

# Performance Management

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# Performance Management: The Balanced Scorecard

## **Purpose of Balanced Scorecard:**

A method of implementing a business strategy by translating it into a set of performance measures derived from strategic goals that allocate rewards to executives and managers based on their success at meeting or exceeding the performance measures.

# Performance Management: The Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## Reasons for the Need of a Balanced Scorecard

1. Focus on traditional financial accounting measures such as ROA, ROE, EPS gives misleading signals to executives with regards to quality and innovation. It is **important to look at the means used** to achieve outcomes such as ROA, **not just focus on the outcomes themselves.**

# Performance Management: The Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## Reasons for the Need of a Balanced Scorecard

2. Executive performance needs to be judged on success at meeting a mix of both **financial** and **non-financial measures** to effectively operate a business.

# Performance Management:

## The Balanced Scorecard

(Source: Kaplan & Norton, 1996)

### Reasons for the Need of a Balanced Scorecard

3. Some **non-financial measures** are drivers of financial outcome measures which give managers **more control to take corrective actions quickly**.

(Example: controls in jet cockpit for pilot)

# Performance Management:

## The Balanced Scorecard

(Source: Kaplan & Norton, 1996)

### Reasons for the Need of a Balanced Scorecard

4. Too many measures, such as hundreds of possible cost accounting index measures, can confuse and distract an executive from focusing on important strategic priorities. The balanced scorecard **disciplines an executive to focus on several important measures that drive the strategy.**

# Performance Management: The Balanced Scorecard

(Source: Kaplan & Norton, 1996)

