

# Comparative Significance of the Four Perspectives of Balanced Scorecard

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## **Introduction**

The history of the performance measurement is as old as the history of the business organizations. Performance measurement has been there in its orthodox form where emphasis was laid upon financial measures such as return on investment, earning per share, net profit rate etc. As the financial measures were profit oriented, these were thought to be short term measures. An organization may be financially sound for the time being because of its monopoly or it may enhance its current profit by reducing research and development expenses. Under each of the situations, the organization may be in trouble in the days to come especially in the competitive environment. Later on, in 1980s, magnitude of performance was shifted to the non financial measures such as customer satisfaction, delivery period, number of complaints etc. The tools introduced were Total Quality Management, Six Sigma, Baldrige Award, CAMELS Rating System etc. Now the existence of financial and non financial measurers at a time resulted in confusion because the management can enhance one measure at the cost of other. We can reduce the training, research and development cost to improve the current profitability. On the other hand, we can spend more on non financial variables to have the future benefits but it would reduce the current profitability. Thus the balance between the financial and non financial measures was inevitable.

In order to create a balance between financial and non financial measures, Kaplan and Norton introduced Balanced Scorecard in 1992. Kaplan and Norton were of the view that the long term

profitability was dependent upon a large number of non financial measures such as research and development, innovation, customer satisfaction, training etc. Thus Kaplan and Norton laid more emphasis on leading instead of lagging measures. The Balanced Scorecard introduced by Kaplan and Norton measures the performance of an organization from four different perspectives. These are;

Financial Perspective

Customer Perspective

Internal Business Perspective

Learning and Growth Perspective

These perspectives represent three of the major stakeholders of the organization that is share holders, customers and employees. The objectives for each perspective are set and the measures are defined. A brief description of each perspective is given here under.

### **Financial Perspective**

The Financial Perspective deals with the long term objectives of the organization. Kaplan and Norton (1996) summarize the financial perspective as rapid growth, sustain and harvest. Growth stage measures the volume of sales, sustain puts stress on return on capital employed; net profit rate etc and the harvest stage deals with cash flow analysis. In short, financial measures are similar to the ones we use in the traditional performance measurement.

### **Customer Perspective**

The customer perspective measures the extent to which customer is satisfied with the products or services of the organization. It can be divided into two measures.

- i. Market Share
- ii. Customer Retention and Customer Acquisition

Market share shows the ratio of sales of a specific product with total sales of that product in a particular market. It can be measured in terms of sales revenue, sales volume and the number of customers.

Customer retention deals with the existing customers. It can be measured by comparing the number of old customers with the total number of customers. The retention of the existing customer reflects the level of satisfaction of the customer.

Customer acquisition, on the other hand, attracts the new customers. It can be measured by comparing the number of new customers to total customers. It shows to what extent our product is attractive.

### **Internal Business Process Perspective**

Internal business process perspective deals with innovation of the production process and the product itself. Kaplan and Norton (1996) identified three basic internal business processes.

Innovation process aims at seeking the priorities of the customers to modify the manufacturing operation for the production of desired product. The priority of the customer can be sought through a market survey. It can be measured by the number times market survey is conducted.

Operation process begins with the receipt of an order and ends with the delivery of the product or service to the customer. It includes the initial information about the product, response to the customer queries when the product is in process, in time delivery etc. The important measurers include the number of in time deliveries, number of unattended queries reported by the customers etc.

The relationship of the company and its customer does not come to an end when the product is delivered to the customer. This is basically the end of first phase of the relationship and the beginning of the second phase which deals with the warranty and repair activities.

### **Learning and growth perspective**

Learning and growth perspective measures to what extent our human resources are capable of meeting the future requirements. This perspective states that the organizations must invest in human resources if they are to achieve their long term financial objectives. This perspective tries to bridge the gap between the required and existing skills. Kaplan and Norton (1996) were of the view that the objectives of this perspective were,

- Satisfaction of employees
- Retention of employees
- Employee productivity

Employee satisfaction can be measured by a periodic survey, labour turn over is a suitable measure for the retention of employees and the employee productivity can be judged by the sales revenue per employee.

The investment in the human resources can be measured by the number of lectures, seminars, workshops, training session etc. arranged by the organization.

