# DITCHING THE BALANCED SCORECARD

Organisations can create a better system for measuring and monitoring performance than the Balanced Scorecard approach. All it takes is six steps.

**By Graham Kenny**

Where an organisation is heading and how well it is performing loom large in the minds of CEOs, accountants and other managers. As a consequence, performance measurement is a major concern in organisations of all types. It is in fact one of the very big issues. Managers and accountants are kept awake at night worrying about the effectiveness of the measures they use to monitor performance.

The Balanced Scorecard emerged as one solution to these concerns and has become widespread among organisations. For more than 15 years now accountants, boards, CEOs and senior management teams have wrestled with this tool. Many have found it wanting, however, leaving them wondering 'Is it the method or me?'

You can stop tearing your hair out – it's the method! And the good news is that there is a new, sounder way to monitor corporate performance that will allow you to rest more easily at night.

### From the particular to the general

First some background. The Balanced Scorecard was not invented by its promulgators, Robert Kaplan and David Norton, but by management at Analog Devices. This is a Massachusetts-based

semiconductor company, founded in 1965 that developed its own "Corporate Scorecard" in 1987. The card contained measures in four categories: finance, customers, manufacturing processes and new product development. Note the similarities with the four categories of the Balanced Scorecard, which are: financial, customer, internal business process and innovation and learning. Note, too, the broadening of the categories in the Balanced Scorecard, intended to widen the tool's appeal beyond manufacturing.

Arthur Schneiderman was vice president of quality and productivity improvement at Analog Devices from 1986 to 1993 and was instrumental in developing the company's card, and the first Balanced Scorecard (you might like to visit his website at www.schneiderman.com for more details on the scorecard's history and Schneiderman and others' roles in developing the original Balanced Scorecard).

We all know the pitfalls in moving from the particular to the general. What worked for Analog Devices in 1987 may not work for all organisations for all times. And, in fact, it doesn't, as I've witnessed many times. Numerous managers and employees have also told me so. It's a pity, then, that the Balanced Scorecard was presented and accepted as the great panacea for the rest of the unsuspecting world, via a *Harvard Business Review* article in 1992.

## Four inconsistent categories

The flaws in the Balanced Scorecard go well beyond the logical weakness of generalising from one particular case. There are conceptual inconsistencies also which cause it to unravel when applied. They lie in the differences in the measurement categories themselves.

Let's start by asking: Why these particular four measurement categories? Why do we have financial, customer, internal business process, and innovation and learning? What's the theory?

The answer is that there is none – nor have Kaplan and Norton ever sought to provide one in any of their publications. So the justification for the four "perspectives", as they're called, is simply that they seemed useful in Analog Devices at the time. That's just not good enough, as accountants will agree.

With no underpinning theory, the measurement categories are open to the charge of inconsistency. "Financial" relates to measures that can be put in dollar terms. "Customer" is concerned with a stakeholder. But wouldn't any measurement based on the customer group contain financial measures also, eg, dollars of revenue? The third category, described as "internal business process", has slipped additional gears. Whereas "customer" referred to a stakeholder type, and "financial" to a measurement type (in contrast to non-financial), "internal business process" is neither. It is simply a description of something. The last category, "innovation and learning", is also different from the other three, being a description of what organisations engage in. But then again, isn't it a process? In which case, why isn't it included in "internal business process"?

I'm sure that this leaves any accountant shaking their head. Kaplan and Norton certainly were when looking at the same issue in 1996 as they wrote, in the first of their numerous books, *The Balanced Scorecard*: "No mathematical theorem exists that four perspectives are both necessary and sufficient.

We have yet to see companies using fewer than these four perspectives, but, depending on industry circumstances and a business unit's strategy, one or more additional perspectives may be needed. For example, some people have expressed concern that although the Balanced Scorecard explicitly recognises the interests of shareholders and customers, it does not explicitly incorporate the interests of other important stakeholders, such as employees, suppliers and the community." (p.34)

## The solution

We have to catch the boat that Kaplan and Norton missed in failing to recognise that what lay behind Analog Devices' very specific tool was the company's stakeholders. In the quote from *The Balanced Scorecard* above, they seem to have belatedly recognised that their four-box model doesn't work. It has to be continually adapted to each organisation's situation. That's because the key stakeholders, those that determine an organisation's success

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or failure, differ from one organisation to the next.

During the period in which the Balanced Scorecard was taking shape in the US (and oblivious to its development) we designed a method in Australia that produces a Focused Scorecard – not balanced or a 'bit of everything', but one that is firmly focused on any entity's key stakeholders. With equal usefulness, the Focused Scorecard has been applied at the organisation level of diversified companies, to organisations in the public and not-for-profit sectors and to divisions, business units and teams within each of these. It can be applied to the receptionist at the front desk in any organisation just as well.

## Start with stakeholders

The first step to developing effective performance measures in each and every case is to ask: Who are your entity's key stakeholders? This is based on sound theory, stakeholder theory, and there's a whole body of literature on the topic.

In the case of a large law firm, the list of key stakeholders was easy to draw up: partners, clients, employees and the community. In the case of the manufacturing department in a company that supplied trusses, frames and other products to builders, the key stakeholders were: general manager, customers, suppliers, sales department, finance department and manufacturing employees. For the receptionist at check-in at a Hilton Hotel, the key stakeholders were: my boss, customers and colleagues.

## Develop a measures matrix

The second step is to work out and develop measures for what your entity wants from each key stakeholder, eg, revenue from customers, funds from owners, supplies in full and on time from suppliers, productivity

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from employees. These measures go into a "measures matrix", a long list from which an entity's shortlist – its "focused scorecard" – is later developed.

The third step is to identify and develop measures for what stakeholders want from your entity. In the case of the owners of a business, these items are generally financial returns, risk and company reputation. In the case of retail-store customers, these are customer service, store location, range of goods sold, hours of operation, store presentation and price. These "strategic factors", as we have labelled them, also link to how you write your entity's strategies. Measures developed on these for each key stakeholder also go into the measures matrix.

## Final refinements

The fourth step is to whittle down the long list of measures in the measures matrix to produce a shortlist – your focused scorecard. This yields, on average, about three measures per key stakeholder. Each selected measure has now become a KPI (key performance indicator). For an organisation with four stakeholders, this produces a scorecard of about 12 KPIs.

The fifth step is to design targets and measurement intervals for each KPI. A measurement interval is the time between readings taken on a KPI, such as monthly, quarterly, etc.

The final step is to use the assembled set of KPIs, targets, etc, on a regular basis to guide decision-making, allocate resources, take corrective action and generally manage the entity for which it was designed.

How often it is reviewed by a management team depends on the shortest measurement interval. If the KPI "dollar revenue from customers", for example, has a measurement interval of a month, then the scorecard needs to be reviewed monthly. Monthly reviews are the norm.

## Accountants should lead

At the beginning of one of my public seminars on performance measurement, I asked the group of accountants, managers and directors present: Why is performance measurement important? Here is a sample of their written responses:

- provides the element of check and balance that encourages efficiency in performance
- measures productivity and improvement
- links management and staff
- tells you whether you are achieving what you set out to achieve
- ensures you have the right people in the right places working towards a common known goal and achieving outcomes
- establishes what is working and what is not
- observes trends in a business
- sets apart performers from non-performers for remuneration levels, rewards, etc.

Performance measurement is clearly important. But you can't do any of this well if your scorecard of KPIs is faulty.

The Balanced Scorecard approach to developing KPIs is flawed. It's time for accountants to take the lead in their organisations and redesign the performance-measurement systems that exist.

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