Using Balanced Scorecard to Drive Performance in Small and Medium Enterprises

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ABSTRACT

The new Balanced Scorecard has revolutionized the way that Business has been formulated and executed. A natural evolution that builds on the success of the first version of Balanced Scorecard in the beginning of the nineteen’s. With the development of the BSC including the Strategy Mapping has been the subject of recent books, articles and discussions. This discourse has greatly raised practitioner awareness and interest in the value of integrated strategic scorecard systems by focusing on what these tools are, why companies adopt them and by providing high level implementation frameworks and examples from practice. As a result of the increasing challenges that companies face today to remain competitive, the comprehensive scope of the BSC makes it the management method of choice for small & medium size enterprises (SME). A purely financial view is no longer sufficient for enterprises. The Balanced Scorecard is a revolutionary performance measurement system that allows SME to quantify critical intangible assets, such as people, information and culture. The BSC in line with the strategy allows companies to describe the links between intangible assets and value creation so all aspects of strategy can be implemented in a manner that ensures sustained value creation. The BSC allows managers to align investments in people, technology and organization capital for the greatest impact. Realizing the full power of BSC initiative calls on top managers to commit to describing and communicating their Business in a way that will guide decision making away from a short-term focus on financial figures.

Key words: Small & Medium Enterprises; Entrepreneurs; Value Management; Leadership; Strategy

JEL classification: L21, L22, M10, M21,

Introduction

The business world today faces a crisis in strategy — but not because managers can’t formulate a good strategy, most actually can. The core of the crisis lies within execution or, more accurately, its lack. In 1999, Fortune magazine claimed that “70% of strategic failures are due to poor execution — not a lack of vision or smarts”. In 2003, it repeated this claim, saying that less than 10% of effectively formulated strategies are effectively executed. Websites that focus on execution of strategy routinely mention similar implementation issues. One such website cited these statistics in 2006:

- 95% of a typical workforce does not understand its organization’s strategy;
- 90% of organizations fail to execute their strategies successfully;
- 86% of executive teams spend less than one hour per month discussing strategy;
- 70% of organizations do not link middle management incentives to strategy;
- 60% of organizations do not link strategy to budgeting.

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A strategy describes how an organization can create sustained value for its shareholders, customers and communities. Most organizations have different methods of communication, alignment and implementation, but the Balanced Scorecard (BSC) is an effective way also for SME to describe strategies for creating value. The BSC includes the lagging indicators of financial performance and customer value proposition, and the leading indicators of internal processes as well as learning and growth.

The development of the BSC by KAPLAN and NORTON (1992) goes back to the start of the 90s. The aim of the BSC is to translate the strategy of the company into material aims and corresponding measuring units. New strategies always mean an adjustment to the criteria with which performance is measured. The requirement for balance means that the interests of company-external stake-holders and the internal requirements of business processes, innovations, ability to learn and growth must be considered along with short and long-term strategic aims and the use of objective and subjective (including non-financial) indicators. The working logic of the BSC has the aim of converting visions into concrete activities. The vision and company strategy must be broken down into individual aspects, and strategic aims derived to achieve these which are then put into relation with each other. Afterwards, variables must be identified which are regarded as essential for attaining the aims. These are referred to as drivers. Measurement units are required in order to evaluate the development of these drivers. As the characteristics of these measurement units should be beneficial to the implementation of ambitious strategies, care should be taken when selecting them with regard to their suitability for benchmarking. Fast and far-reaching changes are a key problem in the current economic environment. A company can therefore only survive if it has a great ability to adapt to such changes and can adjust to new conditions. SME management therefore have to be even more aware of success factors in order to integrate them seamlessly into company planning. The BSC is an instrument for SME management which enables them to take account of financial and non-financial key figures.

**Aim and Structure of this Thesis**

BSC have proven useful in public, notfor-profit and private sector organizations. Indeed, many principles underlying the construction, rollout and communication of BSC are similar for a wide variety of entities. Sectors differ in several important ways The aim of this paper is to examine the theoretical aspects of the introduction and application of the BSC concept in SME. It will describe how the BSC works and how it can be applied in SME in a beneficial way.

