

## BALANCED SCORECARD : A STRATEGIC MANAGEMENT TOOL

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### ABSTRACT

The success of any organization is reflected upon by its performance which is in turn highly dependent upon its strategies. In this era of cut-throat competition, what an organisation requires is not just framing the right strategies, but also managing the same. The impact of the right strategies will automatically be reflected in the results. Moreover, any organisation has to understand that it needs to give impetus not only towards the financial results but also towards satisfaction of the customers, development of state-of-the-art technologies and creation of an environment of learning and growth. The Balanced Scorecard is such an innovative tool which has considered not just the financial indices but also the non-financial indicators as equally critical in determining organizational performance. This tool brings a link between strategy and action. Due to these, the framework is gaining increasing importance among different business houses.

### Introduction

Darwin had once remarked “survival of the fittest”. It was not a statement in the context of any business organization. The saying, however, holds very true in today’s business scenario. Every company has realized that the ones with the best strategies, best operations, best people etc. would outperform those who do not have the superior things in place. All assets deserve equal attention. The best organisations will be the ones who would survive the cut-throat competition. The struggle for existence and growth, is indeed very severe for firms in this competitive environment. The fate of organizations are changing very fast. Strong competitors are entering into industries due to the liberalization, privatization and globalisation which has formed the buzzword in the economic field. The life tenure of any organization is determined by the strength of the protective shield it has been able to build around itself which would not only help capitalise on the opportunities but also counter the threats.

In this competitive environment, the field of management which is becoming increasingly popular and relevant is Strategic Management. This is

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because this subject helps to bring a focus on those actions that should be taken by the management which would ensure the existence, survival and the long-term success of any organization. The scope of application of this field, however, varies with the business size.

Strategic Management is Managing for the Future or Competing for the Future as had been remarked by the renowned strategic management experts, Hamel and Prahalad. As Peter Drucker had warned, management “ has no choice but to anticipate the future, to attempt to mould it, and to balance short-range and long-range goals. The future will not just happen if one wishes hard enough. It requires decision-now. It imposes risk-now. It requires action-now. It demands allocation of resources-now. It requires work-now.”

Having understood these things which are applicable to the business in reality, the applicability of strategic management is getting wider – be it a multinational, domestic or even a national player in the market.

In any strategic management process, one of the most important element is the SWOT analysis which means analyzing the environment – both internal and external. The internal environment analysis highlights the areas of strength and weaknesses which the organization has and the external environment analysis throws light on the opportunities and the threats being offered by the various areas of the environment. The most important thing that can ensure the success of any organization is the development of appropriate strategies which would decide the direction the organization will take as it progresses.

#### **Balanced Scorecard - Concept**

The long-term success of any organization is determined by the capabilities and the competencies it has developed. One of the tools for organizational appraisal that is gaining immense popularity is the Balanced Scorecard, developed by Robert S Kaplan and David P Norton in 1992. This innovative tool is unique in two ways compared to the traditional performance measurement tools. They are–

- (i) It considers the financial indices as well the non-financial ones in determining the corporate performance level and
- (ii) It is not just a performance measurement tool but is also a performance management system.

In the words of the proponents of this tool “ the Balanced Scorecard retains traditional measures. But, financial measures tell the story of past events, an adequate story for industrial age companies for which investment in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technologies and innovation.” These words give the idea behind the development of this framework. Today’s businesses require a better understanding of their customers ( both existing and potential ) and their needs, better streamlined processes and highly skilled people for ensuring future survival and sustainable growth. This shows that the focus of action has rightly considered the non-financial aspects apart from the financial indices. This tool is the end result of sustained efforts to find an ideal tool to measure performance and provide a link to strategy and action. The decisions about the future actions form the key to success of any enterprise in this fast-changing business environment.

The aim of the Balanced Scorecard is to direct, help manage and change in support of the longer-term strategy in order to manage performance. The scorecard reflects what the company and the strategies are all about. It acts as a catalyst for bringing in the ‘change’ element within the organization. This tool is a comprehensive framework which considers the following perspectives and tries to get answers to the following questions –

1. Financial Perspective - How do we look at shareholders?
2. Customer Perspective - How should we appear to our customers?
3. Internal Business Processes Perspective - What must we excel at?
4. Learning and Growth Perspective - Can we continue to improve and create value?

