A BALANCED SCORECARD FOR SMALL BUSINESS

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ABSTRACT

The balanced scorecard (BSC) approach helps organizations manage the implementation of their strategies. The BSC measures an organization's performance from four key perspectives: financial, customer, internal business processes, and learning and growth. Improvements in employee learning and growth result in improved internal business processes, which create better products and services and, therefore, higher customer satisfaction and higher market share, as evidenced by enhanced financial results for the organization.

For a decade, large firms have subscribed to the BSC approach, with mixed results. Most failures follow an inconsistent or half-hearted application of the BSC, or an unwillingness to consider the BSC a dynamic process of self-improvement. Small firms can benefit from the BSC approach by avoiding pitfalls of large firms whose BSC implementations failed.

INTRODUCTION

Elite companies successfully apply performance measurement to analyze and judge their programs, processes, and people (Amaratunga, Baldry, & Sarshar, 2001). One criticism of such programs is their failure to measure and monitor multiple dimensions of performance by focusing almost exclusively on financial measures (Brignall & Ballantine, 1996). Studies by Dixon, Nanni, & Vollman (1990), Ernst & Young (1998), Neely (1998), and Daly (1996) suggest that a comprehensive performance evaluation system has greater predictive validity than one that is purely financially oriented. Kaplan and Norton (1992; 1993; 1996a; 1996b; 2000) advised that long-term organizational excellence can be achieved only by taking a broad, holistic, and balanced approach and not by focusing solely on financials. Using the BSC approach, managers are encouraged to take a "balanced view across a range of performance measures" (Amaratunga *et al*., 2001, p. 180) including "…financial and nonfinancial measures relating to a company's critical success factors" (Chow, Haddad, & Williamson, 1997, p. 7).

This paper discusses BSC as a tool applicable to small business. First, we outline the BSC approach and illustrate some applications. Next, we present the context, strengths, and challenges of a BSC approach. Then we discuss the applicability of a BSC to small business and what it might look like for a small organization. A summary concludes the paper.

THE BSC

The BSC is an integrated set of financial and non-financial measures used in an organization's strategy execution process that emphasizes communicating strategy to the members and providing feedback to help attain objectives (Mendoza & Zrihen, 2001). The scorecard can be used at different levels for the total organization or a sub-unit, or as a “personal scorecard.” For each level, the BSC approach identifies key components of operations, sets goals for them, and finds ways to measure progress toward them. This trend toward seeking better measurement systems is well documented. Birchard (1995) and Kurtzman (1997) report that most US companies seek improvements in performance measurement. Their concern is that measurement systems that focus on the wrong aspects of performance can undermine the enterprise's strategic mission by perpetuating short-sighted business practices (Hoffecker & Goldenberg, 1994).

The BSC is based on several underlying notions. First, because financial measures alone do not adequately measure the health of a company, a single-minded pursuit of financial objectives could lead to long-term ruin. Second, because BSC focuses on process, not metrics, it is forward-looking rather than backward-looking. Third, the scorecard is an analytic framework both for translating a company’s visions and business strategies into specific, quantifiable goals and for monitoring performance against those goals. When fully deployed, the BSC transforms strategic planning from an academic exercise into the nerve center of an enterprise (Figure 1). Kaplan and Norton further describe the innovation of the BSC as follows:

> “The BSC 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” (1996b, p. 7).

There is general agreement that a typical BSC would include the following four components in some form: learning and growth perspective, internal business process perspective, customer perspective, and financial perspective (Horngren, Foster, & Datar, 2000). Inherent in this model is the idea that “gains in the learning and growth perspective lead to improvements in internal business processes, which in turn lead to higher customer satisfaction and market share, and finally to superior financial performance” (Horngren *et al*., 2000, p. 467). Thus, the BSC scheme is organized and rational and identifies for employees and management the importance of each perspective as a feeder of success into the next perspective.

Insert Figure 1 about here

The learning and growth perspective

This perspective includes employee training and corporate cultural attitudes related to individual and organizational self-improvement. In a knowledge-worker organization, people—the only repository of knowledge—are the main resource and should be in a continuous learning mode. Frequently cited BSC measures for the learning and growth perspective emphasize employee capabilities, information systems availability, and motivation and empowerment. Kaplan and Norton (2000) emphasize that learning includes not only training, but also mentoring, ease of communication among workers, and technological tools.

