

**FINANCIAL ACCOUNTING**

**RESEARCH PAPER**

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**BALANCED SCORECARD**  
**&**  
**ITS FINANCIAL IMPLICATIONS**

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## **ABSTRACT**

The purpose of writing this research paper on the balanced scorecard is to show how it outweighs other evaluation methods and techniques, which include Return on Investment (ROI), Residual Income (RI) and Economic Value Added (EVA). It is a performance evaluation method, which unlike other methods, conglomerates the financial perspective of the business with the remaining three perspectives and gives the overall performance picture of the organization.

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## **INTRODUCTION**

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The balanced scorecard is a strategic planning and management system that is used extensively in business and industry, government, and nonprofit organizations worldwide to:

- align business activities to the vision and strategy of the organization
- improve internal and external communications
- monitor organization performance against strategic goals
- capture efficiency and effectiveness
- balance on goals and measures

The first balanced scorecard was created by Analog Devices in the year 1987. The development process of the balanced scorecard continued till 1992 when it finally came into practice. However, it was still not very common and only a limited number of companies placed it into use.

It was originated by Robert Kaplan and David Norton of Harvard University in 1990; but the roots of the balanced scorecard are deep, and include the pioneering work of General Electric on performance measurement reporting in the 1950's and the work of French process engineers (who created the Tableau de Bord – literally, an instrument panel or dashboard of performance measures) in the early part of the 20th century in France.

An article by Robert Kaplan and David Norton entitled "The Balanced Scorecard - Measures that Drive Performance" in the Harvard Business Review in 1992 sparked interest in the method, and led to their business bestseller, "The Balanced Scorecard: Translating Strategy into Action", published in 1996.

There is nothing new about using key measurements to take the pulse of an organization. What is new is that Kaplan and Norton have recommended broadening the scope of the measures to include four areas:

- financial performance
- customer knowledge
- internal business processes
- learning and growth

This allows the monitoring of present performance, but also tries to capture information about how well the organization is positioned to perform well in the future.

Kaplan and Norton cite the following benefits of using the balanced scorecard:

- focusing the whole organization on the few key things needed to create breakthrough performance
- helping to integrate various corporate programs, such as quality, re-engineering, and customer service initiatives
- breaking down strategic measures to local levels so that unit managers, operators, and employees can see what is required at their level to roll into excellent performance overall

## LITERATURE REVIEW

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### **“The Balanced Scorecard: Translating Strategy into Action” (HBSP, 1996), by Robert S. Kaplan & David P. Norton**

This book is the most comprehensive and complete publication about the balanced scorecard, as its authors play a highly important role in the development and implementation of this performance metric. Although the roots of the balanced scorecard date back to the 1050’s, but Kaplan and Norton were the ones who conducted the first formal research on this topic at Harvard University in the early 1990’s.

### **Balance Scorecard: Its Benefits, by Dr. Shaliesh Thaker**

This article states the key benefits of using a balanced scorecard. The author says that it leads to better strategic planning, improved strategy communication, better management information and improved performance reporting.

### **Cascading the Balanced Scorecard: A Case Study on Nova Scotia Power, Inc.**

In this article Paul R. Niven tells us how Nova Scotia Power, Inc. uses the balanced scorecard. The basic theme of the case study is that although initially the balanced scorecard was used solely as a tool to gauge the company’s effectiveness in fulfilling its new strategy, it now uses the BSC as a measurement system, strategic management system, and communication tool. It essentially tells us how to cascade a balanced scorecard throughout the organization and align with strategic goals and objectives.

### **“Top Ten Reasons for a Performance Measurement System” by Paul Arveson 1998**

This article, as the title says, is about the top ten reasons for a performance measurement system. It tells us that such a system reduces process cost, allows an agency to align its strategic activities to the strategic plans, provides a rational basis for selecting what businesses process improvements to make first, allows managers to identify best practices in an organization, supports better and faster budget decisions, provides accountability and incentives based on real data, permits benchmarking of process performance against outside organizations and helps in estimating costs more accurately for future projects. The article also mentions the Government Performance and Results Act of 1993 which requires a strategic plan, and a method of measuring the performance of strategic initiatives.