Hence, from the above lines we can say that this tool has considered not only the financial results to be important but also those factors which actually drive an organization towards future successes as mentioned earlier. The tool has given stress on the other areas which are required to ‘balance’ the financial perspective in order to get a total view about the organizational performance and

## BALANCED SCORECARD : A STRATEGIC MANAGEMENT TOOL

improve the same. The framework tries to bring a balance and linkage between the –

- (a) Financial and the Non-Financial indicators,
- (b) Tangible and the Intangible measures,
- (c) Internal and the External aspects and
- (d) Leading and the Lagging indicators.

### **The Four Perspectives : Cause and Effect Relationship**

The four perspectives as mentioned above are highly interlinked. There is a logical connection between them. The explanation is as follows : If an organization focuses on the learning and the growth aspect, it is definitely going to lead to better business processes. This in turn would be followed by increased customer value by producing better products which ultimately gives rise to improved financial performance.

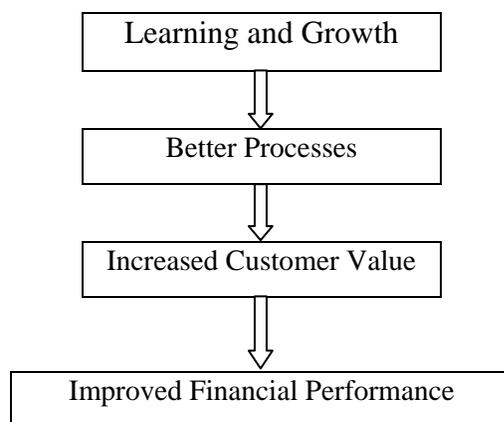


Figure 1 : The Cause and Effect relationships among the four perspectives

## Balanced Scorecard – The Diagrammatic Representation

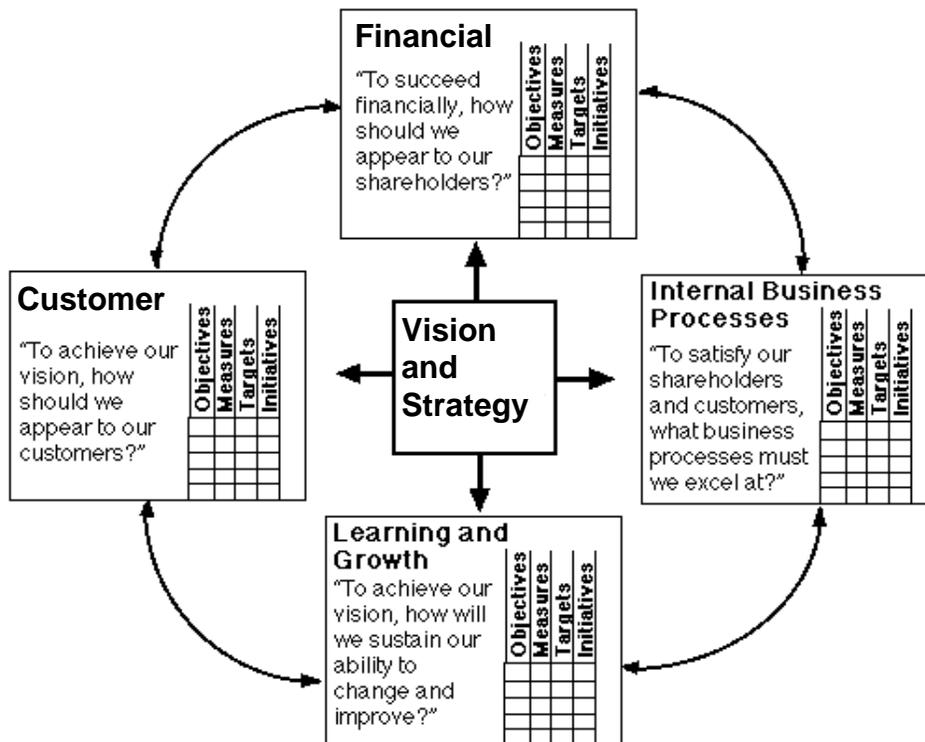


Figure 2 : The Balanced Scorecard Model

Source : [www.balancedscorecard.org](http://www.balancedscorecard.org), Balanced Scorecard Institute, USA