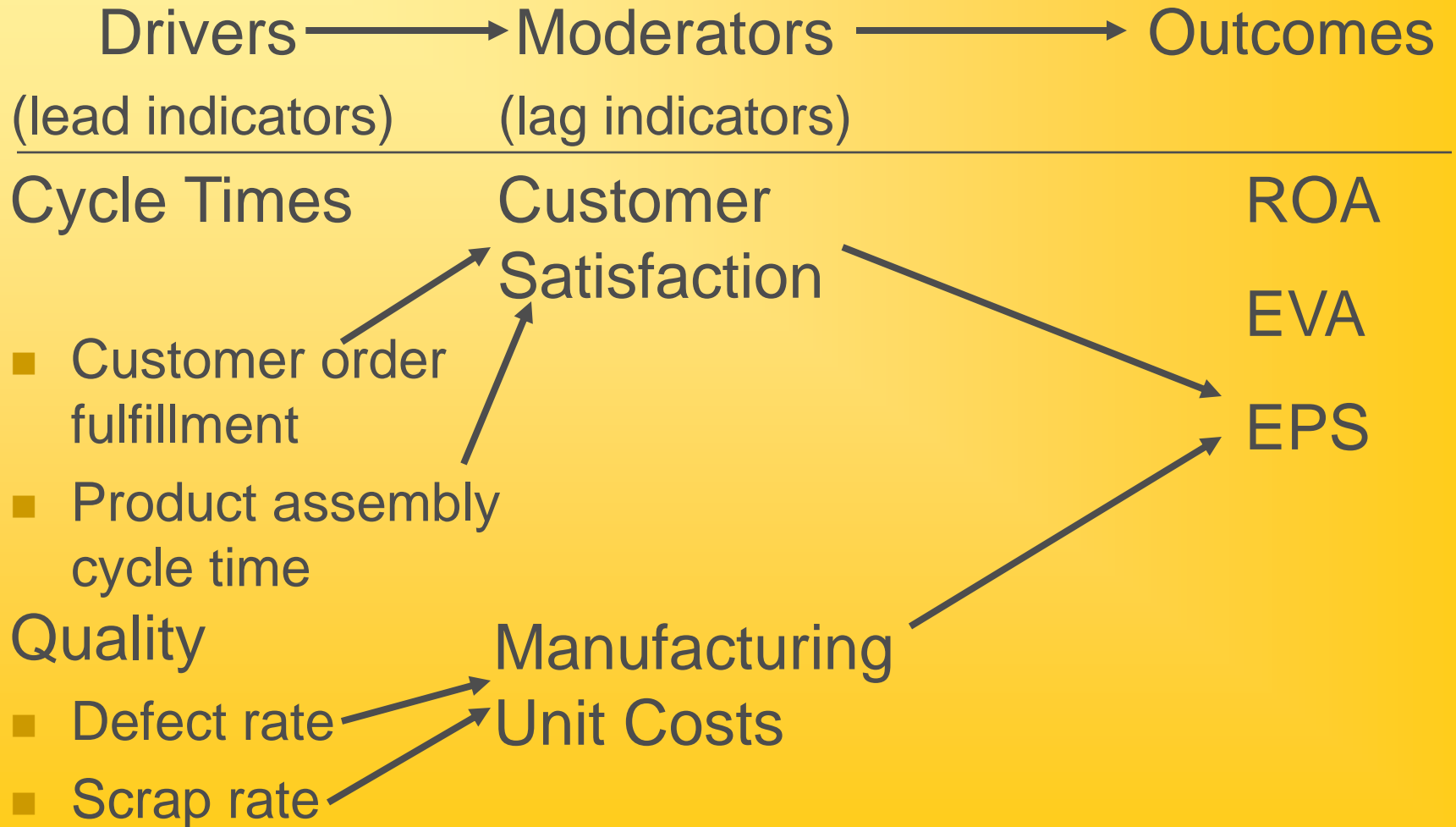
## Balanced Scorecard Perspectives

1. **Financial**: How do we look to our Shareholders?
2. **Customer**: How do our Customers See Us?
3. **Internal Business Process**: What should we do that is Excellent?
4. **Employee and Organization Innovation and Learning**: Can we continue to Improve and Add Value?

# Balanced Scorecard

## Chain of Causality of Performance Measures

(Source: Kaplan & Norton, 1996)