## **FINDINGS & DISCUSSION**

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The Balanced Scorecard Approach is being used by the US government among others. Taxpayers, the ultimate customers of government, are demanding more accountability for the use of their funds. They want to see tangible results from all government agencies, at all levels. In the U.S., this demand is reflected in the Government Performance and Results Act of 1993, one of the most influential laws affecting how the Federal Government works. More recently, the President's Management Agenda, promulgated by the Office of Management and Budget, includes language requiring performance-based scoring and budgeting of all activities of agencies in accordance with top-level strategies. The balanced scorecard is the only framework readily available that can align strategy, performance and budgeting to meet these requirements. Therefore, government agencies are increasingly looking to the balanced scorecard approach

The balanced score card serves as the front end for a performance based budget. Its performance measures provide rational guidance for budget formulation and resource allocation.

Typically, building and implementing the enterprise-level balanced scorecard takes two to three months. Developing aligned scorecards for business and support units and teams and individuals takes another three to six months. These estimates are for a complete strategic planning and management system and include the management, leadership development, and communications strategies and planning activities that make the scorecard system sustainable. The development process needs to be undertaken by a cross-functional team guided by an experienced balanced scorecard facilitator.

The balanced score card has the following advantages:

- It makes strategy operational by translating strategy into performance measures and targets.
- It helps focus entire organization on what must be done to create breakthrough performance.
- It integrates and acts as an umbrella for a variety of often disconnected corporate programs, such as quality, re-engineering, process redesign, and customer service.
- It breaks down corporate level measures so local managers, operators, and employees can see what they must do well in order to improve organizational effectiveness.
- It involves strategic initiatives that follow "best practices" methodologies cascade through the entire organization.
- It leads to increased creativity and unexpected ideas.

- It helps align key performance measures with strategy at all levels of an organization.
- It provides management with a comprehensive picture of business operations.
- The method facilitates communication and understanding of business goals and strategies at all levels of an organization.
- Maximized Cooperation - team members are focused on helping one another succeed.
- Usable Results - transforms strategy into action and desired behaviors.
- The Balanced Scorecard concept provides strategic feedback and learning.
- A cross organizational team - more open channels of communications - enthusiastic people.
- Initiatives are continually measured and evaluated against industry standards
- It helps reduce the vast amount of information the company IT systems process into essentials.
- It provides unique competitive advantage by:
  - reduced time-frames
  - improved decisions and better solutions
  - improved processes

There are disadvantages to this technique too; which are stated below:

- It is not a quick fix approach; it takes considerable thought to develop a scorecard.
- It takes quite a while for the balanced scorecard to be staged.

Balanced Scorecard is a better evaluation method as compared to other financial evaluation methods since it captures the four major perspectives of the business namely the financial, customer, learning and growth and businesses process perspectives. The other performance evaluation tools i.e. ROI, RI and EVA only focus on the financial perspective.

ROI (return on investment) is how much profit or cost saving is realized. An ROI calculation is sometimes used along with other approaches to develop a business case for a given proposal. The overall ROI for an enterprise is sometimes used as a way to grade how well a company is managed.

Formula:

**ROI= capital turnover × return on sales**

On the other hand, RI (residual income), is the amount of income that an individual has after all personal debts, including the mortgage, have been paid. This calculation is usually made on a monthly basis, after



the monthly bills and debts are paid. Also, when a mortgage has been paid off in its entirety, the income that individual had been putting toward the mortgage becomes residual income.

Formula:

**RI= Operating Earnings - (minimum acceptable return × invested capital)**

Last but not the least, EVA is a measure of a company's financial performance based on the residual wealth calculated by deducting cost of capital from its operating profit (adjusted for taxes on a cash basis- also referred to as "economic profit")

Formula:

**Net Operating Profit after Taxes (NOPAT) - (Capital \* Cost of Capital)**

The financial perspective measures of the balance score card include not only the three above mentioned performance evaluation methods but also capital turnover, return on sales, net income and bond ratings.

