

15.16: The Need for a Balanced Scorecard

Learning Outcomes

- Identify the four typical components of the balanced scorecard.
- Explain the need for a balanced scorecard.

A balanced scorecard is a strategic planning and performance management concept developed by Dr. Robert Kaplan and Dr. David Norton, published in a *Harvard Business Review* article titled “[The Balanced Scorecard—Measures That Drive Performance](#).” What differentiates the balanced scorecard concept is the inclusion of non-financial operational data in addition to the customary financial metrics. In introducing their balanced scorecard concept, Kaplan and Norton sought to identify measures that give managers a “fast but comprehensive” view of the business. As they put it: “The balanced scorecard includes financial measures that tell the results of actions already taken. And it complements the financial measures with operational measures on customer satisfaction, internal processes, and the organization’s innovation and improvement activities—operational measures that are the drivers of future financial performance.” The authors suggest thinking of the balanced scorecard as the dials and indicators in an airplane cockpit, noting that in business, as in flying, reliance on only one instrument can be fatal.

Watch the following video for Dr. Kaplan’s findings regarding why two former Marine CEOs adopted the balanced scorecard framework. Short version: it is highly effective in indoctrinating the firm’s mission and objectives. That is, it’s a framework that ensures that employees know what they are trying to accomplish rather than simply fixating on what it is they do. This is particularly important since, as discussed previously, the actual operating environment generally requires adaptability and a clear understanding of “success.”

A link to an interactive elements can be found at the bottom of this page.

You can [view the transcript for “Leadership and the Balanced Scorecard” here \(opens in new window\)](#).

Bain & Company, a global consulting firm, ranks the balanced scorecard fifth of the top 10 management tools used around the world. The Gartner Group has found that more than 50 percent of large US firms use a balanced scorecard (BSC). Moreover, many large firms all over the world use the balanced scorecard in business operations.^[1]

Balanced Scorecard Components

The balanced scorecard analyzes a business from four perspectives—customer, internal business processes, innovation and learning and financial. To develop these perspectives, management asks four key questions:

1. **Customer Perspective:** How do customers see us?
2. **Internal Business Perspective:** What must we excel at?
3. **Innovation and Learning Perspective:** [How] can we continue to improve and create value?
4. **Financial Perspective:** How do we look to shareholders?

To implement a balanced scorecard, organizations articulate goals for each perspective and translate them into specific measures. Note, however, that this is not done in the abstract. Adoption of a balanced scorecard approach to strategic and performance management starts with an analysis of an organization’s current internal and external environments. This analysis is conducted with reference to the organization’s mission, vision and values and other strategic planning elements. Thus, a BSC is the plan at the executional level that supports achievement of an organization’s mission. Let’s drill down into the four perspectives.

Customer Perspective

In order to remain viable businesses, organizations need to deliver value to their customers. Indeed, a recent Knowledge@Wharton article noted that “customer experience is now Job #1 for CEOs.” To elaborate: “Job No. 1 for CEOs today is ensuring the company delivers a compelling customer experience.”

To develop the customer perspective component of a BSC, managers must translate their general statement of commitment—i.e., Ford’s Quality is Job 1—into specific measures that reflect what matters to their customers. According to Kaplan and Norton “customers’ concerns tend to fall into four categories: time, quality, performance and service, and cost.” Measures of time might be the elapsed time between placing and delivery of an order. For new products, time might be the number of weeks or months it takes to go from concept to market availability. Measures of quality include the number of defects as judged by the customer.

To develop this view, Kaplan and Norton recommend a combination of internal and external research. For example, a company would have the data required to measure a goal of reducing delivery time. However, to evaluate competitive standing or market perception of quality or performance requires a company to survey customers. It's worth noting that customers often define factors such as "on time delivery" differently. Compiling the data for major customers will allow the organization to make a determination on what the target should be.

Internal Business Perspective

As stated above, the prompt to identify a company's internal business goals is "what must we excel at?" That is, what does the company need to do in order to meet customer and stakeholder (financial) expectations? This view focuses on internal processes, human resource capabilities and productivity and product and service quality. In detailing this component, Kaplan and Norton advise managers to identify and leverage the company's core competencies and to focus on processes and competencies that differentiate the company from its competitors.