In short, the paper will assist SME to:

Understand the benefits of BSC
- Understand the steps in the BSC process
- Understand how efficiency can be increased by using BSC
- Understand how employee can be motivated with clear and measurable aims

**The Balanced Scorecard in Theory**

The BSC is an effective and universal instrument for management which enables the strategic orientation of the actions (programs, measures) of a group of people (organisations,
companies, institutions, sectors, departments, project groups ...) towards a common goal.\(^3\) The BSC is a management system which links strategies and key figures with financial aims.\(^4\) Initially, translations of the term BSC were common in German literature. In the meantime however, the English term is more frequently used.\(^5\)

The importance of key figures can be summed up thus: "if you can’t measure it, you can’t manage it." The key figure system of a company has a huge influence on the behaviour of persons both inside and outside the company.\(^6\)

MbO is a method for target-orientated company management. Its aim is to attain targets efficiently and to counteract bureaucracy and over-concentration on processes. MbO is future and results-orientated. It is not "what" someone does that is important, but "why" he is doing it, what he achieves and realises. Success is not gauged in the quantity of work performed but in the attainment of goals.\(^7\)

Performance measurement is a management system that is used to measure performance and enterprise management. Its has functions beyond those of a system which only uses key figures. The measurements are not restricted to conventional performance values such as turnover, profit and ROI, instead a holistic view of many influence factors is used. In addition to the conventional, purely financial key figures, these factors can include employee and customer satisfaction, the number of new customers, fluctuation rates, etc.\(^8\)

(Latin movere = move) in human sciences and in ethology motivation is a condition of the organism which influences the direction and the energy of current behaviour. Here the direction of the behaviour means the orientation towards objectives. Energy denotes the physical forces which drive the behaviour. A synonym for "motivation" is "willingness to act", a lack of motivation is informally known as "working on autopilot".\(^9\)

**Elements of the Balanced Scorecard**

Over the course of time, the BSC has developed further since its conception as a performance measuring approach. Originally it was limited to improving management with financial measurements. Financial measurement units are indicators which report on the past. They do not provide information on drivers for future success for customers, suppliers, employees, technology and innovation. The BSC provides a framework which enables value calculation to be examined from different points of view.\(^10\) The BSC approach can be used from the initial formulation of strategies through to their operative implementation – the implementation of strategies in a focussed action with a clear ultimate aim, underlined with a transparent, key figure-based measuring system.\(^11\)

\(^3\) cf. Friedag, Schmidt 2004: 11
\(^4\) cf. Scheibeler 2003: 1
\(^5\) cf. Kaplan, Norton 1997: 19
\(^6\) cf. Kaplan, Norton 1997: 20
\(^7\) cf. Stroebe 2003: 12
\(^9\) cf. Zimbardo, Gerrig 2004: 503
\(^10\) cf. Kaplan, Norton 2001: 21
\(^11\) cf. Stroebe 2006: 58
The Vision

The vision primarily focuses on the company. Its task is to make the long-term company objectives clear to company employees. The vision presents the desired future condition of the company to the employees and formulates a requirement to which the skills available in the company should be orientated. A clearly formulated, challenging and inspiring vision has a motivating function and provides a sense of purpose in the company. It creates commitment and facilitates identification with company objectives. A mission statement can serve as a means of communication. Why does a company need a vision? In a time of rapid change it is important to "use the light of the stars to plan the course and not to chart the course according to the lights on every passing ship." Therefore companies which do not have a vision will struggle in global competition.

The Mission

As a rule a mission is understood as the general description of the business purpose which ideally should correspond with the values and expectations of the most important stakeholders and define the boundaries of business activities. A mission highly significant for positive awareness and employee motivation in the company but is not vital for external target audience. Very employee enjoys working in a company that has a positive image among their friends, acquaintances and family.

The Strategy Map

How strong is the evidence that the use of strategy maps has had a positive operating and financial impact on organizations adopting them? Here are some observations from practice and from the performance measurement literature. Little in the academic literature proves or disproves the hypothesis that adoption of balanced scorecard and strategy mapping systems is positively associated with superior financial returns. Hoque and James (2000) documented a positive association between BSC use and organizational performance. On the other hand, Ittner and Larcker (2003) showed that BSC use had no impact on performance unless organizations established causal linkages between their non-financial measures and financial outcomes. Those that did produced significantly higher returns on assets and equity than those that did not. Perhaps these mixed results are not surprising. With all that is going on inside modern organizations, it is extremely difficult for academic studies to tease out the effects of a single initiative on the financial performance of an entity. Despite this lack of general empirical evidence, it is noteworthy that a large number of organizations themselves claim significant financial or market share gains as a result of adopting strategy mapping/balanced scorecard initiatives. The best evidence of this comes from the approximately 70 “Hall of Fame” companies from around the world that claim to have achieved breakthrough results after implementing strategy maps and balanced scorecards. Readers can view these organizations and their testimonials by going to http://www.bscol.com/bscol/hof/ and looking at current members.

