# SIGNIFICANCE OF BALANCED SCORECARD IN BANKING SECTOR: A PERFORMANCE MEASUREMENT TOOL

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**ABSTRACT**

Performance management tool plays a pivotal task in evaluating strategic performance of banks. Financial ratios have long been used as a tool to evaluate the overall financial performance of a bank. But recently BSC has become increasingly important strategic management tool that translates visions into profitable actions, particularly focusing on intangible assets such innovation, employee skills and knowledge levels, customer relationships etc. Due to intensity of characteristics comprised in today's markets whereby banking sector face fierce competition not only on a domestic scale but also on a global scale which compel them to drive strategy to achieve performance objectives such as long-term profitability and customer loyalty. In this paper, a relation between the significance of measurement of intangible assets and integration of contingencies in performance evaluation is shown which establishes the need to design a comprehensive performance evaluation system for Indian banks.

***Keywords***: Balanced Scorecard, Financial Ratios, Intangible Assets, Performance Evaluation.

**Introduction:**

For some time there has been considerable interest in performance measurement. Well-rehearsed adages such as ``what gets measured gets done'' and ``you get what you measure'' suggest that implementing an appropriate performance measurement system will ensure that actions are aligned to strategies and objectives (Lynch and Cross, 1991).It is absolutely essential to develop a performance evaluation system that encompasses all aspects of an organization, if the organization aims at the long term survival, growth and development. Such a system could be capable of bringing out the strengths and weaknesses of the organization for the purpose of further improvement. With the advances in computational tools, various performance measurement and evaluation systems have evolved over a period of time from single-aspect systems to more comprehensive systems covering all aspects of an organization.

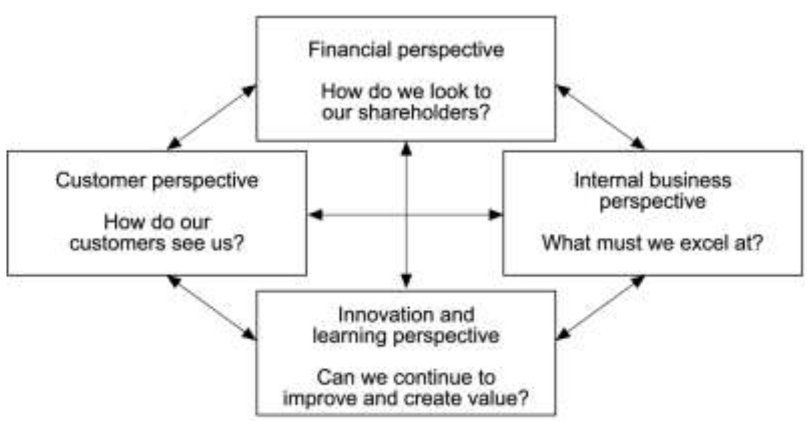
In the business world the only thing that really matters is organization's performance. The introduction of performance management of commercial banks is of crucial significance owing to the openness of India to the world and investors abroad after 1991 liberalization, privatization and globalization. The banking sector has begun adopting holistic performance measurement systems such as the Balanced Score Card (BSC) to exhibit to stakeholders that this sector is turning to take advantage of financial and non-financial measures to offer investors with performance information.

**Framework of Balanced Scorecard:**

Balanced Scorecard, a strategic performance measurement framework and methodology focuses on developing and monitoring strategy via a family of performance measures. The BSC approach grew out of a multi-company study group in the early 1990s, sponsored by CEO of The Nolan Norton Institute, David P. Norton, with support from Dr Robert S. Kaplan, the Arthur Lowes Dickinson Professor of Accounting at the Harvard Performance of intellectual capital Business School.

(Kaplan and Norton,2000) define the Balanced Scorecard as a comprehensive system to measure performance from a strategic perspective which is translating the strategic of business organizing to strategic objectives, measures, targets and preliminary and clear procedural steps. Kaplan and Norton defined the balanced scorecard in 1992 as “one of the most successful, endurable management concepts in recent years” (Olve et al., 2004).

According to (Frigo, 2002), the Balanced Scorecard is a management tool that uses a combination of financial and non-financial measures to evaluate the performance of an organization. So, the Balanced Scorecard is an overall control tool. The Balanced Scorecard is based on the idea that managers must evaluate the performance of their organization by looking at it from four perspectives, namely, financial, customer, internal business process and learning and growth (Philip, 2008). These four perspectives provide the framework for the balanced scorecard.