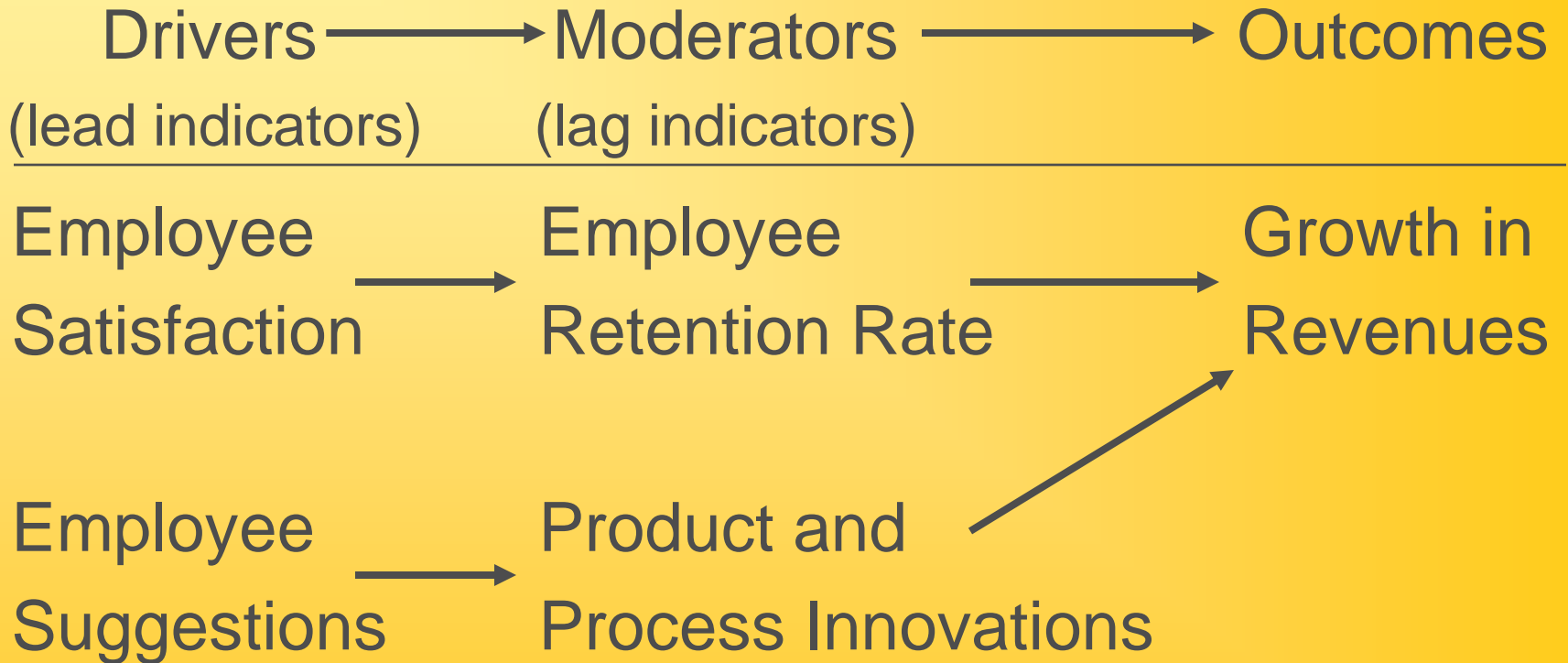




# Balanced Scorecard

## Chain of Causality of Performance Measures

(Source: Kaplan & Norton, 1996)



# Financial Measures & the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

- Financial measures are outcomes that represent the executive's success at achieving **strategic performance goals**
- Financial measures are influenced by the Stage of the **Life Cycle** which reflects different **strategic priorities**

