolve over time.

Implementing the Balanced Scorecard

Putting knowledge into action is challenging. The following outlines a 6 step process to implementing a balanced scorecard.

This process should be executed with the entire management team so that the team takes ownership and understands and agrees to the measures, targets and the outcome the organization is trying to achieve.

- 1. Assess the current situation** – Step one is an assessment of the organization’s strengths and weaknesses, core beliefs, market opportunities, competition and financial position.
- 2. Develop the strategy** – Step 2 is to create a statement of where the company wants be 3 to 5 years down the road.
- 3. Identify objectives** – The next step is to define a set of objectives. These objectives are the components or activities that make up the complete business strategy. As we discussed in the last article, they might be objectives like “improved customer retention” or “improved customer satisfaction”. It is important to consider the cause-effect linkages, for example, improved customer service should result in higher customer retention. Thinking about objectives and the cause-effect relationship between the objectives will allow the management team to focus on actions needed to achieve the strategic destination.
- 4. Identify performance measures** – In the last article we discussed identifying measures, setting targets and avoiding over commitment. Measure selection should be influenced by the ability to obtain information quickly and inexpensively. Remember that it is better to develop a few good measures than to develop many poor measures.
- 5. Create the implementation plans** – Who is going to do what and when will it get done. Unless a specific plan of action is developed nothing will probably happen.
- 6. Evaluate** – Performance should be evaluated on a regular basis, probably a monthly or quarterly basis will work for most organizations. The review meetings become a forum for continually updating and refreshing the balanced scorecard design which is essential if the tool is to have long term value.

In this article we’ve tried to introduce you to the concepts of performance measurement and the balanced scorecard. There are countless books and articles that explain these management tools in more detail and attest to their value to all sizes of organizations. A good place to start is the book “The Balanced Scorecard: Translating Strategy into Action” by Robert S Kaplan and David P. Norton.

Taking those first steps to promote and offer any new service may seem like an insurmountable obstacle. If you’re new to this area, I would encourage you to start small. Limit your focus on your client’s most important long term goal, deal with one step at a time and make sure you keep the system manageable!