

## BALANCED SCORECARD AND THE MANAGEMENT INSTRUMENTS COMPLEMENTARITY

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**Abstract.**

*The Balanced Scorecard (BSC) presents the quantitative goals selected from multiple perspectives for implementing the organizational strategy and vision. This article considers how Total Quality Management, Activity Based Management (ABM), Customer Value Analysis, EVA and Budgets approaches may complement a balanced scorecard effort. It briefly outlines how this tools are defined, considers their strengths and weaknesses. The paper concludes that when other tools used in conjunction with BSC approach, the resulting hybrid tool can be a powerful basis for encouraging organizational change and performance improvement.*

**Keywords:** strategic management, Balanced Scorecard, performance, Activity Based Management, Total Quality Management, Economic Value Added

**JEL Classification:** G39, M21

## 1. INTRODUCTION

Strategic management has become more and more important to different kinds of organisations. Development of a management and strategic planning system, including total quality management, moving towards the management of processes, improving customer intimacy, and better management of people are among the most topical management issues. Focusing on the future, and on the enablers, instead of only measuring the consequences of past actions, is essential.

Performance is the final result of all activities. Performance means the efforts extended to achieve the targets efficiently and effectively.

Efficiency means “*doing things right*” and effectiveness means “*doing the right things*” (Peter F. Drucker, 1981 p. 83.). Efficiency refers to the ability to get things done in the correct manner. It is the degree to which inputs are used in relation to a given level of outputs. A manager is regarded efficient when “*he achieves results or outputs that measures up to the inputs (i.e. labour, materials and time) used to achieve them. Managers who are able to minimise the cost of the resources, are able to attain their goals efficiently*” (Stoner, James A.F., 2006, p.13) .

Effectiveness has a different connotation from efficiency. “*Effectiveness is concerned with the effect of work on people, with the appropriateness of goals, with long term results and with humanistic and idealistic values. It is the ability to choose appropriate objectives. An effective manager is one who selects the right things to get done. A manager who selects an inappropriate objective is an inefficient manager. No amount of efficiency can compensate for lack of effectiveness*”(Stoner, James A.F., 2006, p.14) .

## 2. CONCEPT OF BALANCED SCORECARD

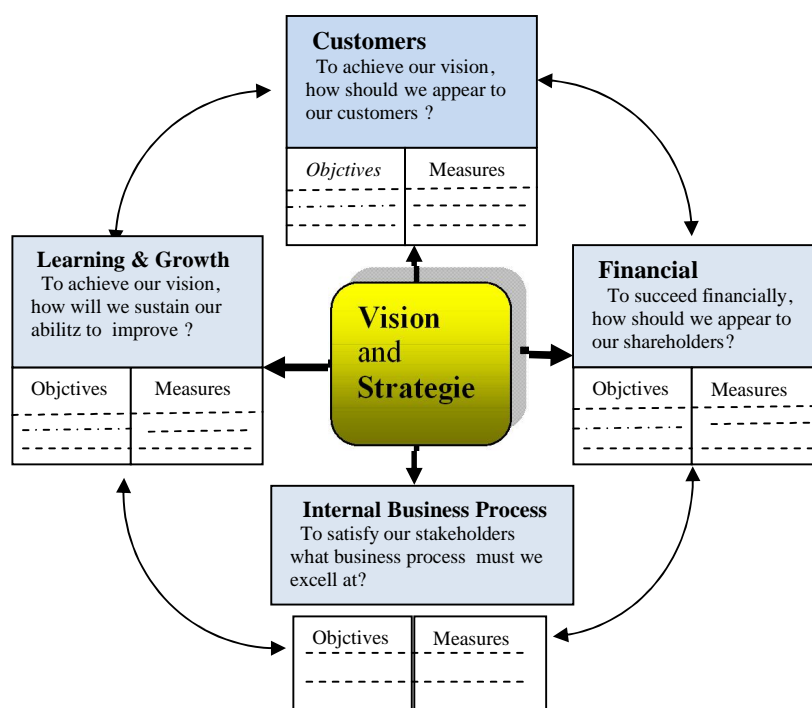
Balanced Scorecard is a new dimension in the field of performance evaluation. The concept of “Balanced Scorecard” was first introduced in the journal “Harvard Business Review” (January-February, 1992) by Robert S. Kaplan and David P. Norton . Aim of this model is to give managers and leaders a comprehensive view of the business and allow them to focus on critical areas, as customer perspective, financial perspective, internal business perspective and innovation and learning (Wongrassamee, Gardiner and Simmons, 2003) . The Balanced Scorecard is a simple yet powerful concept. It has evolved based on the recognition that organizations create value for shareholders in several ways:

- through synergies and linkages based on corporate strategies- at the corporate level;
- with emphasis on creation of a differentiated value proposition- at the Strategic Business Unit (SBU) level;

- by reducing the risk of a shareholder's investment through transparency and governance - at the board level.

The organization's overall vision and strategy are particularized for the various organizational structures within each of these dimensions -e.g., accounting for the financial dimension, marketing and customer support for the customer dimension, logistic for business processes, and human resources and business development for the learning and growth dimension. Metrics for calibration performance against the specific strategic goals of the organization's structures are then devised.