Figure 1 shows the relationship of the four perspectives.

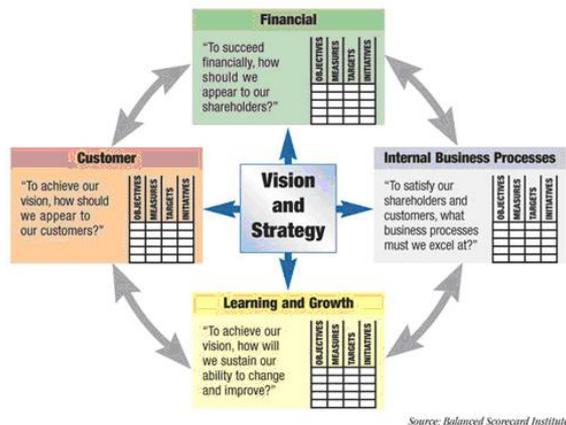


Figure 1

## Literature Review

Colin Drury (2000) said that prior to 1980s, management accountant used to focus on the financial measure such as return on capital employed, profit margin, earning per share etc.

Niven (2005) stated three problems with the traditional performance measurement system.

- Traditional measures relied upon financial measures and the financial measures were short term measures. It was evident from the fact that 2/3 of the fortune 500 companies in 1954 were either found nowhere or if some were found there, they were not in that prosperous form.
- Financial measures were lagging measures.
- Slow response to change. In 1999, it was found that 75% failures of the CEOs came not because of poor strategy but because of poor strategy implementation.

Thus, managers needed to manage the determinants of performance at all levels. For that purpose, emphasis was laid on non financial measures such as customer satisfaction, number of complaints, number of intime deliveries etc.

The problems with non financial measures stated by Niven (2005) were as follows.

- A large number of non financial measures were there and it was difficult to select some of them.
- Non financial measures might be misleading.

- Difficulty of translation of non financial measures into financial outcomes.

Niven (2005) stated the experience of Horizon Fitness. The CEO there was worried about the strategy implementation. The author and the CEO developed Balanced Scorecard for the Horizon Fitness. It was so effective that the sales revenue reached \$85 million in the third year of Balanced Scorecard implementation from \$6.6 million in the first year of its operation.

Barkley (2000) said that a recent survey showed that 88% of the organizations felt that the Balanced Scorecard had improved the performance of the employees. Balanced Scorecard was considered motivating, measuring and rewarding the people and then innovating the strategies.

Will Kaydos (2004) explained that each old system was to be replaced with a new system. The same was the case with performance measurement where Balanced Scorecard is very popular those days. Finally the author stated that the Balanced Scorecard was the best performance measurement system but its success is dependent upon its proper implementation.

Lincoln (2008) has quoted Bailey, CEO of Nemours, stating that the success that they had at Nemours was proof of the usefulness of the Balanced Scorecard.

Martin (2004) explained that the Balanced Scorecard created a balance between short term and long term measures, internal and external business processes, leading and lagging indicators, objective and subjective measures etc.

Elefalk (1998) stated that the Swedish police adopted the Balanced Scorecard in 1998. The perspectives of the Balanced Scorecard were different from the ones given in the original Balanced Scorecard. The perspectives included in this Balanced Scorecard were operational, staff, citizen and resources.

Stawar T (2002) studied Kaplan's famous book "Balanced Scorecard: Measures that drive Performance" and concluded that Balanced Scorecard was much more than the traditional performance measures.

Richardson (2004) has given the following six elements of Balanced Scorecard success,

- Develop your business strategy
- Involve the senior leadership in the process of development of the Balanced Scorecard.
- Develop your Balanced Scorecard according to the vision of your organization and describe the vision of your Balanced Scorecard.

- Implement the Balanced Scorecard everywhere in your organization.
- Communicate the objectives of the Balanced Scorecard to everyone and educate all of your employees about it.
- Implement your Balanced Scorecard in such a way that it can be adjusted automatically in accordance with day to day changes.

Rhom (2004) said that Balanced Scorecards was equally applicable to public sector organizations only after having certain modifications. This change may be in the form of an additional perspective.

