# Value Balanced Score Card

## —A Tool of Performance Appraisal

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< EXECUTIVE SUMMARY >

◆Balanced Score Card is a new dimension in the field of performance appraisal. It is a comprehensive, top down view of the organizational performance with a strong focus on vision (i.e. goals) and strategy (i.e. performance measures).

The Balanced Score Card has become the pre-eminent strategic tool for the management. The success of its implementation is attributable to its focus on strategy and the future. By the help of this the managers are able to translate broad mission statements into tactical action plans. It paves the way for the managers to exploit the firms information resources and ultimately produce economic results while directing the firm towards the achievement of its goals.


Balanced Score Card is a new dimension in the field of performance appraisal. Performance means the efforts extended to achieve the targets efficiently and effectively. The achievement of target involves the integrated use of human, financial and natural resources. Erich L. Kohler referred to 'performance' as "A general term applied to part or all of the conduct or activities of an organisation over a period of time, often with reference to some standard such as past or projected costs, an efficiency base, management responsibility or accountability, or the like".[1]

Appraisal refers to a critical review with a view to improve performance. It evaluates the actual performance in the light of predetermined targets, measures deviations in between actuals and targets, locate alternatives and suggests remedical action. Thus the term 'performance appraisal' can be defined as a critical assessment or evaluation of various activities in different areas of operation of an organisation. It is known that to keep an individual healthy, doctors advise periodical check-up and examination of body. Similarly to safeguard the interests of the shareholders, outsiders, creditors etc. every concern should have a proper appraisal of its performance in different spheres viz., customer satisfaction, value addition in share price, human resource development index etc.

Drucker has argued that "performance can be measured in terms of two concepts viz., efficiency and effectiveness".[2] Efficiency means "doing things right" and effectiveness means "doing the right things".[3] 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 upto 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".[4] Effectiveness has a different connotation from efficiency. "Effectiveness is con-

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cerned with the effect of work on people, with the appropriateness of goals, with long term results and with humanistic and idealistic values".[5] In the words of James A.F. Stoner "Effectiveness 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".[6] There is always a more effective way of performing work from the view point of recognizing the desire of people to use their intelligence and imagination and to develop their skill and talent fully and fruitfully. Jobs can always be improved so that they may meet human needs in a better way. Organisation can be designed to be more congruent with human personality and with the goals, norms and values of the society. Thus effectiveness can be defined as 'the ability to bring about the result intended' or ;making striking impression'.[7] Therefore effectiveness refers to achieving the desired results well in time. So a person will be treated effective if he is performing the work in the desired fashion.

The traditional performance measures viz., Earnings Per Share (EPS), Return On Capital Employed (ROCE), Return On Net Worth, Net Profit Margin etc. are focused entirely on cost efficiency and effectiveness. A drastic change in the organisational goals from the earlier socio-economic issues to the newly minted shareholders' value has led to a revolutionary change in the performance appraisal criteria of corporate entities from the traditional profit based measures to the new value based performance measures like Market Value Added, Economic Value Added, Cash Value Added, Total Quality Management (TQM), Financial Reengineering and Balanced Score Card. Among these in the present article the concept of Balanced Score Card has been discussed.

## MEANING OF BALANCED SCORE CARD

Balanced Score Card is a performance appraisal and reporting system that strikes a balance between financial and non-financial measures, links performance to rewards, and gives explicit recognition to the diversity of organisational goals.[8] The Balanced Score Card gets its name from the attempt to balance financial and non-financial performance measures to evaluate both short run and long run performance in a single report. Paul Arveson describes Balanced Score Card as "an approach which provides information to the management and assists them in formulation of organisation's mission and strategy".[9] The main purpose of balanced score card is to provide the user with a set of information which reveals all relevant areas of performance in an objective and unbiased manner. As a tool of management it assists companies to assess overall performance, improve operational processes and enable management to formulate better plans for improvements. It provides a fair and balanced view of the organisation to the managers upon which they can-base real change.

## OBJECTIVE OF BALANCED SCORE CARD

The prime objective of Balanced Score Card is to provide a platform for translating a firm's strategic objectives into a coherent set of performance measures. Kaplan and Norton recommended that "an organisation should articulate the major goals for each of the four perspectives and then translate these goals into specific performance measures". Basically three to five performance measures are set for each goal.

