Performance Management Frameworks – A Need for Adaptation (focusing on the Balanced Scorecard).

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Traditionally performance management systems have been financially focused. While this may have the advantage of expressing business performance through financial numbers (e.g. sales, profitability, net margin, cash flow or return on capital employed) and by implication having an in built process of measuring business performance through quantitative data this sole emphasis on financial numbers in today's competitive environment (as indicated by a number of commentators, Peter Clarke & Andrew Toal, Stephen Drury, Kaplan & Norton) is deficient from a number of dimensions. We will examine these deficiencies while also presenting a framework that in overcoming these deficiencies enables an organisation to translate its objectives – both financial and non-financial – into a series of performance measures and actions that can guide the organisation for the future. This framework is known as the Balanced Scorecard that was created by Kaplan and Norton in 1992. While it was presented by them over 25 years ago it is still relevant today and can become increasingly relevant as organisations seek to adopt and adapt it for their circumstances.

Initially, we will examine the deficiencies of traditional performance measurement systems so that we can then set the context for the Balanced Scorecard (BSC) enabling us to see that the BSC attempts to overcomes these deficiencies.

Firstly, traditional performance management systems use financial measures that rely on past historical data; past data that represent results of past performance – profit for example is a lagging indicator. Lagging indicators indicate results of past decisions. In the context of performance management, we need to also consider leading performance measures that will be future oriented – these leading measures can alert managers to the likely results of business operations. They can be indicators or determinants of future business performance. Furthermore, they are long term and will include non- financial dimensions such as customer service, customer retention, employee development, product innovation to name but a few. By contrast, financial measures tend to be short term, myopic and not linked to overall corporate strategy. For today's organisations identifying these non-financial performance measures *that relate to their business in today's competitive environment* can be the key task in achieving strategic advantage. It also gives a more meaningful picture of overall organisational performance than solely financial numbers. From Kaplan & Norton's perspective with the Balanced Scorecard the performance measures – lagging and leading- are derived from an organisation's strategy and objectives. Lag measures (being outcome measures) indicate whether strategy is being implemented successfully generating the planned financial outcomes (e.g. profit margin and return on capital employed). Lead measures are the drivers of future financial performance. They cause the outcome and are normally unique to a particular strategy – hence supporting the objective of linking measures to strategy. As we will see later in this article, lead measures in the Balanced Scorecard approach tend to be the non–financial measures encapsulated in three of the four perspectives of the Balanced Scorecard. These are the customer, internal business process, and learning and growth, perspectives. The fourth perspective in the BSC is the Financial perspective, or as Kaplan & Norton indicate – how does the company look to shareholders. Kaplan & Norton are aware of the need for an integrationist viewpoint. This lack of strategic intent is the undoing of a short term traditional financially oriented view point. Returning to the deficiencies of an overly financial focus (as seen in traditional systems) we can expand on this further now.

Secondly, traditional financial measures focus on what has been reported – the results rather than explaining how the result was achieved or indeed what should be done differently in the future. Internal management reports tend to focus on results in specific business areas, often emanating from a budgeting perspective where the focus can be on the amount spent (compared with budget) and other significant variables (e.g. quality of service or amount of returns) can often be missing. The overall alignment with corporate strategy can be sparse if not non-existent.

Thirdly, in today's competitive environment of changing customer needs, especially with advancing technology and dynamic customer preferences there is a need for organisations to consider the customer perspective. As Porter had indicated organisations need to be 'outside-in focused'. This has the advantage that changing customer preferences and customer retention measures can be developed as part of a customer focused business strategy that can be aligned with financial planning. Amazon is an exemplar in this area of customer retention as it exploits the power of social media and technology in retaining customers. This in turn compliments Amazon's mission statement of 'to be earth's most customer-centric company'.

Perhaps more importantly through deploying technology Amazon has involved customers in the feedback process where the customers will suggest improvements and products that are directly related to their changing needs. Moreover, this external information in turn is re-embedded into the business operations as products and services are created or enhanced that are attuned to customer needs – a critical success factor for Amazon. From Kaplan & Norton's stance this re-embedding of quality information into Amazon's business is a response to their call for ownership and adaptation of the framework.

As the two authors indicate in their 1996 Article 'Using the Balanced Scorecard as a strategic management system':

> "Without a balanced scorecard most organisations are unable to achieve a consistency of vision and action as they attempt to change direction and introduce new strategies and processes. The balanced scorecard provides a framework for managing the implementation of strategy while also allowing the strategy itself to evolve in response to changes in the company's competitive, market, and technological environments".

To summarise thus far we can say that the hall marks of a contemporary performance management framework are:

- Recognition of financial and non-financial performance measures
- Inclusion of lagging and leading performance indicators
- Linkage with corporate strategy
- Recognition of the customer perspective and other non-financial perspectives that are meaningful for your business
- Usage of feedback within the framework, ideally with strategic intent that compliments the corporate strategy.