The internal business process perspective

Metrics based on this perspective allow managers to evaluate how well their business is running, and whether products and services conform to customer requirements (the mission). These metrics must be carefully designed by those who know these processes most intimately; with firms' unique missions these cannot be developed exclusively by outside consultants. Frequently cited BSC measures for the internal business process perspective include the innovation process, operations process, and post sales service.

The customer perspective

Managers increasingly realize the importance of customer focus and customer satisfaction in any business (Chabrow, 2003; Holloway, 2002; Needleman, 2003). Dissatisfied customers will find other suppliers who meet their needs. Poor performance from this perspective is thus a leading indicator of future decline, even if the current financial picture looks good. In developing metrics for satisfaction, the kinds of customers and the kinds of processes needed to provide a product or service to those customers should be analyzed. Frequently cited BSC measures for the customer perspective include market share, customer satisfaction, and customer retention percentage.

The financial perspective

Kaplan and Norton do not disregard the traditional need for financial data. Timely and accurate funding data will always be a priority and, with the implementation of a corporate database, more of the processing can be centralized and automated. Frequently cited BSC measures for the financial perspective include operating income, economic value added, and return on investment.

Extant BSC implementations

Several articles and books discuss the advantages of the BSC and its application in the for-profit sector (e.g., Hoffecker & Goldenberg, 1994; Kaplan & Norton, 1992; 1993; 1996a; 1996b; 2000; Kurtzman, 1997; Maisel, 1992; Migliorato, Natan, & Norton, 1996; Newing, 1994; 1995). Among the numerous successful users of the BSC are the AM & R division of Mobil Oil, Tenneco, Brown and Root, AT&T, Intel, 3Com, and Elf Atochem.

Adopters in the service sector include the international accounting firm Ernst and Young (Vitale, Mavrinac, & Hauler, 1994), the Bank of Montreal (Birchard, 1995), Allstate Corp. (Birchard, 1995) and Cigna Insurance's property-and-casualty division (McWilliams, 1996). Even non-profit organizations such as universities (e.g., U. of California at San Diego) and governmental agencies (e.g., Department of Commerce) have embraced the BSC to help them become more effective (Relyea, 1998; Haddad, 1999).

CONTEXT, STRENGTHS, AND CHALLENGES OF THE BSC

Context

According to Abernathy (2000), the typical employee does not understand the organization's strategy and consequently fails to focus on the right things, and does not know how well he or she is doing or how to improve strategic results and thus, assuming performance is adequate, does not try to improve. Some employees also pursue personal rather than organizational goals, because of disharmony between employee and organizational strategies and goals (Kerr, 1975). In such an environment, organizational suboptimization is the result of sub-organizational optimization. Frigo and Krumwiede (2000) suggest that the BSC can help remedy this situation because it requires engagement in several beneficial activities, as outlined in the next section.

Strengths

First, the BSC approach is a focus on the company's strategic direction. While the idea of tailoring a company's performance measurement system to its strategy is commonsensical, several studies note that too many firms fail to implement it properly. Kerr (1975), for example, described how many companies' performance measurement systems rewarded behaviors other than desired behaviors (e.g., firms often hope for teamwork but reinforce individual effort).

Second, the implementation of performance measures for each perspective clearly relate to each other and to the mission of the organization. Thus, communicating the importance of each activity as a crucial link in the larger chain of events offers employees an appreciation of the context in which each task is performed and the context in which each result will be evaluated.

Third, the BSC approach limits the number of performance measures used and avoids a proliferation of measures and focuses management attention on measures crucial to the successful implementation of strategy. The BSC avoids the tendency to engage in the "majoring in the minors" characteristic of many managers (Busby, 1999; The Nielson Group, 2003).

Finally, implementing the balanced scorecard is a beneficial activity because it responds to common questions raised in annual employee motivation surveys, such as "How does what I do every day fit into the bigger picture of the company?" The BSC enables employees to understand what they need to do on a daily basis to impact results (Gumbus & Lyons, 2002, p. 49).