## MAJOR CONTENTS OF A BALANCED SCORE CARD

The contents of Balanced score card vary from business to business. However, a well designed balanced score card combines financial measures of past performance with measures of firm's drivers of future performance. The vision and strategy of the firm is the pivot around which the contents of a balanced score card revolve. Generally, a balanced score card has the following four perspectives from which a company's activity can be evaluated.

## CUSTOMER PERSPECTIVE

Today the customer is regarded as the king of the market. The success of an organisation depends upon the customer perspective i.e. how do customers see it. In order to achieve organisational success customers/clients must be happy with the service they receive. To make the picture more clear, consider the example of banking companies. A multinational banking company is considered superior as compared to a nationalised bank as it provides more satisfaction to customers on account of speed, accuracy, faith and facilities. The customer perspective considers the business through the eyes of the customers, measuring and reflecting upon customer satisfaction. The prevalent performance measures of customer perspective generally include the satisfaction index, retention ratio, market share of the customers, competitive price, lead time from receipt of order to delivery to customers, maintenance of quality of

products relative to industry standards and the control on defects. To judge the above facts customer satisfaction surveys are conducted.

## INTERNAL BUSINESS PERSPECTIVE

This perspective focuses attention on the performance of the key internal processes which drive the business. Hence it gives answer to the question what must we excel at ? Since the nature of the processes are dependent on the nature of the organization hence the score card is not a 'fully cooked' solution, it must be adjusted according to circumstances of each organization. For instance, the efficiency of manufacturing process can be judged by measuring manufacturing cycle time, similarly sales penetration can be judged by comparing actual sales with budgeted sales, and increase in number of customers in a unit of time.

## LEARNING AND GROWTH PERSPECTIVE

This perspective is a measure of potential future performance. It directs attention to the basis of all future success. It is concerned with the organization's people and infrastructure. Adequate investment in these areas is critical to all long term success. For instance, for measuring market leadership the market share in all major markets should be studied, similarly for measuring the goal of cost leadership the measure adopted should be calculating manufacturing overhead per quarter as a percentage of sales, and rate of decrease in cost of production per quarter. The measures to be used for measuring the goal of technology leadership are comparison of product performance with competitors, number of new products with patented technology etc.

## FINANCIAL PERSPECTIVE

Finally, the financial perspective measures the results that the organization delivers to its stakeholders. For measuring the goal of sales the performance measure used should be revenue and profit growth. The financial perspective focuses on how much of operating income and return on capital employed results from reducing costs and selling more units of the product.

## PROCESS OF CREATING A BALANCED SCORE CARD

The process of creating a balanced score card begins with identification of a vision i.e. where an organization wants to go, the second step is to identify organization's strategies i.e. how an organization is planning to go there, the third step is to define critical success factors and perspectives i.e. what we have to do well in each perspective, the fourth step is to identify measures which will ensure that everything is going in the expected way, the fifth step is concerned with evaluation of Balanced Score Card i.e. ensuring what we are measuring is right, the sixth step is to create action plans and plan reporting of the Balanced Score Card, the final step is concerned with follow up and manage i.e. which person should have reports and what reports should look like.

Although the process to create balanced score cards is the same for all organizations, yet each organization must decide what are its critical success factors (i.e. set of goals) and what are its performance measures.

## ADVANTAGES OF BALANCED SCORE CARD

The Balanced Score Card is a management system that enables the organization to clarify their vision and strategy and convert them into performance driving activities. It provides a mechanism for implementing the strategy of a business unit into a comprehensive system of performance measurement. As Robert Kaplan and David Norton state "The balanced score card is more than a tactical or an operational measurement system. Innovative companies are using the score card as a strategic management system to manage their strategy over the long run. They are using the measurement focus of the score card to accomplish critical management processes."[11]

The balanced score card pulls together in a relatively simple management report, many of the key elements like customer orientation, shortening response time, improving quality etc. of the competitive agenda of a company.

The balanced score card provides strategic feedback and learning, it guards against subordination. It emphasis on an integrated combination of traditional and non-traditional performance measures. It assist the managers to consider all significant performance measures together and lets them to see whether an improvement in one area may have been achieved at the expense of another. The methodology of balanced score card facilitate communication and understanding of business goals and strategies at all levels of an organization.