### The Model – An Explanation

Hence, from the aforesaid model, it is clear that the following are to be done so as to utilize the Balanced Scorecard as a strategic management tool :

1. The major objectives are to be set for each of the perspectives.
2. Measures of performance are required to be identified under each of the objectives which would help the organization to realize the goals set under each of the perspectives. These would act as parameters to measure the progress towards the objectives.
3. The next important step is the setting of specific targets around each of the identified key areas which would act as a benchmark for performance appraisal.

#### BALANCED SCORECARD : A STRATEGIC MANAGEMENT TOOL

Hence, a performance measurement system is build around these critical factors. Any deviation in attaining the results should raise a red signal to the management which would investigate the reasons for the deviation and rectify the same.

4. The appropriate strategies and the action plans that are to be taken in the various activities should be decided so that it is clear as to how the organization has decided to pursue the pre-decided goals. Because of this reason, the Balanced Scorecard is often referred to as a blueprint of the company strategies.

An example will help the readers to understand it better. Some of the objectives together with a measurement measures are given below.

##### A. Financial Perspective

Objectives	Measures
Survive	Cash flow
Prosper	Increase in market share
	Return on equity

##### B. Customer Perspective

Objectives	Measures
New products	% of sales from newer products
Customer relationship	% of retained customers

##### C. Internal Business Processes Perspective

Objectives	Measures
Manufacturing excellence	Cycle time per unit
Safety incidence index	Number of accidents

##### D. Learning and Growth Perspective

Objectives	Measures
Technology leadership	Time to develop newer products

Hence, the above paragraphs show that all the four areas have been given equal importance in measuring performance level. The measures and the objectives, however, depend upon the type of business the organization is in. The financial indicators are complemented by the non-financial ones. Since, objectives and goals are set for each of the critical success factors under each of the heads, it brings about a focus on the strategic vision.

Thus, all activities would be directed towards achievement of the long-term goals which have been set by the top management. The identification of the key result areas (KRAs) help an organization in moving towards the right strategic direction. This tool creates a link between objectives, measures, targets and initiatives. It is, therefore, absolutely clear that the Balanced Scorecard acts as a focal point for the organisation's efforts, designing and communicating priorities to the managers, employees, investors and the customers.

### **Utilising The Balanced Scorecard As A Strategic Management Tool**

The tool has become a weapon for organizations to identify the pressure points, conflicting interests, objectives setting, prioritization of objectives, planning and budgeting. The four main important steps that need to be taken care of are –

#### **1. Translating the Vision**

It is to be remembered that the vision of any organization should be understood by each and every employee of the organization. If it is understood by the top management only, then it is definite that the organization will fail to realize its goals. Hence, before starting with the strategic implementation process, the organizations needs to be clear about the reason for its existence, where it wants to see itself after a certain number of years and properly decide its business definition. The managers should build a consensus around the organisation's vision and strategy. The strategies, in fact, emanate from the vision and mission of the company which means that a linkage is formed between the strategies of the different business units and the vision of the organization. The lofty statements must be translated into an integrated set of objectives and measures. Thus, by using this tool, the overall strategic objectives for the company gets clarified which helps to achieve consensus across different business units on the overall strategic objectives for the company.