A software developed by Microsoft Corporation by the name of Microsoft dynamics allows the easy use of a balanced scorecard (see appendix 1).

Nowadays a number of companies have shifted to the balance score card approach in countries like USA, Canada, Japan, Netherlands, etc. These companies are either high school or university level institutes or from the banking, retail, insurance and health care sectors. (Refer to appendix 2)

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## CONCLUSION

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We can conclude by saying that the development and use of the Balance Scorecard technique has marked a higher rank among the old performance evaluation techniques. Despite certain disadvantages it had benefits which exceed and over shadow its shortcomings and definitely aid managers in the evaluation of their business.

## **METHODOLOGY**

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While deciding the topic for this research paper, we took help from our teacher. The main pattern and layout was given to us beforehand. After deciding the topic most of the research was done on the internet. We consulted different websites and articles, taking notes and relevant information. After that we organized, summarized and structured all the material which resulted in the final form of the research paper.

It basically starts with the definition of the balanced scorecard, followed by a brief history. The Literature review has information about some books and articles written by various people about the topic at hand. This is followed by a discussion on the different aspects of a balanced scorecard, its advantages and shortcomings, and its financial implications. Comparison with other methods and ratios lead to the final conclusion.

## REFERENCES

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- Quick Mba Accounting  
[http://www.quickmba.com/accounting/mgmt/balanced-scorecard/\)](http://www.quickmba.com/accounting/mgmt/balanced-scorecard/)
- Articles at [www.scribd.com](http://www.scribd.com)
- Microsoft Dynamics

# APPENDIX

## Appendix 1: Balance Scorecard in Microsoft dynamics

Microsoft dynamics is a term which can help translate a company’s visions and strategies into an integrated set of performance and action. They help you monitor and optimize a company’s performance. With the functionality of a balance scorecard a company can measure how well it is realizing its strategy.

With the help of Microsoft dynamics you can actually track your business performance. Your goals can be broken down into measurable targets for each organizational unit—right down to the individual employee. Once these targets are entered into Microsoft Dynamics AX, progress towards achieving them is continually tracked using a range of data such as financial and operational measures, customer satisfaction data and overall growth.