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12 cf. Friedag, Schmidt 1999: 93
13 cf. Abplanalp, Lombriser 2005: 49
14 O. Bradley, quoted in Hilb (1994) p. 42.
16 Abplanalp Abplanalp, Lombriser 2005: 49
17 cf. Friedag, Schmidt 1999: 91
In addition Strategy maps can provide significant value to companies using other quality programs in these four ways:  

18 They provide explicit and testable causal linkages between strategy and reality.
1. They establish targets beyond existing best practices.
2. They identify entirely new processes that are critical for achieving strategic objectives.
3. They set strategic priorities for process enhancements.

Strategies are exceptionally important in the BSC concept, as the main task of the BSC is seen as converting strategies into concrete aims. This means that personnel resources, company culture and the management system play a decisive role in developing strategy.  

**The Four Perspectives of the BSC**

One major characteristic of the BSC concept is viewing the company from different points of view to ensure that information from various company areas is integrated in managing company success.  

20 Kaplan and Norton recommend viewing the company from four perspectives.  

![Image No. 1: The Perspectives of the BSC](image)

The aims, key figures, guidelines, measures, performance requirements and indicators of the four perspectives (Image no. 1) represent the core management tools of the company. They ensure an equilibrium between short-term and long-term aims, desired results and the performance drivers for these results and concrete key figure targets and softer, more subjective measurements. A balance between company-internal and company-external measurements as well as financial and non-financial values is also sought. The balanced scorecard forces the manager to concentrate on a handful of especially important measuring criteria. At the same time he minimises the quantity of superfluous information, as the number

18 cf. Kaplan, Norton 2004
19 cf. Abplanalp, Lombriser 2005: 50
20 cf. Kaplan, Norton 1997: 76
22 Source: Kaplan, Norton 1997: 9
of measurements used should be restricted to approx. 25. For each perspective around four to seven key figures are necessary which is also a sufficient quantity.23

**The Financial Perspective**

The financial perspective is a very important part of the BSC. Conventional financial key figures are used to provide an overview of the economic consequences of previous actions. They show whether the company strategy, its execution and implementation has brought about an improvement of results. The key figures of this perspective cover narrow and broad definitions of profitability, as financial aims always relate to profitability. Typical key figures are return on capital, cash flow or period-specific profits.24

![Image No. 2: Measuring/Evaluating Strategic Financial Themes](image)

Different key figures have to be selected depending on the life-cycle phase and the selected strategy. Image no. 2 gives some examples of these.

**The Customer Perspective**

In the customer perspective, companies identify the customer and market segments in which they wish to compete. Targets and key figures and the corresponding measures for attaining them are drawn up for customer and market segments. The performance drivers are derived from the value propositions that the company would like to offer its customer and market segments. Here, the five key figures of customer loyalty, market share, customer acquisition, customer profitability and customer satisfaction play a vital role.26 These key figures can be presented in a causal chain (Image no. 3).

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25 Source: Kaplan, Norton 1997: 50
By selecting specific targets and key figures from the following three property classes, management can enable the company to focus on an exact service offer for the target customer segment\textsuperscript{28}:

- Product and service properties: functionality, quality, price, time
- Customer relationships: quality of the purchase experience, personal relationships
- Image and prestige

\textbf{The Process Perspective}

Which aims should be set with regard to processes to ensure that the aims of the financial and customer perspectives can be fulfilled?

Previous performance measurement systems often concentrate on improving existing business processes.\textsuperscript{29} Where conventional systems and the BSC differ is in the top-down derivation of aims and key figures from the explicit strategies for the internal process perspective. The focus is on identifying processes which promise the greatest success for the implementation of the company strategy. Here particular emphasis should be given to long-term innovation processes which have the aim of localising properties of market segments in order to provide customers with the highest possible levels of individual utility with specially developed products.\textsuperscript{30} The strategic importance of internal processes for acquiring and retaining lasting competitive advantages has been demonstrated by Porter's value chain analysis.\textsuperscript{31} When examining business processes, the BSC takes the complete value chain as a basis, as shown in Image No. 4.