## **2. Communicating and Linking**

Just communicating the vision and the strategies is not an end in itself. The strategic goals and the measures to be set in the different areas have to be decided upon. The long-term strategic goals have to be translated into both departmental and individual goals which should be aligned to each other in order to realize the long-term goals. In fact, each and everyone at different levels in the organizational hierarchy needs to be educated about the action plans and reasons for accepting the same. The tool contains three levels of information :

- (i) It describes the corporate objectives, measures and the targets
- (ii) It helps in deciding the business unit targets and
- (iii) It helps in framing the departmental and the individual objectives which will help in attaining the objectives of the business unit directly which would lead to the attainment of the corporate goals. The employees are given the freedom to decide their measures, objectives and the targets attainment of which would move the organization in the right strategic direction. Then the compensation level is linked to the performance level which in reality involves a lot of subjectivity.

## **3. Business Planning**

This step helps in the resource allocation process. One has to keep in mind that objectives form an important criteria in deciding the quantum of resources that are required to be allocated to the various departments, activities and the processes. No strategy can bring successful results to an organization if the allocation is not in line with what is required to meet the results. This allocation is dependent on the budgeted estimates which are decided on the basis of the said objectives. Hence, through this step the Balanced Scorecard tries to bring about an integration between strategic planning and the budgeting exercise. The short-term milestones are also needed to be figured out which in totality brings about a linkage between strategic goals and the budgets. This procedure helps in actualizing what has been set by the organization. Thus, this step brings about a shift from the 'thinking' exercise to the 'doing' stage and the organization tries to achieve the long-term goals through the short-term actions.

#### **4. Feedback and Learning**

The first three steps as mentioned above help in the strategic implementation process. But, for knowing whether the organization is in a position to achieve the strategic goals and whether it is in the right track, the process of feedback and learning is essential. The strategic learning consists of acquiring knowledge about which way the organization is moving to, testing whether the premises considered before hold true even now and finally making adjustments wherever required. The corrective measures are required so that the necessary rectifications are made which will help an organization pursue the correct path.

Another point is that an organization gets to know whether the cause-and-effect relationships among the different perspectives really hold true, to what extent they are strongly linked and also whether positive results are being obtained. In case, an organization realizes the existence of a gap in the cause-effect relationships, an immediate correction would be required so that a positive relationship can be build among the various factors. Thus, the tool with its specification of the causal relationships between performance drivers and objectives allows corporate and the business unit objectives executives to use their periodic review sessions in order to evaluate the validity of the unit's strategy and the quality of its execution. Also, this feedback and learning exercise may force an organization to change the measures set in each of the perspectives and adopt those, which if attained would ensure the success of the corporate and the business strategies.

#### **Advantages of Using The Balanced Scorecard**

This tool is being used by several organizations throughout the world because of certain advantages this scorecard has been able to deliver which are cited below :

- It translates vision and strategy into action.
- It defines the strategic linkages to integrate performance across organizations.
- It communicates the objectives and measures to a business unit.
- It aligns the strategic initiatives in order to attain the long-term goals.

#### BALANCED SCORECARD : A STRATEGIC MANAGEMENT TOOL

- It aligns everyone within an organization so that all employees understand how they support the strategy.
- It provides a basis for compensation for performance.
- The scorecard provides a feedback to the senior management if the strategy is working.

#### **Conclusion**

The Balanced Scorecard is therefore a very important strategic management tool which helps an organization to not only measure the performance but also decide/manage the strategies which are needed to be adopted/modified so that the long-term goals are achieved. Thus, in other words, the application of this tool ensures the consistency of vision and action which is the first step towards the development of a successful organization. Also, its proper implementation can ensure the development of competencies within an organization which will help it to develop a competitive advantage without which it cannot expect to outperform its rivals.

However, one fact is that it is not easy to implement this tool because it involves a lot of subjectivity. Also, the tool is much more complex compared to the other tools. The measures that need to be taken is contingent upon the kind of environment, industry and the business the organization is in. The reason behind its gaining popularity is that the organizations have understood the capability this tool has in bringing the desired results to the business by managing the strategies. The tool has tried to fill up the void that exists in most management systems- that is the lack of a systematic process to implement and obtain feedback about the organizations strategy. But, a lot of refinement is still required to be done so that it becomes understandable to every stakeholder associated with the organization and the subjectivity is removed to a large extent.

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