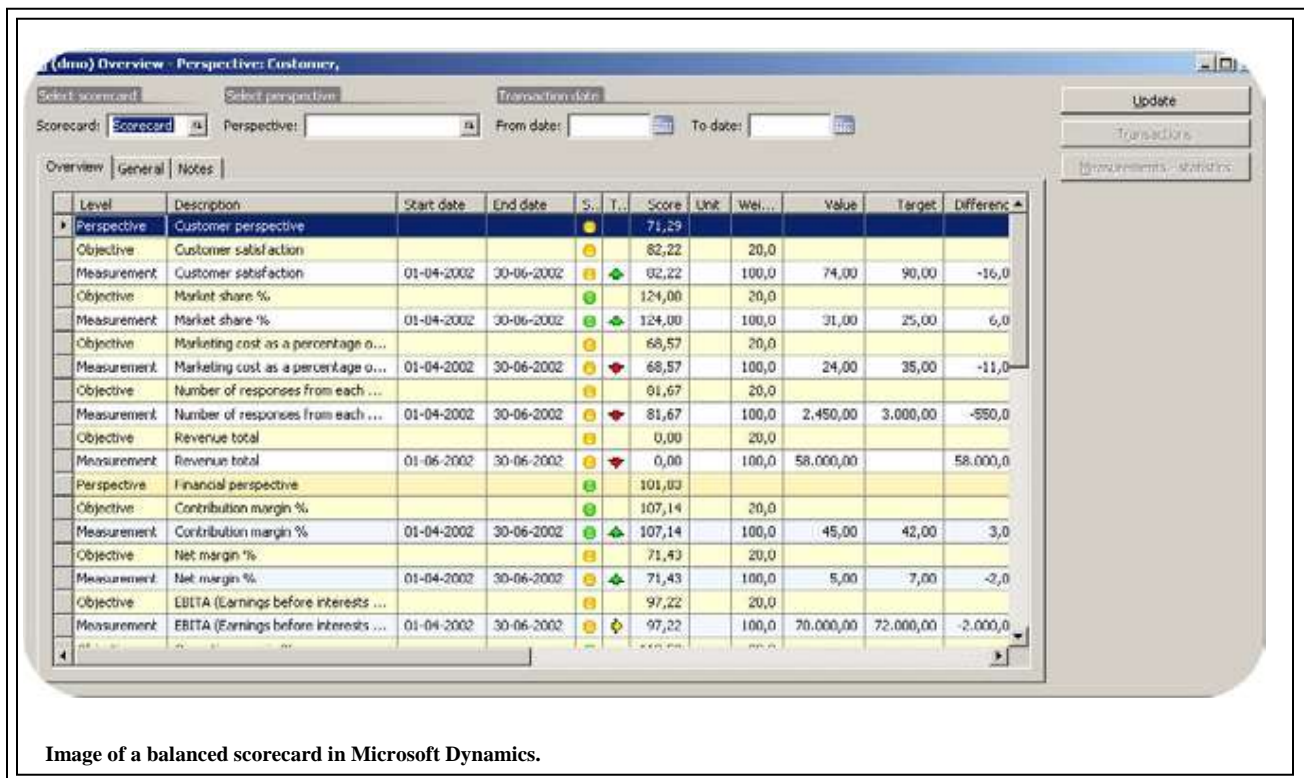


Image of a balanced scorecard in Microsoft Dynamics.

## **Appendix 2: Corporations which have adopted the Balanced Scorecard**

Allfirst Bank	Banking		USA
Ann Taylor Stores	Retail		USA
AT&T Canada Long Distance	Telecommunications		Canada
Bank of Tokyo-Mitsubishi	Banking		Japan
Blue Cross Blue Shield of Minnesota	Health Care		USA
BMW Financial Services	Financial Services		Germany
Bonneville Power Administration	Utilities		USA
Boston Lyric Opera	Entertainment	Boston	USA
British Telecommunications Worldwide	Telecommunications		UK
CA Poly. State Univ. San Luis Obispo	Financial Services	San Luis Obispo	USA
California State University system	Higher Education		USA
California State University, Pomona	Higher Education		USA
Carleton University	Higher Education	Ottawa	Canada
Caterpillar, Inc.	Manufacturing		USA
Charleston Southern University	Higher Education	Charleston	USA
Chemical Bank	Banking		USA
Cigna Property & Casualty	Insurance		USA
Citizen Schools	Middle Schools	Boston	USA
City of Charlotte	Local Government	Charlotte	USA
Cornell University	Higher Education	Cornell	USA
Crown Castle International Corp.	Telecommunications		USA
DaimlerChrysler	Manufacturing		Germany
Datex-Ohmeda	Health Care Supplies		USA
DDB Worldwide	Marketing		USA
Defense Logistics Agency	Government		USA
Devereux Foundation	Health Care		USA
Duke University Hospital	Health Care		USA
DuPont	Manufacturing		USA
Entergy	Energy	New Orleans	USA
Equifax, Inc.	Financial Services	Atlanta	USA