Stella Mooraj et al (1999) stated that the Balanced Scorecard was necessary good because it covered all the features of the management control system.

Lapointe (1999) stated that Balanced Scorecard helped marketers and executives. It provided measures for input and outcomes. He suggested that the Balanced Scorecard might be adopted or adapted. Whatever the case was, it must have observed the organization from various angles. Some organizations might be using some other names for the Balanced Scorecard and many companies used it without even knowing it.

Averson (1998a) said that performance based management was introduced during and after World War II by “Whiz Kidz” in Ford Motor Company and the same was used in the Pentagon during Viet Nam war.

Deming is considered to be the founder of modern performance based management who laid emphasis on quality, innovation and employee empowerment.

Traditional performance measures used to assess the performance on the basis of number of rejects. That was why the causes of defect remained unidentified. Deming emphasized upon the detection of causes of defect at various stages of production. The system Deming proposed is known as PDCAC (Plan, Do, Check, Act, Cycle).

Deming study was adopted in the USA in the form of Total Quality Management and Baldrige Award. A brief description of Baldrige Award is given here.

National Institute for Standards and Technology evaluates the performance of large and small manufacturing and service organizations through a structured questionnaire which is called Baldrige Criteria. The winner is given a beautiful trophy in a grand ceremony in Washington. This trophy is called Baldrige Award. The winner of the award is requested to give a presentation on their best practices for the guidance of others.

In 1933, US Govt. introduced Govt. Performance and Result Act. The organizations used to measure their performance on the basis of financial data such as profit. Later on, it was found that the financial measures were the lagging measures which measured the things partially and told the history.

Kaplan and Norton developed Balanced Scorecard in 1992. It was an alternative approach for the measurement of performance of an organization. It comprised leading and lagging measures. It measured the effectiveness of the strategy.

Hendricks et al (2004) stated that the first Balanced Scorecard type was adopted in 1950 in General Electric.

A survey, conducted by Bain & Company on 708 organizations all over the world, showed that 62% of the responding organizations had adopted Balanced Scorecard. At the same time, 50% of the fortune 1000 firms had been using Balanced Scorecard in some form. Another survey conducted by Hendricks on 179 Canadian firms reported that 42 of those had adopted Balanced Scorecard.

The author further stated that the Balanced Scorecard was a useful technique for

- The prospector and analyzer type of organizations.
- The large size organizations
- The organizations having large environmental uncertainties
- The organizations having investment in intangible assets

So far as the relationship between Balanced Scorecard and financial performance was concerned, a survey on 42 Balanced Scorecard adopter organizations showed that their financial performance was not up to the mark before adopting Balanced Scorecard. The results did not improve much after adopting the Balanced Scorecard. It was perhaps because of the fact that most of the organizations adopted Balanced Scorecard after 2003 and this study did not cover it.

Lenhard (2007) explained that if the leaders did not know whether they were moving towards their objectives or not, they needed to study Balanced Scorecard. In order to follow Balanced Scorecard approach, the managers should have set the objectives and they were to select the measures to assess whether the stated objectives were being achieved. The author stated three stages for the development of Balanced Scorecard,

- Beginning stage: Initial metrics are defined.

- Present stage: Measure results from the beginning state to the present.
- End stage: measure results from both the beginning and present state towards targeted objectives.

Figg (2000) said that many of the world's leading organizations had got benefits out of Balanced Scorecard approach.

Despina (2008) stated that originally the Baldrige Criteria and Balanced Scorecard were developed for the business organizations but these could be equally adopted by the nonprofit organizations.

Ho and McKay (2002) said that Balanced Scorecard was a comprehensive measure and showed that ABC Manufacturing Company was successfully using a Balanced Scorecard with very simple and easy measures. The production manager of the company stated that he had never seen a system better than Balanced Scorecard. On the other hand, Ho and McKay showed that a bank introduced Balanced Scorecard and after three and half year, it was replaced with a Compensation Plan Program. This bank states four difficulties in the application of Balanced Scorecard,

- Different interpretation of the Balanced Scorecard by the different managers
- Branch managers thought it to be ineffective because it created hurdles for the employees to get bonuses.
- Balanced Scorecard did not ensure good customer services.
- It required additional time of the management.