\textsuperscript{27} Source: Kaplan, Norton 1997: 66
\textsuperscript{29} cf. Kaplan, Norton 1997: 89
\textsuperscript{30} cf. Kaplan, Norton 1997: 94
\textsuperscript{31} cf. Porter 2002: 59 ff.
The key figures selected for this can relate to the measurement of company flexibility or specific product characteristics which contribute to customer utility. In the customer service processes, performances can be measured with key figures for time, costs and quality. A possible measurement unit for time could be the response speed between the time a customer makes an inquiry and the time a solution is provided. In terms of cost key figures, a measurement could be used that gauges the resources required for the provision of a solution. The quality could be measured in terms of the number of calls that were required to solve the problem for the customer. A number of other key figures are also feasible for this perspective. These can be selected and adapted according to the branch and characteristics of the company.

The Learning and Development Perspective

This perspective was proposed by the inventors of the BSC and it identifies the infrastructure which is either available in a company or which needs to be implemented to ensure long-term growth and improvement. The company should development into an organisation that learns. Kaplan/Norton differentiates between three main categories:

- **Employee potential**, with the key values *employee loyalty, employee satisfaction and employee productivity.*

- **Information systems potential**, which ensures that the company is constantly provided with the latest information with regard to the competitive environment and customers.

- **Motivation, empowerment and goal mindedness**, to create a good working climate for independent and motivated employees.

Here it can be seen that the emphasis of the BSC is very much on investment in the future. Companies must invest in their infrastructure if they wish to achieve long-term growth aims.

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32 Source: Kaplan, Norton 1997: 93
36 cf. Kaplan, Norton 1997: 121
Image No. 5 shows the basis of the three employee-orientated key figures (satisfaction, productivity and loyalty) that yields the result in terms of investment. Employee satisfaction is regarded here as the driving force for the two other key figures. It does not necessarily have to be the case that every company uses these four perspectives (finance perspectives, customer perspective, internal process perspective and learning and development perspective), it is possible to leave out a perspective or add another perspective. The strategic aim is essential for the view of the company and the perspectives must be chosen accordingly. The key figures of the learning and development perspective must be subdivided into groups for early and late indicators.

The BSC improves employee motivation by:

- Communication in a two-way process, between the employee and management
- This shows the employee that "I am needed here"
- Agreed (not imposed) aims improve employee performance
- The employee has greater scope for independent activity and can develop initiative and search for new solutions
- The employee becomes actively involved in company management and company success
- The employee takes responsibility for his own performance

Source: Kaplan, Norton 1997: 93

cf. Friedag, Schmidt 1999: 197

• Performance can be judged using agreed performance standards and
• Monitoring procedures are fairer and more precise

**Cause and Effect Relationships**

Cause-and-effect chains are formed by a series of "if - then" statements which can be derived using the perspectives of the BSC. They show the relationship between the strategic aims, promote common understanding, provide a logical explanation for the strategy, meaning that it can be communicated more easily. Every key figure should be part of a chain so that the financial aims can be attained (see Image No. 6).

**Image No. 6: The Cause-and-Effect Chain of the BSC**

[Diagram showing the cause-and-effect chain]

**Benefits of the BSC**

The particular benefit of the BSC is the systematic implementation and conversion of visions and strategies into aims, key figures and measures by all employees. The BSC links strategic aims with operative measures. By involving management and employees in the creation of the BSC, everybody can recognise the importance of their contribution to attaining the strategy. This makes the strategy transparent for every employee on all company levels. Employee involvement and participation in the BSC team motivates them and results in greater acceptance for the new controlling instrument. The BSC enables a balanced approach to company management as it uses financial and non-financial key figures and gives explanations for the causes of financial success. The use of different perspectives (financial,

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40 cf. Stroebe 2003: 48
41 Source: Kaplan, Norton 1997: 29
customer, process as well as the learning and development perspective) to observe company events prevents short-term financial success from being the sole aim. The BSC is also effective in arousing the interest of employees and in this way suggestions for improvements flow continuously. It may not be regarded as a finished system, but as a method for ensuring continuous growth, improvement and achievement. Innovation is encouraged and easier to introduce. It creates transparency in terms of company value creation. This is attained with the causal relationships of the cause-and-effect chain.