## VALUE BALANCED SCORE CARD

The theme of "Value Balanced Score Card" is highly appropriate to the present business scenario. The term 'value' is related with utility and satisfaction. Utility may be

defined as the power of a commodity or service to satisfy a human want. Satisfaction here means the 'realized satisfaction' i.e. the satisfaction secured after consumption of commodity. Anything that has utility and provides satisfaction to an individual is regarded to have value for him. Value addition can be both monetary and non-monetary.

## MONETARY VALUE ADDED

When the value added can be measured in terms of money, it is regarded as Monetary Value Added. The following are the main categories of Monetary Value Added:

**(1) Accounting Value Added**

Accounting value added is the surplus of sales revenue plus other incomes from goods and services over the cost of bought in goods and services from outside. Ruggles opined that, "the value added by a firm, i.e. the value created by the activities of the firm and its employees alone, can be measured by the difference between the market value of the goods that have been turned out by the firm and the cost of those goods and materials purchased from other firms".[12]

**2. Economic Value Added**

Economic Value Added (EVA) attempts to measure a corporation's true economic profit as it compares company's actual rate of return as against the required rate of return. It describes whether a business unit best utilises its assets to generate return and maximise shareholders value. To simplify, EVA is just a way of measuring an organisation's real profitability.

**3. Market Value Added**

In order to measure shareholders' wealth, Stewart[13] coined the term Market Value Auded (MVA). MVA is the difference between market value of invested capital and book value of invested capital at a given point of time. The market value of debt is not readily available as debts are not generally traded. Thus, the definition of MVA can be modified as, MVA = Market Capitalisation less Net Worth. Market capitalisation is measured as closing share price multiplled by the number of outstanding shares as on that date (i.e. date of balance sheet). Whereas, net worth is measured as equity share capital plus reserves and surplus minus accumulated losses and miscellaneous expenditure.

## NON-MONETARY VALUE ADDED

The non-monetary value added relates to the attributes and social factors. Non-monetary value added can be classified in the following two ways:

**(a) Human Resource Value Added**

The human resources of an organisation are also known as 'personnel' or 'people at work' and they include all employees engaged in the productive activities of the organisation. In the words of Harbison, "Human resources are the energies, skills, talent and knowledge of people which are, or which potentially can, or should be, applied to the production of goods or the rendering of useful services".[14] It is the human resource that can coordinate the best of machines, money and even men to the optimum advantage of the organisation. Recognizing the importance of human resource in modern organisation, Rensis Likert has rightly observed, "All the activities of any enterprise are initiated and determined by the persons who make up that institution. Plants, offices, computers, automated equipment, and all else that make a modern firm are unproductive except for human effort and direction of all the tasks of management. Managing the human component is the central and most important task, because all else depend on how well it is done".[15]

Human resource is also regarded as an important corporate asset, and the economic performance of companies depends upon the extent to which they are effectively utilised. Therefore, the management should try to increase the value of this asset. Value addition in human resource is possible through job enrichment, job rotation. coaching, assigning of projects, films, counselling, work-shops, seminars, assignments, lectures etc.

**(b) Intellectual Value Added**

Intellectual capital consists of intangible and knowledge based items controlled by an organisation which are expected to produce a future stream of benefits for it. With the shift from resources and manufacturing to knowledge and services as the prime drivers of modern economies, many business organisations are now paying more attention towards value addition in intellectual capital. This seems imperative if an organisation has to survive in the competitive world of today. Intellectual capital is categorised into two classes viz., organisational capital which includes intellectual property and infrastructure (e.g. patents, copyrights, design rights, trade secrets, trademarks etc.) and relational capital which includes the beneficial relationships that people outside the organisation have with it. Thus, customer loyalty, customer penetration, market share, distribution chan-

nels, business collaborations, licensing agreements, etc. fall under the category of relational capital.