**Source:** Adapted from Kaplan and Norton (1992)

**Figure 1**

The BSC study came to existence on the premise that traditional performance measurement systems, that are based on financial accounting measures were no longer sufficient indicators of performance in today's rapidly changing business environment. Such traditional measurement systems do not take into account the value of intangible and intellectual assets, which are increasingly important in our knowledge-based economy. It is evident in a knowledge based business environment that the traditional tangible assets become less important as compared to intangible assets that create value for organizations. Innovation that competitors find difficult to copy has become increasingly crucial for organizations in knowledge based economy, which also makes this type of innovation an unmanageable to measure with traditional financial accounting systems. Therefore, a need is created to find a different measure to the increasing importance of intangible assets. The aim of the Balanced Scorecard is to clarify and communicate a company's vision and strategy into action.

**Financial Perspective:**

Financial measures provide managers with a good picture of the economic consequences of actions already taken. The financial measures commonly used are return on investment (ROI), return on equity (ROE), and operating income. They give a clear picture of the financial performance of the company to ascertain that the implementation of company's strategy and execution are indeed contributing to bottom-line improvement and achieving the desired "goal congruency". The choice of the appropriate financial measures to be incorporated in to the BSC depends on the stage of business's life cycle (growth, maturity and decline).

**Customer Perspective:**

The customer perspective aims at identifying the customer and market segments in which the organisation competes. The first step is to determine the best measures of the business unit's performance for these targeted segments and core measures that will describe the successful outcomes of a well-formulated and implemented strategy. According to (Kaplan and Norton, 1992), core measures include customer satisfaction, retention, new customer acquisition, customer profitability, and market and account share, and building a sustainable customer relationship.

**Internal Business Process Perspective:**

The purpose of the internal business perspective is to determine the key business processes that create and deliver the goods and services of the company to the customers whilst develop measures to ensure that these processes are working well. By focusing on the activities and key processes required, it enhances the company's efforts to excel at providing the value expected by the customers, hence that the measures in the customer perspective will be supported.

**Learning & Growth Perspective:**

The purpose of the innovation and learning perspective is to determine the ability of the company to continually improve and innovate. This is the foundation of any strategy and centers on the human and intangible assets of the company. This perspective tries to define the human and developmental requirements of the company that will enable ambitious objectives in the other three perspectives to be achieved. To increase shareholder value a firm must constantly able to innovate, learn and improve which will result in firm growth.

**Balanced Scorecard & Business Strategy:**

The process of translating strategy into action associated with the BSC involves turning the company's strategic vision into clear and understandable objectives based on the all four perspectives. A well formulated balanced scorecard depends on how well an organization manages strategy if it is to achieve its purpose. The balanced scorecard results are only useful if the management reviews them and openly passed on to employees dealing with the execution phase. Communication is the essence in the process of converting visions and strategies into action. Communication can be an effective tool for motivating employees involved in change. Appropriate communications provide employees with feedback and reinforcement during the change. A link exists between the balanced scorecard and strategy management to attain firm performance. Therefore,

**Balanced scorecard + Managed strategy = Firm performance**

Many researchers have reviewed the significance of BSC as a performance measurement tool in the different organizations and tried to show the link and impact on business strategy of the concerned organizations.

**Robert S. Kalpan , David P. Norton(1996):** These two researchers had tried to prove that Balanced Scorecard is not really a “strategy formulation” tool. With the help of two cases i.e. The Metro Bank and National Insurance, they had illustrated the translation of an SBU business strategy into a measurement framework. BSC had been implemented in those organizations where the strategy had already been articulated and accepted in the organization. The disciplined measurement framework enforced by the Balanced Scorecard stimulated a new round of dialogue and debate about the specific meaning and implementation of the strategy.

**Arthur K. Yeung, Bob Berman(1997):** Using Eastman Kodak as a case study, three paths have been identified for addressing the issue of human resource measurement i.e. building organizational capabilities, enhancing employee satisfaction and shaping customer satisfaction. A unique integrative model has been formulated which as shown a connection of strategic HR framework to key result areas. And without moving through a complete cycle, HR measures cannot drive the desirable behaviours of line managers in utilizing employee contribution.

**Garrett Walker, J. Randall MacDonald (2001):** This study has given the solution of questions arisen by GTE’s HR managers in order to effectively manage the value created by investments in employees because the primary source of competitive advantage is the ability to effectively manage the employee talent. So, researchers found the Human Resource challenges and strategy in order to built the communication and reinforcement in the linkage between HR actions and business results.And the solution to all the questions is to track financial results while monitoring progress in developing human capital and acquiring talent and capabilities for business success.