The main reason for the failure of the Balanced Scorecard shown in the article was frequent regulatory changes.

Finally the author has given four findings for the successful implementation of the Balanced Scorecard.

- Prompt feedback.
- Involvement of the employees
- It might be effective during time of organizational change
- A number of well thought predetermined parameter.

Mazumder (2006) said that the performance of an organization provided basis for the various economic decisions. Thus an organization ought to need a reliable system of performance measurement. It is especially the case in public organizations where public money was involved.

The four types of the banks scheduled commercial banks, joint venture banks, foreign banks and private banks were formed under special statute or under Banking Companies Act of Bangladesh 1991. Bangladesh Bank monitored the performance of these banks by using CAMEL rating where C stands for Capital adequacy, A for Asset Quality, M for Management Capacity, E for earning available and L for Liquidity.

CAMEL rating ignored the non financial measures completely. On the other hand, Balanced Scorecard was a comprehensive measure to achieve the long term objectives of the organization.

However CAMEL has not proved to be a comprehensive performance measure because it lays emphasis on short term financial objectives of the organizations.

On the other hand, Balanced Scorecard laid emphasis on non financial measures also, which led to future performance of the organization,

Financial perspective aimed to hit the quantitative measures such as Return on Capital Employed (ROCE), Residual Income (RI), Net profit margin etc.

Customer perspective tried to know the level of satisfaction of the customers.

Internal process perspective aimed at the desired internal process to meet the expectations of the customers.

Innovation and learning perspective innovated and improved the existing products and process to meet constantly changing requirement of the customers.

All the perspectives of the CAMEL rating were covered by Balanced Scorecard but the perspectives of the Balanced Scorecard were not met by the CAMEL especially the qualitative measures.

Finally the author stated that in order to make the CAMEL competitive, measures like Customers Perspective, Internal Process and Learning and Growth should have been introduced.

Steele J (2001) in an article stated that a number of organizations gained financial success through Balanced Scorecard. According to a series of three surveys conducted to know the application of the Balanced Scorecard, 40% of the organizations in North America were following Balanced Scorecard.

The author gave a five point strategy to show what Balanced Scorecard meant to the managers. These five points are,

- It enables managers to review past and predict future performance.
- It let the managers recognize useful measures.
- It let the managers understand the big picture of enterprise strategy execution.
- It let the managers to translate the objectives and measures into different levels within an organization.
- It empowers the front line employees with the collaborative tools necessary to encourage the swift implementation of improvement initiatives.

### **Research Methodology**

This study was conducted to know whether all the four perspectives of the Balanced Scorecard were equally significant. The study was conducted at the managers' level in the commercial banks in Pakistan. To accomplish the objective, a sample of 27 out of total 34 commercial banks was taken. These banks included public banks, private banks, foreign banks and Islamic banks. The number of the respondents varied from bank to bank. Total number of respondents in this study was 161. Out of total 161 respondents, 141 were post graduate, 19 were graduate and one respondent was CA finalist. 141 respondents were male and the remaining 20 were female. The experience of the responding managers was ranging from one year to 35 years.

Table 0.0 shows the demographic characteristics of the respondents.

Table 0.0: Demographic Characteristics of Respondents

<b>Gender</b>	<b>N</b>	<b>%age</b>
Male	141	87.58
Female	20	12.42

<b>Age</b>	<b>N</b>	<b>%age</b>
21-25	24	14.91
26-30	50	31.06
31-35	28	17.39
36-40	27	16.67
41-45	12	7.45
46-50	4	2.48
51-55	13	8.08
56-60	3	1.86
<b>Qualification</b>		
Post Graduate	141	87.58
Graduate	19	11.80
Other	1	0.62
<b>Experience</b>		
1-5 Years	67	41.62
6-10 Years	31	19.25
11-15 Years	29	18.01
16-20 Years	15	9.32

21-25 Years	6	3.73
26-30 Years	9	5.59
31-35 Years	4	2.48

In order to know the significance of each perspective, the respondent were given a scale from 1 to 4 where 1 was most important, 2 was important, 3 was less important and 4 was least important.

### Findings

The study revealed the followings;

Figure 2 shows the significance of Financial Perspective.