Realising the key role that intellectual capital plays in the success of an organisation, a large number of organisations have experimented with measuring and managing intellectual capital. To measure value addition in intellectual capital, the difference between the market value of the organisation and the replacement cost of its net tangible assets is taken. The logic underlying this approach is that if the market is prepared to pay a certain sum for the organisation as a whole which is in excess of the replacement cost of its net tangible assets, the difference represents the value that the market attributes to its intellectual capital. The objective of measuring value addition in intellectual capital is to monitor the growth of the intellectual capital and compare the same with that of other organisations so that priority areas where action is required can be identified and progress with regard to the same be monitored

**Exhibit 1.1**

**Balanced Scorecard for Dominion Company**

| Component and Measures | Maximum Score | Expectation | Expected Score | Actual Score |
|---|---|---|---|---|
| **Monetary Value Added** | | | | |
| Accounting Value Added | 80 | 80% | 64 | 50 |
| Economic Value Added | 60 | 90% | 54 | 40 |
| Market Value Added | 70 | 50% | 35 | 45 |
| **Non-Monetary Value Added** | | | | |
| Human Resource Value Added | 80 | 50% | 40 | 60 |
| Intellectual Value Added | 60 | 80% | 48 | 35 |
| **Customer Satisfaction** | | | | |
| Price | 20 | 50% | 10 | 8 |
| Satisfaction Index | 30 | 40% | 12 | 18 |
| Quality | 60 | 60% | 36 | 40 |
| Service | 80 | 70% | 56 | 60 |
| **Learning & Growth** | | | | |
| Technology Leadership | 50 | 60% | 30 | 25 |
| Research and Development | 10 | 90% | 9 | 7 |
| Market Leadership | 60 | 50% | 30 | 45 |
| Cost Leadership | 80 | 80% | 64 | 70 |

## HOW TO PREPARE VALUE BALANCED SCORE CARD

The preparation of a Value Balanced Score Card involves the following steps.

**Step 1.** The first step is to determine the maximum scores which can be achieved for both monetary and non-monetary perspectives of Value Balanced Score Card. These scores are generally determined on the basis of business strategy, prevelant market condition and past records of the company. These scores form the basis of planning hence they should be determined more carefully and by an expert. Once these scores are determined, there are least chances that they can be changed.

**Step 2.** The next step is to determine the expectation i.e. probability of achieving the score.

**Step 3.** On the basis of maximum score and expectation, the expected score is determined. Hence,

Expected Score = Maximum Score x Expectation

**Step 4.** Determination of actual score.

Exhibit 1.1 shows a balanced score card for Dominion Company. This score card is for the organisatior; as a whole. It has performance measures for both monetary and non-monetary components of organisational success. There are many score cards for an organisation, since each area of responsibility will have its own score card. Score cards for some lower level responsibility centers that are focused strictly on day to day operations may be entirely focused on only one of the measures. It should be also noted that it is not necessary to show all performance measures on score cards. Managers of responsibility center include only those measures that are key performance indicators - measures that drive the organisation to achieve its goal. For example, top management at Dominion Company set "exceed shareholders value" as one organisational goal. The balanced score card should have at least one key performance indicator that is linked to this goal. The accounting value added, economic value added, and market value added measures all are linked to this goal.

## CONCLUSION

To summarize, the balanced score card is a comprehensive, top down view of organizational performance with a strong focus on vision (i.e. goals) and strategy (i.e. performance measures). To achieve an effective score card the first step is to set up a strong vision. After this, .while keeping organizations structure in mind, managers must decide which strategies will contribute towards successful goal attainment. This strategy is translated into specific tactical performance driving activities. The balanced score card has become the pre-eminent strategic tool for the management. The success of its implementation is attributable to its focus on strategy and the future. By the help of this the managers are able to translate broad mission statements into tactical action plans. The balanced score card paves the way for the managers to exploit the firm's information resources and ultimately produce economic results while directing the firm towards the achievement of its goals.

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### ANNOUNCEMENT

"The Professional Development Committee is happy to announce that NABARD has agreed to increase the audit fees for Central Statutory audit and Branch audit for their Regional Rural Banks and their branches by 20% with effect from the year 2003-04 audits. The traveling allowances and out-of-pocket expenses have also been increased by 20%. This is the decision of a working group set up by NABARD. Matter now awaits formal ratification.

The Professional Development Committee also informs all the members that the Reserve Bank of India has recommended to the Government an average of 40% to 45% increase in the audit fees of the seven financial institutions which include NABARD, IDBI, SIDBI etc., including the RBI itself."