Given the need for these hall marks in an integrated ‘balanced’ performance related framework and in turn to overcome the deficiencies of purely traditional financially oriented performance measures of their own (as indicated earlier) we can now see that the Balanced Scorecard enshrines four perspectives.

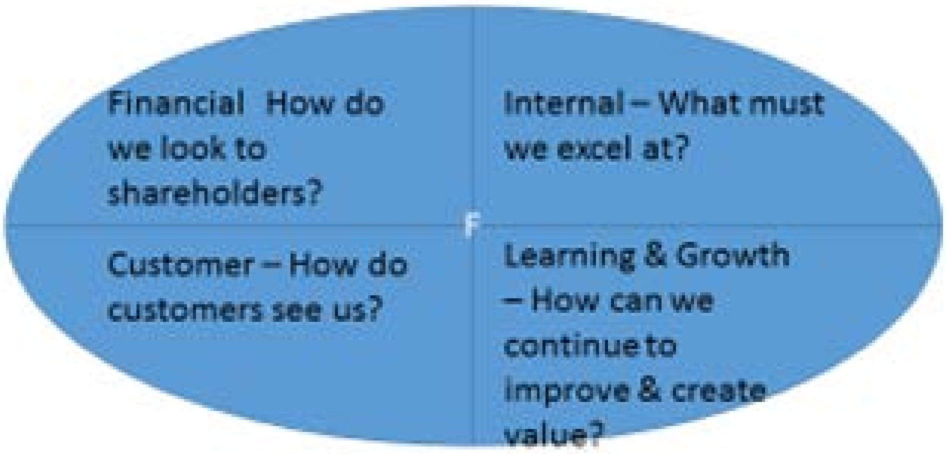
- Customer perspective – How do customers see the organisation?
- Internal perspective – What must the organisation excel at?
- Learning and Innovation – Can the organisation continue to improve and add value?
- Financial Perspective – How does the organisation look to shareholders?

Furthermore, the framework links objectives with causes in an integrated manner that can operationalise business strategy. As Kaplan & Norton have stated:

> “The Balanced Scorecard should translate a business unit’s mission and strategy into tangible objectives and measures. The measures represent a balance between external measures for shareholders and customers, and internal measures of critical business processes, innovation and learning and growth. The measures are balanced between the outcome measures – the results from past efforts- and the measures that drive future performance.”

Perhaps, as Clarke has posited the benefit of the BSC as a performance management framework is this linkage between mission, objectives, strategy and performance measures. This is supported when one considers that strategy concerns the matching between what a company can do (given organisational strengths and weaknesses) with what it might do (within the context of environmental threats and opportunities). Hence, strategy is the selected route to the destination represented by its objective. Performance measures should drive strategy throughout the organisation so that all management levels and all employees understand what the strategy is and how their performance is linked to that overall strategy. The performance measurement system should focus on the critical success factors that represent areas in which the organisation must excel for it to be successful. They are therefore the ‘areas where things must go right’ for the business to succeed. The central message of the balanced scorecard is the twinning between the maxim from Kaplan & Norton that ‘what gets measured gets managed’ and the realisation that managers need a broad range of performance measures to manage their business. Kaplan & Norton have provided for us the analogy of an airline pilot that has a variety of dials and indicators in the cockpit for airspeed, altitude, direction, fuel and position. All of these are needed for a successful flight – the pilot cannot (and should not) rely on just one performance measure.

A further consideration here is that the framework can provide a bridge between efficiency measures and effectiveness measures. With efficiency measures the focus is on cost reduction, profitability, financial position and ‘doing things right’ as encapsulated in traditional financial domains. With effectiveness measures, the focus is on ‘doing the right things’ as encapsulated in the non- financial domains of customer retention, product development and innovation. The framework brings together both efficiency and effectiveness measures. Hence Kaplan & Norton indicate that the scorecard supplements traditional financial measures with criteria that measure performance from three additional perspectives – those of customers, internal business processes, and learning and growth. The scorecard isn’t a replacement for financial measures; it compliments them.



FINANCIAL Perspective	INTERNAL Perspective
Objective	Objective
Performance Measure	Performance Measure
CUSTOMER Perspective	LEARNING & GROWTH Perspective
Objective	Objective
Performance Measure	Performance Measure

Summary of Balanced Scorecard: Kaplan & Norton (1992)

Returning to the four perspectives we need to consider each in turn, notwithstanding that the integrationist perspective is paramount as the scorecard is 'balanced'. It is balanced in two ways. Firstly, there is a balance between financial and non-financial measures. Secondly, it is balanced between internal and external measures.

We can now treat each of the perspectives that are part of the BSC

Financial perspective:

This perspective concentrates on answering the question: **How do we appear to shareholders?** The performance measures invoked will relate to financial performance – e.g. profitability, sales growth, cost reduction.

The Balanced Scorecard uses three other perspectives that complement the financial perspective. These three perspectives are generally represented by non- financial performance measures.