Kaplan and Norton describe the innovation of the balanced scorecard as follows: *"The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation."*



**Fig.1. Balanced Scorecard adapted from Kaplan and Norton**

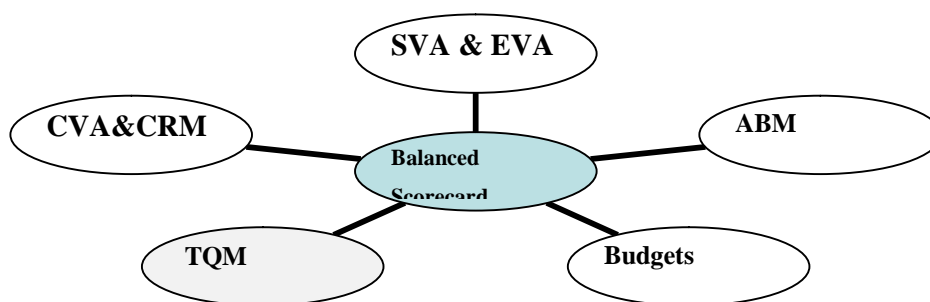
The concept of Balanced Scorecard is new by its name but not by its origin. It has made only a development over a number of existing concepts and theories like Activity Based Management, Management By Objectives, Total Quality Management, Strategic Management, Behavioural Theory Of Economics, Delegation Of Authority, Decentralization Of Decision -Making etc.; but what is unique about Balanced Scorecard is that it brought and pooled together the benefits of such theories and concepts into a single integrated measure of corporate performance covering all aspects of an organization.

The appropriate performance measurement tool should be:

- Relevant to the strategic goals of the organization and accountable to the individuals concerned.
- Focus on measurable outputs.
- Verifiable.

One of the strengths of the Balanced Scorecard is the ability to work well in combination with existing management theories and associated tools. Figure 1 shows the BSC at the centre of a

strategic management system and five other management tools that can be applied in the pursuit of strategic goals.



**Fig.1. Links to Balanced Scorecard**

Further we look at how some of these common management tools can link with the Balanced Scorecard.

### 3. TOTAL QUALITY MANAGEMENT (TQM)

Total Quality Management, TQM, is a management philosophy that seeks to integrate all organizational functions (marketing, finance, design, engineering, and production, customer service, etc.) to focus on meeting customer needs and organizational objectives. It is a method by which management and employees can become involved in the continuous improvement of the production of goods and services. The goal of TQM is to deliver the highest value for the customer at the lowest cost, while achieving sustained profit and economic stability for the company. Top management must commit to a vision and align and train its employees toward a common mission. Finally, it is a combination of quality and management tools aimed at increasing business and reducing losses due to wasteful practices.

The BSC and TQM share a common theme of improving communication in an organization. Organizations must communicate their mission and goals to their employees and customers. Communication links employees and customers to achieve the ultimate goal of an organization, which is to provide *“the best product, at the lowest cost, at the right time.”*

Other shared goals of the BSC and TQM are the reduction of costs and improvement of services of an organization. The BSC and TQM base decisions on quantitative data and not opinion, to improve services and reduce costs. Furthermore, each management tool stresses the importance of organizations managing the system and not the people. By analyzing the business process, companies reengineer business processes and improve the overall product quality and services while reducing costs. Another similarity between the BSC and TQM is top management support; each is a long-term process. Top management support is vital to ensure that all employees support the new initiatives. Without it, each of the business measurement/management systems will fail. People within an organization generally resist change, and it is the job of the chief executive officer/commander to inform employees and customers of any changes within the organization. Neither measurement/management system is a quick fix solution. Although most organizations may see initial improvements, the true benefits will not be seen for 1 to 5 years. As a result, top management must encourage employees to support whatever strategy the company adopts.

The major difference between the BSC and TQM is that the BSC places more emphasis on finance. TQM does not diminish the importance of financial solvency but focuses more on the system(s) of the organization, the concept of empowering people, and employee involvement.

### 4. CUSTOMER VALUE ANALYSIS AND CRM

From the outside, customers interacting with a company perceive the business as a single entity, despite often interacting with a number of employees in different roles and departments. The

higher level of product or service quality means higher level of customer satisfaction and results in better customer loyalty and high level of profitability (Ghobadian, A., Speller, S. and Jones, M., 1993). To transfer the quality to service means to satisfy customers' requirements. So that the firms aspiring to adopt the customer oriented approach should determine the customer requirements and associate the customer requirements with service design and capabilities. (Chow-Chua, C. and Komaran, R., 2002)

Customer relationship management (CRM) consists of the processes a company uses to track and organize its contacts with its current and prospective customers.

Several CVA/CRM frameworks have evolved over the years. One illustrative framework (Ghobadian, A., Speller, S. and Jones, M., 1993) decomposes the customer problem down to three top-level areas, with further decomposition beneath each of the three:

- Value equity refers to the customers' perceptions of value ;
- Brand equity refers to the customers' subjective appraisal of the brand ;
- Retention equity refers to the firm building relationships with customers and encouraging repeat-purchasing.