ExxonMobil Corp.	Energy		USA
Fannie Mae	Banking	Washington	USA
Finnforest, UK	Natural Resources		UK
First Energy Corp.	Energy		USA
Ford Motor Company	Manufacturing		USA
Fort Hays State University	Higher Education	Hays	USA
Foster Farms	Agriculture		USA
General Electric Company	Manufacturing		USA
High Performance Systems, Inc.	Information Technology		USA
Hilton Hotels Corp.	Hospitality		USA
Homestead Technologies	Internet Communication		USA
Honeywell	Manufacturing		USA
IBM	Information Technology		USA
Illinois Benedictine College	Higher Education		USA
Indiana University	Higher Education		USA
Ingersoll-Rand	Manufacturing		USA
International Data Corp.	Information Technology		USA
KeyCorp	Financial Services		USA
Lawrence Hospital	Health Care	Westchester	USA
Link List	Multiple		USA
Link List	Multiple		USA
Lloyds TSB Bank	Banking		UK
May Institute	Health Care	Norwood	USA
McCord Travel Mgmt (WorldTravel BTI)	Leisure and Travel		USA
MDS	Health and Life Science		USA
Media General	Media		USA
Mercury Computer Systems, Inc.	Information Technology		USA
Mercury Computer Systems, Inc.	Information Technology		USA
Mobil North American Marketing & Refining	Energy		USA
Montefiore Medical Center	Health Care		USA
National City Bank	Banking	Cleveland	USA
National Reconnaissance Office	Government	Dulles	USA
NCR Corp.	Information Technology		USA
Northern States Power Company	Energy		USA
Northwestern Mutual	Insurance		USA

Nova Scotia Power, Inc.	Utilities		Canada
Ohio State University	Higher Education	Columbus	USA
Ontario Hospitals	Health Care		Canada
Owens & Minor	Health Care Supplies		USA
Pennsylvania State University	Higher Education	State College	USA
Pfizer Inc.	Pharmaceuticals		USA
Philips Electronics	Manufacturing		Netherlands
Prison Fellowship Ministries	Humanitarian		USA
Reuters America, Inc.	Financial Services		USA
Ricoh Corp.	Manufacturing		Japan
Royal Canadian Mounted Police	Government		Canada
Saatchi & Saatchi Worldwide	Marketing		USA
Saint Leo University	Higher Education	Saint Leo	USA
Scudder Kemper Investments Inc.	Financial Services		USA
Sears Roebuck & Company	Retail		USA
Siemens AG	Manufacturing		Germany
Skyline College	Higher Education	San Bruno	USA
Southern Gardens Citrus Processing Corp.	Food Processing		USA
St. Mary's/Duluth Clinic Health System	Health Care		USA
St. Michael's Hospital	Health Care	Toronto	Canada
T. Rowe Price Investment Technologies, Inc.	Financial Services		USA
Texas Education Agency	Education		USA
The Handleman Company	Wholesale distribution		USA
The Store 24 Companies, Inc.	Retail		USA
The Thompson Corp.	Information Systems		USA
UK Ministry of Defence	Government		UK
Unicco Service Co.	Industrial Services		USA
United Way of Southeastern New England	Humanitarian		USA
Univ. of California	Higher Education		USA
Univ. of California San Diego	Higher Education	San Diego	USA
Univ. of California San Diego	Higher Education	San Diego	USA
University of Akron, Ohio	Higher Education	Akron	USA
University of Alaska	Higher Education		USA
University of Arizona	Higher Education	Tucson	USA
University of California, Berkeley	Higher Education		USA

University of California, Los Angeles	Higher Education	Los Angeles	USA
University of Denver	Higher Education	Denver	USA
University of Florida	Higher Education	Gainesville	USA
University of Iowa	Higher Education	Iowa City	USA
University of Louisville, KY	Higher Education	Louisville	USA
University of Missouri	Higher Education	Kansas City	USA
University of North Carolina at Wilmington	Higher Education	Wilmington	USA
University of Northern Colorado	Higher Education		USA
University of Northern Colorado	Higher Education		USA
University of St. Thomas	Higher Education	Minneapolis	USA
University of Vermont	Higher Education	Burlington	USA
University of Virginia Library	Higher Education		USA
University of Washington	Higher Education	Seattle	USA
UPS	Shipping	Atlanta	USA
US Army Medical Command	Health Care		USA
US West	Telecommunications		USA
Vanderbilt University Medical Center	Health Care	Nashville	USA
Verizon Communications Inc	Telecommunications		USA
Volvofinans	Financial Services		Sweden
Walt Disney World Company	Entertainment		USA
Wayne State University	Higher Education	Detroit	USA
Wells Fargo Bank	Banking		USA