Customer Perspective:

This perspective concentrates on answering the question: **How do customers see us?** This should be an assessment by the customer and not the organisation's own assessment of what the customer thinks. Our earlier example of the customer centric view of Amazon Limited is the embodiment of this as the centrality of the customer is a key tenet of the Balanced Scorecard with the development (and further re-embedding) of measures that reflect factors that matter most to customers. Key measures here from the organisation's view will be customer satisfaction, customer retention, profitability and market share.

Today, within the customer perspective performance measures can be more easily obtained as cloud based Enterprise Resource Planning systems and readily available data analytics can provide in built dashboards that are meaningful to organisational performance. An example of such integrated solutions being Sage Business Cloud and Salesforce where customer relationship management (CRM) solutions are seamlessly inter-meshed with financial solutions e.g. Pareto Graph of Top 20 customers with supporting drilldown of sales related transactions (CRM) and debtor analysis within financial dashboards of these same customers (Financials). Availability of these integrated metrics can provide opportunities for enhanced innovation in addressing customer related matters and in providing supporting information for the third perspective of the Balanced Scorecard – viz. Internal Perspective as critical processes need to be identified to achieve the organisation's customer and financial objectives.

Internal perspective:

This perspective concentrates on answering the question: **What must the organisation excel at?** Hence, the organisation is required to look at the internal business processes with the activities in its value chain and ensure that they support the customer and financial perspectives to yield relevant objectives and performance measures. Analysis of the value chain helps to identify processes that are critical to the organisation's success as the value chain is the sequence of business processes through which value is added to goods and services. Kaplan & Norton posited three primary activities in the generic value chain – being the innovation process, the operations process and the after sales service process. Today, organisations need to consider their extended value chain as opportunities for outsourcing and extended supply chain management are becoming more prevalent with contemporary business process management while revealing gaps in existing capabilities of employees and internal systems. The fourth perspective of the Balanced Scorecard – Learning and Growth deals with this area of capabilities of employees, internal systems and information technology.

Learning and Growth perspective:

This perspective concentrates on answering the question: **Can we continue to improve and add value?** Organisational learning and growth emanate from three areas – employee capabilities, employee motivation and the information systems and procedures. Identification and management of objectives and performance measures here need to be aligned with the other perspectives. The learning and growth perspective can be enhanced by acting on the information and feedback provided by the other perspectives and disseminated throughout the organisation. A readily discernible measure here may be employee training and the number of days training.

Where traditional financially oriented short term myopic view prevails where profitability and cost reduction may be the driving forces, employee training costs, being discretionary costs, may be reduced to achieve the single over-riding objective of cost reduction. This being within traditional systems is at the expense of the overall long term benefit of the organisation and indeed customer retention. Hence this emphasis on cost reduction and measures to achieve this would not represent what we might term a 'balanced view'.

Kaplan & Norton have posited that within the BSC framework there is the in-built process of feedback and learning. As they indicated

> "Feedback and learning gives companies the capacity for what we call strategic learning. Existing feedback and review processes focus on whether the company, its departments, or its individual employees have met their budgeted financial goals (italics emphasised). With the balanced scorecard at the centre of its management systems, a company can monitor short term results from the three additional perspectives – customer, internal business processes and learning and growth- and evaluate strategy in the light of recent performance. The score card thus enables companies to modify strategies to reflect real-time learning".

This is another major benefit of the Balanced Scorecard – while Kaplan & Norton have indicated that what gets measured gets managed, there is also the flexibility consideration as what is measured can be changed over time to reflect changing priorities. In sum, the balanced scorecard provides that framework which translates the aims and objectives of a company into a series of performance targets that can be measured but has the capacity for strategic learning. Kaplan & Norton are alive to the risks that organisations face in establishing this linkage, especially if rewards and compensation systems are further linked to balanced scorecard measures. As they have indicated "As attractive and powerful as such linkage is, it nonetheless carries risks. For instance, does the company have the right measures on the scorecard? Does it have valid and reliable data for the selected measures?" In today's age of increasingly competitive and technology driven business environments data is more readily available these risks are still relevant. However, the use of cloud based systems with drill down facilities and in built data analytics can provide valid and reliable data for performance measures. The challenge of identifying these performance metrics may be eased but they need to be managed in a coherent holistic way – in short in a balanced manner.

As Clarke has indicated the Balanced Scorecard is balanced from the view point of time as it reflects the past, present and future.

> "The financial perspective reflects past decisions, and represents the historical financial perspective of the firm. The customer and internal process perspectives represent current performance. The learning and growth perspective represent what must be done in the future that will have a positive future impact on the firm".

Students should therefore be aware of the advantages of the Balanced Scorecard as indicated over traditional financially led performance management systems while recognising the need for each of the four perspectives within the BSC. This provides the basis for an organisation to translate aims and objectives into a series of measurable performance targets that can be subsequently managed.

Finally, we can say that while Kaplan & Norton presented four perspectives as a suggested framework this was not done as a constraining straitjacket and they encourage the adoption and subsequent adaptation of their framework as one of the key benefits is its flexibility together with its conciseness and clarity of presentation.