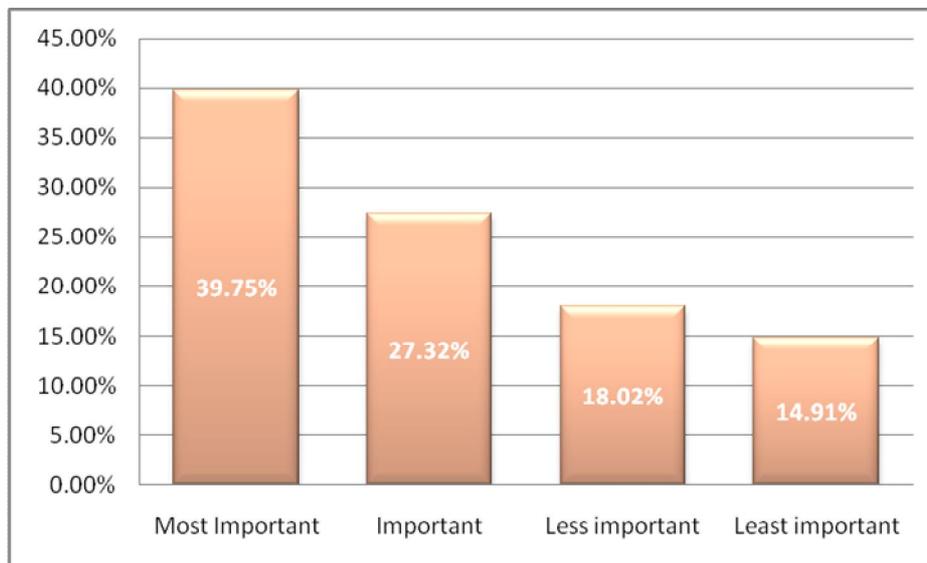


Figure 2 shows that 40% of the respondents considered financial measures as the most important. 27% reported these measures as important. On the other hand, 18% and 15% of the respondents reported the financial measure as less important and least important respectively.

Figure 3 shows the significance of Customer Perspective.

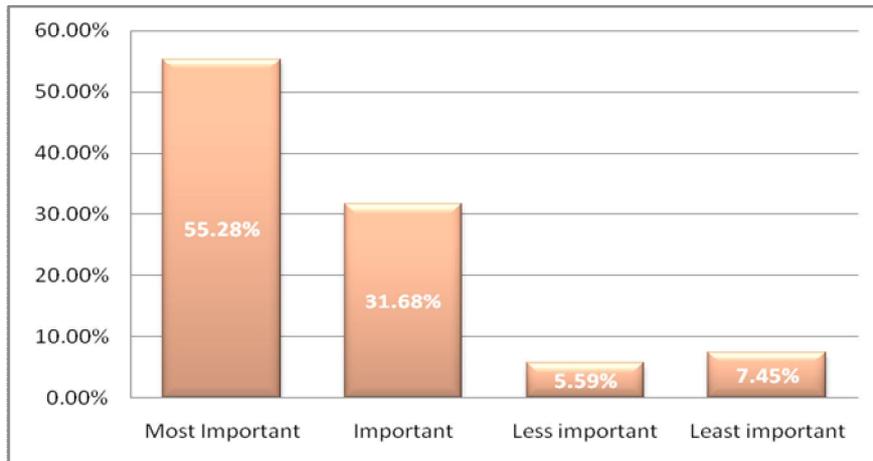


Figure 3 shows that 55% of the respondents considered customer satisfaction as the most important perspective of the Balanced Scorecard, whereas 32% reported customer satisfaction as important perspective. 6% of the respondents considered this perspective as less important and 7% of the respondents declared it least important.

Figure 4 shows the significance of Internal Business Perspective.