# Financial Measures & the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## Life Cycle Stage

### **Growth**

Sales Growth

Revenue

Productivity

Generate new  
accounts &  
increase market  
share

### **Sustain/Maturity**

ROCE

EVA

Earn excellent  
return on capital  
invested

### **Harvest/Decline**

Cash Flow

Reduce Unit

Costs

Obtain  
immediate  
payback on  
investments from  
cash cow

# Customer Measures & the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## **Different Customer Models**

## **Relevant Customer Metrics**

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**Business → Business**

Inventory cycle time

Quality defect rate

**Business → Distributor/Dealer → Customer**

Distributor satisfaction

Customer satisfaction

Distributor price margin

# Customer Measures & the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## **Different Customer Models**

**Business** —→ **Customer**

## **Relevant Customer Metrics**

Customer order fulfillment  
cycle time

Customer satisfaction

Customer price margin

# Internal Business Process Measures and the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

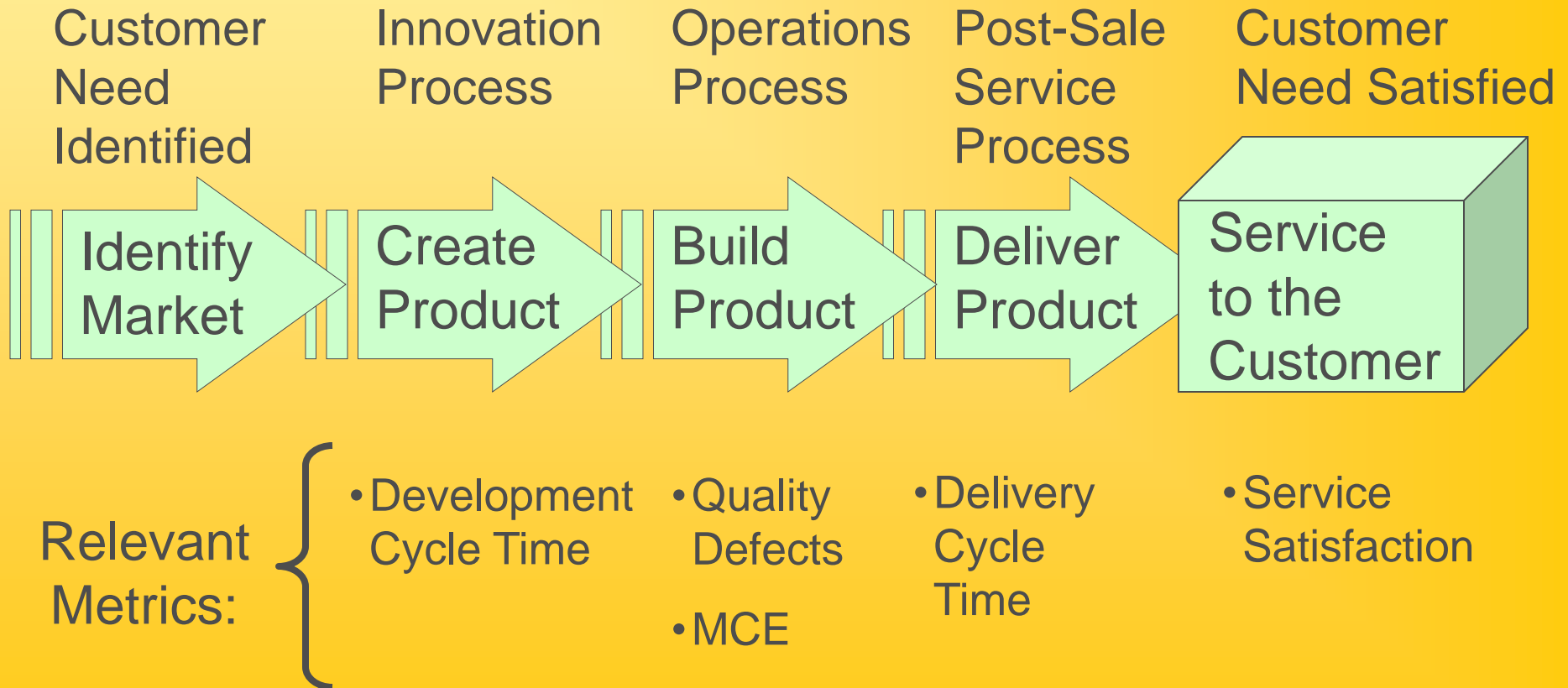
## Internal Business Process Measures

- Quality
- Yield
- Throughput
- Cycle time
- Cost efficiency
- Order Fulfillment
- Procurement
- Repair service quality/downtime
- Warranty quality

# Internal Business Process Measures and the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## Model of Internal Business Process Logistics



# Internal Business Process Measures and the Balanced Scorecard

(Source: Kaplan & Norton, 1996)

## **Manufacturing Cycle Effectiveness (MCE)**

$$\text{MCE} = \frac{\text{Processing Time}}{\text{Throughput Time}}$$

Throughput Time = Processing time + inspection time +  
movement time + waiting/storage time

MCE → 0, implies inefficient process

MCE → 1, implies less wasted time, greater efficiency



# Employee and Organization Capabilities for Innovation and Learning Measures (Kaplan & Norton, 1996)

## **What are employee and organization capabilities for innovation and learning measures?**

- Represent ways to improve the other 3 scorecard outcomes or measures.
- They cultivate the other 3 areas

# Employee and Organization Capabilities for Innovation and Learning Measures

(Kaplan & Norton, 1996)