Challenges of the BSC

In many cases, the BSC delivers improvements over what existed before. But almost any organizational intervention triggers the Hawthorne effect (Kenny, 2003), named for studies that showed that attention placed on the activities being measured invariably led to performance improvements. Hence, early BSC successes may simply be a manifestation of this phenomenon.

Although the BSC is comprehensive in its coverage of perspectives, an organization might do better by focusing on one or more but not all of the four areas, because different strategies have different requirements for success. Indeed, Slater, Olson, and Reddy (1997) argued that the scorecard should be “unbalanced.” Using Treacy and Wiersema's (1993, 1995) “value disciplines,” they posited that product leaders should emphasize the innovation and learning perspective; the operationally excellent should emphasize the internal business perspective; and all of the value disciplines should pay attention to the financial perspective.

This “unbalanced” perspective is supported by Olson and Slater (2002) who found that as a group, prospectors (organizations seeking to locate and exploit new product and market opportunities; Miles & Snow, 1978) emphasized the innovation and growth perspective, and high-performing low-cost defenders placed greater emphasis on the financial perspective than did low-performing ones. McAdam & O’Neill (1999) suggest that the BSC method may divert resources from those few areas vital to shareholder return and does not readily weight the relative importance of the metrics it uses.

THE APPLICABILITY OF THE BSC TO SMALL BUSINESS

Many large organizations have identified the BSC methodology as their chosen approach for deploying strategic direction, communicating expectations, and measuring progress towards corporate objectives. According to a recent survey by Bain & Company, approximately 50% of *Fortune* 1,000 companies in North America and about 40% in Europe use a version of the BSC (Gumbus & Lyons, 2002). Heaney (2003) indicates that the BSC is used by over half of the companies in *Fortune’s* Global 1000 companies. Large international firms tend to face more competitive environments, have more products and processes to coordinate and monitor, and have more resources for undertaking change initiatives. Small or local companies have different needs, and what works for large companies may be ineffective or unnecessary for them (Chow *et al*., 1997).

However, the benefits of the BSC can be just as significant for small businesses, who focus mostly on financial goals, because they are often fighting for survival and it is difficult to make plans for the future when most of the effort is directed to making ends meet in the present (DeFeo, 2000). Most small firms require lower volumes of information to carry out their operations and evaluate their performance than do their larger counterparts. Nonetheless, the value of the information, and the communication of that information within the small firm, is crucial to the success of the small firm. Therefore, while the scope and magnitude of performance evaluation across the firm may be less in the small firm, the need for, and the benefits of, an effective system of performance evaluation is vital to all firms. Small firms enjoy innate advantages in their ability to achieve consensus and impart to employees news of change. The smaller number of interested internal parties reduces challenges to effective communication and facilitates corporate-wide team participation. It is easier to get ten people on board than it is to get ten thousand people on board, and it is easier to identify a party or parties not on board within a group of ten than within a group of ten thousand.

The underpinnings of the BSC approach are as relevant to the small firm as to the large. Small firms have employees performing operational tasks and processes. If the employees are effective and efficient (i.e., sufficiently trained and motivated), then internal business processes will be efficient. Efficient operations run by effective employees should generate higher quality output, which will attract and keep satisfied customers. Repeat customers contribute marginally more to the firm's bottom line than do new customers who must be wooed. In short, the BSC can work as well for the small firm as for the large firm. The BSC's complexity may be diminished and its formality may be dampened in the context of a small firm, but neither its importance nor its utility suffers negative consequences related to firm size.

CONCLUSION

The BSC emphasizes measurement in four key business perspectives that results in a more comprehensive evaluation of the organization than the traditional emphasis on tangible and financial assets. Incorporating these perspectives in the BSC offers a framework for translating strategic objectives into performance measurements that gauge the effects of implemented strategies and provide feedback on the performance of strategic initiatives.

We believe that the BSC offers some useful generic performance measurements that apply to practically all organizations. Companies, small or large, need to know how they measure up to their own goals and standards, and the BSC can give them the advantage they need to evaluate themselves accurately and, as a result, place themselves in a better position to compete. The main goal for small business is to manage their overall performance so that they make a profit. Birch (1998) said it best when he indicated that "The key point to remember is that what get measured gets managed" (p. 45).

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Figure 1. Key perspectives in the balanced scorecard approach to increasing organizational excellence. Adapted from the Balanced Scorecard Institute.