These three areas correspond to three distinct disciplines in the CVA/CRM and marketing literature (brand management, customer value analysis, and customer loyalty analysis) —each with its own detailed measurement approaches.

The implications for organizational performance measurement systems are clear: measuring business activities and outcomes regarding customers is becoming increasingly complex and increasingly important to the successful execution of a firm's strategy.

Proponents of the BSC note that the BSC framework includes the customer as one of four perspectives, while CVA and CRM techniques fail to account for important noncustomer aspects of a business. That being said, CVA and CRM are often used by BSC practitioners to drive improvements in the customer perspective of the BSC. In other words, the benefits of CVA and CRM technologies are increasingly used in a BSC framework evaluation.

## 5. SHAREHOLDER VALUE & ECONOMIC VALUE ADDED

Value dimensions identified include market, supply chain, customer, enterprise, and product and service, and therefore the adapted value-based BSC framework contains market, supply chain, customer, as well as business structure and process as balanced perspectives.

Shareholder value has become an increasingly important demand among investors now more than ever. In the 1980's, shareholder activism reached unforeseen levels among companies in the United States. (Mäkeläinen 1998, p.1)

The theory of Economic Value Added has traditionally suggested that every company's primary goal is to maximize the wealth of its shareholders, which should be a given since it is the shareholders that own the company and any sensible investor expects a good return on his investment. Economic value added is a fashionable management performance measure pioneered by Stern Stewart & Company, a management consulting firm. EVA emphasizes the residual wealth creation in a company after all costs and expenses have been charged including the firm's cost of capital invested. In its simplest terms, EVA measures how much economic value the company is creating, taking into account the cost of debt and equity capital. EVA is designed to give managers better information and motivation to make decisions that will create the greatest shareholder wealth.

Since EVA is a single metric (although it can cascade down and across an enterprise to evaluate the performance of specific investments) it is complementary to the BSC and can be included in a BSC framework (for example, as a financial perspective measure ). Because it is a pure financial model, EVA does not serve as a vehicle for articulating a strategy but when coupled with the BSC, the tradeoffs between short-term productivity improvements and long-term growth goals can be managed. (Kaplan, Robert, 2001)

## 6. ACTIVITY BASED MANAGEMENT (ABM)

Activity-Based Management (ABM) is a discipline that focuses on the management of activities to maximize the profit from each activity and to improve the value received by the customer. This discipline includes cost-driver analysis, activity analysis, and performance measurement. ABM draws on ABC as its major source of information.

The concept of ABC looks at how resource costs like salaries, utilities and rental, are consumed by work activities, which are components of various processes in an organisation. The activities and processes are in turn consumed by the output of the organisation. The output includes products and services provided to the customers.

Using the ABC approach, companies get insights into profitable and profitless activities based on a customer or a product viewpoint. ABC then is a way of measuring which of the firm's activities generate revenues in excess of costs and, as a result, provide keen insight into what is really providing value for customers. (Meyer, Marshall W. 2002)

A major benefit of ABC is thus higher accuracy in products and services costing, and hence in profitability computations. Bear in mind that in today's competitive environment, profitability analysis is not just about looking at the last figure in the Profit & Loss statement. It is more about knowing which the profitable products are and which the unprofitable ones are. Above all, the ABC methodology provides critical information for the effective management of the activities and processes of the organisation.

ABC is used by many organizations that implement the BSC because ABC enables businesses to more accurately define and measure their metrics. While firms will likely benefit from ABC, the system is mainly an accounting and cost-based method of viewing and analyzing an organization and its activities. ABC also lacks the strategic and nonfinancial elements that are captured in the BSC.

The BSC benefits from the inclusion of ABC performance measures. These include the cost of activities and activity outputs which are used in the internal business process dimension of the BSC of the organizations. This activity information covers support services as well as primary business processes. For companies, ABC profit measures by customer, market segment, market area and distribution channel are used in the customer dimension of the BSC. Thus, most successful firms use ABC and BSC to manage costs and gain insight into their internal competitive advantages.

## 7. BUDGETS

A “budget” can be described as an action plan to transform strategic goals into action and lead the company toward achieving its goals. Simply, a budget is a plan that identifies the financial resources required to achieve programmatic objectives. Once constructed, this plan assists staff and board in managing the organization both programmatically and financially throughout the year. Budgeting is done by estimating values for various financial parameters relating to future financial requirements in all organizational activities. This starts with an estimation of ‘sales’, covers the “recruitment needs” to accomplish this, zeroing on the “appropriate sources of funds” and “arranging for the repayments of debts, if any”. Some of the directions in which Balanced Scorecard can be formed include management perspective, structural perspective, continuous improvement and learning, and conformance perspective.

Understanding budgeting is a core competency for all leadership teams. The budgeting process, if applied correctly, can effectively manage a company's operations. But its approaches and techniques need to be improved in accordance with changes in the company's business environment or objectives in corporate management.