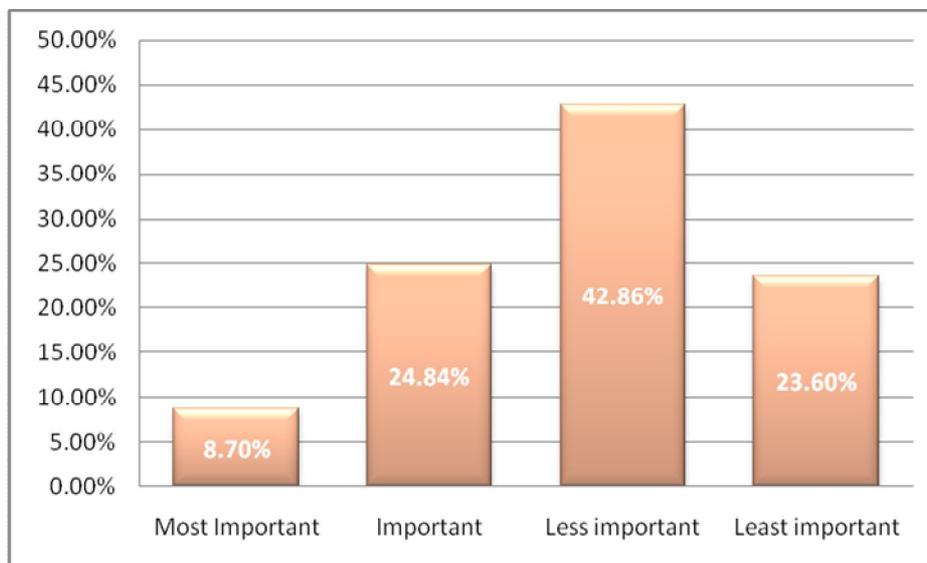


Figure 4 indicates that 9% of the respondents declared internal process perspective as the most important. 24% of the respondents considered this perspective as important, 43% and 24% of the respondents considered internal process as less important and least important respectively. Figure 5 shows the significance of Learning and Growth Perspective.

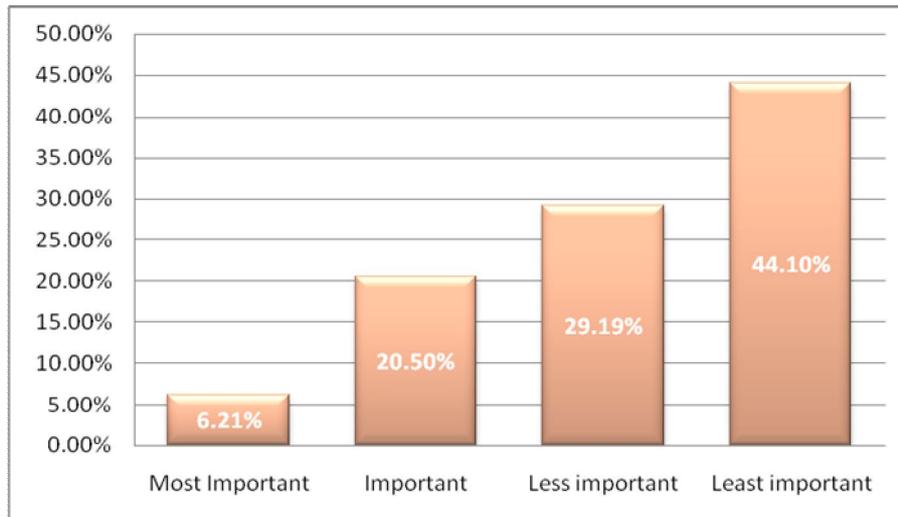


Figure 5 shows that 44% of the respondents considered learning & growth in the total measurement through Balanced Scorecard as the least important whereas 6% considered it most important. 21 % of the respondents showed that it was important and 29% of respondents felt that learning and growth was less important.

### Conclusion

In order to draw relative significance of the four perspectives of Balanced Scorecard, figure 6 shows the mean value for each perspective. It is reminded again that 1 stands for the most important, 2 for important, 3 for less important and 4 for least important.

Figure 6: Mean value for each



Figure 6 indicates that the mean value for Financial Perspective is 2.08 which is close to important, Customer Satisfaction 1.65 which is in between most important and important, Internal Process

Perspective 2.81 which is close to less important and Learning and Growth 3.11 which is towards least important.

We may draw a conclusion here that the respondents rate the customer satisfaction as the most important perspective, financial perspective as important, internal process as less important and learning and growth perspective as the least important perspective of the Balanced Scorecard.

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