**Stan Davis, , Tom Albright( 2004):**In this quasi-experimental study, they had investigated that bank branches implementing the Balanced Scorecard (BSC) outperformed bank branches within the same banking organization on key financial measures. They had evidently proved that financial performance for branches implementing the BSC are superior when compared to performance of non-BSC implementing branches.

**Manoj Anand, B S Sahay, and Subhashish (2005):** In this study, they have analyzed the current practice of the organizational performance management system with a focus on the Balanced Scorecard. It may also be useful to the management accounting academics to consider the practice for re-examining the theory. The difficulty in assigning weightage to the different perspectives and in establishing cause and effect relationship among these perspectives has been found to be the most critical issue in the implementation of the Balanced Scorecard in corporate India. The implementation of the Balanced Scorecard has led to the identification of cost reduction opportunities in their organizations which, in turn, has resulted in the improvement in the bottom line.

**P. K. Chakraborty (2007):** This study has proved that Balanced Scorecard integrates strategic management, performance measurement, strategic thinking and planning, change management and performance budgeting into a structured framework for building a strategic management system. The BSC is not a Management Control System but itself a Management System with focus on four major areas that can go a long way in successfully implementation of BSC in any organization, be it a manufacturing company or service providing company.

**T. K. Mukherjee, Smita Pandit (2009):** In this study, Business Balanced Scorecard(BBSC) has been implemented in line with the quality policy at Phoenix Yule Limited(PYL) to improve teamwork, better downtime, efficient processes and customer orientation. In context of PYL, the balanced scorecard approach provides a clear prescription as to what the company should measure in order to ‘balance’ the financial and operational perspectives. The BBSC concept has provided strategic feedback and learning to the management with a comprehensive picture of business operations.

**Souad Moufty (2009):** This paper has explored the role and the current stage of usage of Balanced Scorecard (BSC) in UK banks as a performance measurement (PM), and also explored that how management behavior can be influenced by PM data to better facilitate management interventions. This paper firstly reviewed the traditional PM, critics pointed to them and revealed the need for new system such as BSC. Also the special nature of service businesses in general and the forces that affect banking sector in specific is revealed. And the methods chosen to be conducted in this study are presented.

**Rahat Munir, Sujatha Perera, Kevin Baird(2011):** This paper has concluded that various macro-level environmental factors which affect the functioning of banks, for example, economic conditions, technological innovations, socio-cultural and political factors, exert pressure to change their performance measurement practices. Also proposed that rather than passively confirming to such pressure, banks respond strategically, with the strategic responses taking various forms including non-compliance.The researchers have developed a framework to examine and understand changes in PMS in banks which could facilitate managers to adopt and implement PMS in an effective manner.

**Ghassan F. Al- Matarneh(2011):** In this study, researcher has used a questionnaire and found that there is recognition by the Jordanian industrial companies of implementing the BSC in assessing the overall performance. Also the Jordanian industrial companies had found the high mean for the importance of using the operational measurements (nonfinancial) for assessing the overall performance. And this company can afford the cost of application of the BSC with having the necessary human resources to implement the BSC.

After reviewing the researches on BSC in the different organizations, there is a great need to focus on the change in the mission & vision of companies of all the sectors. Some companies have moved beyond the early vision for the scorecard, to discover its value as a cornerstone of a new strategic management system with the potential to deliver a firm's strategic objectives (Anthony and Govindarajan, 1998). In this regard, (Olve et al. 1999) suggest that there are four processes involved in establishing this new strategic management system. These are:

(1) Translating the vision, which helps managers to build a consensus around the company's strategy and express it in terms that can guide action at the local level;

(2) Communication and linking, which lets managers communicate their strategy up and down the organization and link it to unit and individual goals;

(3) Business planning, which enables companies to integrate their business and financial plans; and

(4) Feedback and learning, which gives companies the capacity for strategic learning, which consists of gathering feedback, testing the hypothesis on which strategy was based, and making the necessary adjustments.

Figure 2 below shows the process of translating the vision into operational terms that provide useful guides to action at the operational level.