**Critical Appraisal of the Balanced Scorecard**

Kaplan and Norton both authors recommend its introduction in nearly every branch, even in organisations which do not have profit-making as their top priority. This wide scope of companies means that information on the introduction of the BSC is somewhat sparse in the Kaplan and Norton book. The recommended time-span of three months for the introduction of the BSC is unfeasible for the vast majority of companies. This has been shown by various research projects into company practice. The reasons for this are as follows: Kaplan and Norton leave the conception of the BSC almost entirely to the individual companies. A division into four areas is recommended, however, it may be necessary for companies to integrate other areas. This can be performed by adding a fifth perspective or by omitting one perspective depending on factors important to the particular company. This is the major problem. The BSC is developed by a team of employees from different departments. Each department will of course attempt to ensure that its own interests are included. This results in a time-consuming problem that has to be solved to ensure success. One of the biggest problems of the BSC is its implementation. The same applies for determining the cause-and-effect relationships. This determination is frequently affected by the major problems present in the company. Lengthy discussions can occur even when determining which key figures are to be used. Many aims can be measured with several key figures. Problems frequently arise when trying to convince bosses and employees of the benefits of the BSC. It is much more difficult than described in the literature. As a rule managers and bosses have little time for the introduction of a BSC, as (in particular in SME) they are fully occupied with the everyday running of the business. In the learning and development perspective, Kaplan/Norton do not provide suitable key figures for measuring the success of this perspective. The companies are expected to develop their own key figures. The BSC is not a new theoretical approach. Just as with the previously established key figure system, there is a danger that the exact definition of the key figures is not observed and key figures are doctored in reporting processes. Another fault is the insufficient attention paid to suppliers and competitors. These are only considered in the internal process perspective and the customer perspective. This begs the question as to whether the importance of suppliers and the competition/market necessitates the creation of special perspectives. However, it is also possible to regard this lack as a positive aspect of the BSC. By reducing the perspectives to a minimum, companies can concentrate on the most important issues. By specifying 4-7 key figures for each perspective, the danger of becoming lost in a morass of key figures is avoided. Plus points of the BSC are its strategic aspects. The flexible concept of the BSC is also highly regarded. The development sequence (vision – aims – key figures – cause-and-effect relationships) ensures that insignificant and superfluous key figures are not included on the BSC from the outset. This is also prevented in discussion rounds during the creation of the BSC. Another positive aspect of the BSC is communication. Active communication can also uncover conflicts of interest between certain objectives. This allows such contradictory aims to be corrected immediately. Viewing the company from different points of view is also held in very high regard. The requirements of external stakeholders and internal interests are given their due consideration.
Conclusion and Recommendation

BSC is an effective and powerful initiative that can help keep a company at its competitive peak. The tools, techniques and steps provided in this paper enable organizations to effectively and efficiently conduct their own BSC and to successfully implement strategy where others have failed. Companies struggling with strategy execution will find maps a compelling way to think about, agree upon, and communicate their strategic initiatives to various stakeholder communities. To implement successfully BSC it needs a clearly strategy which is the Basis not only for the BSC but also for scorecard performance measures, linkages to appropriate management and validation techniques, and allocating resources to initiatives and strategies that support its value creation and principal objectives. This has proven to lead to better performance for many SME’s. Realizing the full power of a BSC in a way that will guide decision making away from a short-term focus on financial figures. As employees at all levels learn to use the BSC to guide their actions, they will align themselves, and their company, to execute in a manner never before experienced. In doing so, the company will position itself to generate the profitability and to demonstrate the accountability demanded by customers, shareholders, employees, and the communities around them. As a result of the increasing challenges that companies face today to remain competitive, the comprehensive scope of BSC makes it the management method of choice. A purely financial view is no longer sufficient for enterprises. Instead, management requires a more substantial and up-to-date report on the company's situation at all times.

Recommendations

BSC initiatives have a mixed track record in a variety of industries and organizations. However, when you study organizations that have had success with the development, implementation and ongoing utilization of a balanced scorecard, you will notice several recurring themes that provide important lessons for success for all balanced scorecard practitioners.

1. Embedding the BSC in a business performance management process that begins with business strategy creation starts the process of building strategic alignment within your organization up front
2. Lack of leadership support can destroy your balanced scorecard initiative so: Without a strong commitment and Leadership don’t start work on your BSC
3. Achieve BSC success through a dedication to focus.
4. Implement the BSC at all levels of the organization to maximize organizational alignment
5. Be sure to plan and budget for BSC communication activities because experience shows that these activities are critical, they need to happen, and they won't without a solid plan and dedicated funding.
6. Build integration into your business performance management system until the BSC changes from just a measurement framework to the framework by which the business operates.
References