Examples of internal business measures include product, service or functional efficiency or expertise. Think Nordstrom's for service, Apple for design capabilities and Proctor & Gamble's marketing and distribution expertise.

To achieve internal business measures, managers must ensure that the goals are clearly communicated and understood by the employees who are responsible for the processes, projects or initiatives. The importance of communication—of employees internalizing and focusing on specific goals—is the point that the CEO's Dr. Kaplan spoke to emphasize in the video above. Effective operational information systems—collecting and reporting relevant data—are critical to be able to identify and troubleshoot variances from target in this view. The best case scenario is for scorecard information to be reported in a timely manner (based on organizational dynamics) and for the measure to be linked to relevant manager and employee evaluations.

Innovation and Learning Perspective

The Customer and Internal Processes perspectives discussed above identify what an organization needs to accomplish from a competitive standpoint based on the current situation. However, the larger operating environment is dynamic and businesses need to continuously adapt or risk obsolescence.

The innovation and learning perspective (also referred to as learning and growth or organizational capacity) is the future view, seeking to answer the question "How can we continue to improve and create value?" According to Kaplan and Norton, "A company's ability to innovate, improve, and learn ties directly to the company's value. That is, only through the ability to launch new products, create more value for customers, and improve operating efficiencies continually can a company penetrate new markets and increase revenues and margins—in short, grow and thereby increase shareholder value."

Measures for this category include the percent of sales from new products (innovation) and continuous improvement of internal business processes. An example of the latter is industrial manufacturing company Milliken & Co.'s "ten-four" continuous improvement program, a challenge to reduce quality issues—process issues, product defects, late deliveries and waste—by a factor of ten over the next four years.

Financial Perspective

The financial perspective is the classic numbers—some would say the "bottom line" view. Ultimately, this view shows whether the company's strategy and execution are successful. Typical financial goals include profit, operating costs, target market revenue and sales growth. Kaplan and Norton cite a company that stated its financial goals in terms we can all understand: to survive, measured by cash flow, to succeed, measured by quarterly sales growth, and to prosper, measured by an increase in market share and return on equity. The authors note that although there is significant criticism of financial measures due to their focus on past performance and inability to account for value-creating initiatives, "the hard truth is that if improved performance fails to be reflected in the bottom line, executives should reexamine the basic assumptions of their strategy and mission."

The authors conclude with a caveat: a balanced scorecard—specifically, the measures of customer satisfaction, internal business performance, and innovation and improvement—are based on a specific company's interpretation of their business and operating environment. However, that view may not be accurate.

To quote: "An excellent set of balanced scorecard measures does not guarantee a winning strategy. The balanced scorecard can only translate a company's strategy into specific measurable objectives. A failure to convert improved operational performance, as measured in the scorecard, into improved financial performance should send executives back to their drawing boards to rethink the company's strategy or its implementation."

? Practice Question

<https://assessments.lumenlearning.co...essments/12324>

Why a BSC Is Needed

Fannie Mae is a financial services company. Before 1992, Fannie Mae's compensation structure was linked to a wide range of performance measures. Beginning in 1992, earnings-per-share growth and growth were the only measures used to set incentive pay for Fannie executives. The incentive pay handed to Fannie executives more than quadrupled after this change, rising from \$8.5 million to \$35.2 million (1993 to 2000). In 2003, the regulator overseeing Fannie Mae found accounting fraud.

Without a balanced scorecard, executives focus on only one or a few aspects of the organization. A company may be doing well financially but performing poorly in another area. Even if a company is doing extremely well in one area and outperforming the competition, the area that needs the most improvement may destroy the company. For example, a company may exceed customer expectations related to product quality, corporate social responsibility, and customer service; however, its gross profit margin could be low. With a low gross profit margin, the company may not be able to grow, compete, or overcome obstacles.

A BSC forces managers to look at the company as a whole to measure performance and thus more accurately determine the company's overall state. Managers can then work to improve in areas in which it is lacking.

? Practice Question

<https://assessments.lumenlearning.co...essments/12325>

1. <https://hbr.org/1992/01/the-balanced-scorecard-measures-that-drive-performance-2> ↩

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