**Source:** Author

**Figure 2**

**Inclusion of Intangible Assets in Performance Measurement:**

In the contemporary economic environment, factors like employee knowledge, relationship with the customers and the culture of innovation and changes define success for an organization. Thus, the intangible assets are the key to long term success in today's world. The power of intangibles manifest in the valuations is quite visible in modern organizations. Following this, (Kalpan and Norton,1992) recommended broadening the scope of the performance evaluation measures to include four areas of an organizational functioning. Apparently the BSC system addresses the shortcomings in financially oriented performance measurement systems. It also provides a number of mechanisms for linking long-term strategic objectives with short-term actions:

- Consensus on firm's vision & strategy.
- Communication of the firm's strategy throughout the organization.
- Allocate resources to & set priorities for long–term strategic objectives.
- Monitoring & modification of strategies to prevent an organizational downturn.
- Integration of the lagging indicators, with the leading indicators.

For banks, studying financial indicators in isolation does not yield a very effective strategy since their performance interlinks financial indicators with other invisible indicators. In fact, financial performance is the translation of many intangible business processes and performance indicators. Subsequently, banks find it difficult to design a comprehensive strategy for long-term growth. This is where more comprehensive techniques such as the BSC can be incorporated. Indian banking sector can also adopt such a technique to overcome the limitations of the existing evaluation methods. The first step towards this is to recognize appropriate performance drivers. Alignment of these performance drivers ensures effectiveness of the strategy. For an organization like a bank, the customer behaviour is a major indicator of the bank performance. The more is the value creation by a bank among the customers, the better the performance of the bank. This can be realized by the bank's efforts to understand the customer's requirements, offer products that satisfy customer's requirements, help the customer in the choice of alternative solutions, and effectively differentiate one's own services from the competitors. A simple Performance Driver Model with a focus on the culture, strategy, process, structure and people can be useful.

**Contingencies in performance Evaluation:**

For an organization like a bank, the customer behaviour is a major indicator of the bank performance. The more is the value creation by a bank among the customers, the better the performance of the bank. However, banks tend to focus upon financial aspects alone and concentrate on return on equity (ROE) as the central objective; but it does not present the entire picture of bank performance measurement and evaluation. Several seemingly financial indicators also point towards the performance of intangible assets of a bank. For instance, growth rate of deposits is a significant indicator of customer confidence in the bank. Similarly, growth rate of credit / advances is a significant indicator of customer preference for the services of a specific bank. Majority of the banks use growth rate of the net profits as the sole indicator of the health of their organization. Banking sector should also consider the internal processing perspective while analysing the performance of the bank so that the entire picture of a bank can be evaluated. It can be achieved by adoption of more modern systems such as the BSC, which incorporate the correlation between technology and customer relationship management as well as the correlation between technology and human resources. A more comprehensive method of evaluation has been implemented as an improvement over annual financial inspection introduced by the RBI in 1992 i.e CAMEL (Capital adequacy, Assets quality, Management, Earning quality and Liquidity). It includes financial performance indicators as well as managerial aspects of organizational performance.

**Conclusions:**

Financial ratios analysis focus on financial results that reflect the owners' perspective, whereas the Balanced Scorecard focuses on financial and nonfinancial results that reflect not only the owners' perspective, but also the customer perspective, internal process perspective and learning and growth perspective. The balanced scorecard has three main benefits. Firstly, it focuses on the whole organization as a one unit by using a few basic items that are needed by the organization to innovate. Secondly, it helps to integrate the various programmers of the organization such as quality, reengineering and customer service initiatives. Thirdly, it sets out the standards of the strategy for lower levels of the organization, such as unit managers and employees. It is necessary for the banks to adopt a system which encompasses various organizational aspects of performance measurement if they aim at designing business strategy that ensures better performance in future. Banking sector can consider and realize the importance of this tool as a strategic and valuable performance management system. The successful application of the BSC does not come from a vacuum; rather top management of the bank should demonstrate its commitment to the adoption of the BSC. So, if there is no follow up, that is, no implementation of management policies to make the necessary improvements, then the balanced scorecard will fail. From the above, we can conclude that financial ratios analysis is not an adequate method by which to evaluate the overall performance of an organization; also the balanced scorecard is more efficient than financial ratios analysis.

**Scope for Further Research:**

In India, the performance measurement system used in the banking sector are based on financial measures and monthly or annual reports. The dependence on financial measures is misleading because it does not provide a holistic view about how the banking sector is doing on the internal processes, customer, and learning and growth perspectives.
Future researches regarding banks operating in India are needed in this domain. It should focus on studying the contingent factors that facilitate or impede the implementation of the BSC such as, organizational culture, organizational structure, private vs. public organizations, environment, and technology. More studies are also needed to identify the relevant measures of the BSC for the banking sector.
So, there is a need to develop the understanding about how the BSC may be applied within the context of banking sector and how human resource can create sustainable competitive advantage for the organization.

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