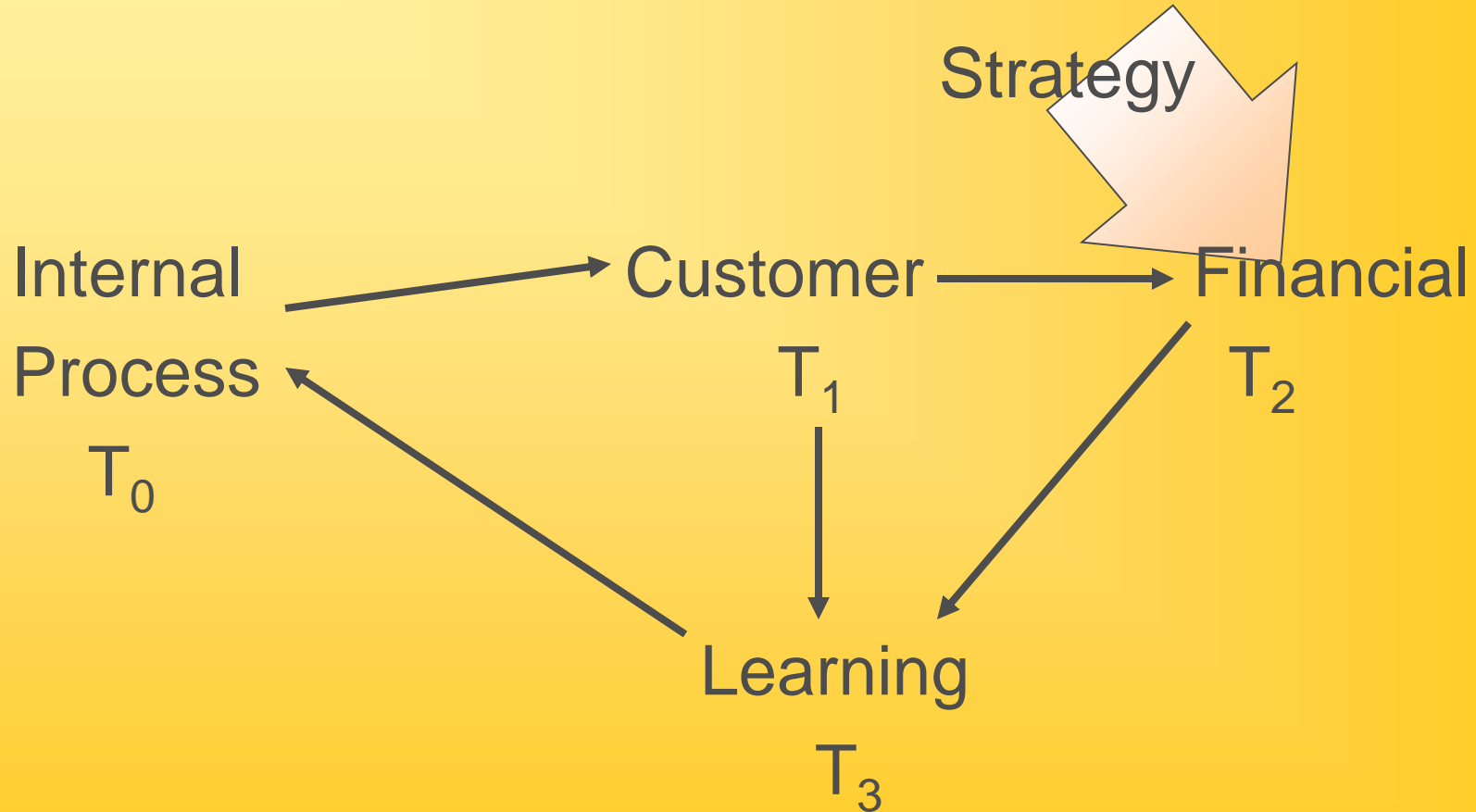
## **Employee Measures**

- Employee satisfaction
- Employee retention
- Employee productivity

## **Learning Measures**

- Employee skill levels (certification rate)
- # suggestions per employee
- Employee learning curve (time to reach acceptable level of output or quality)

# Balanced Scorecard: Causal Relationships



# Balanced Scorecard: Cascading Goals

Customer Satisfaction

Corporate



SBU



Retail Store

# Employee Suggestions

Corporate



SBU



Department



Team

ROCE

Corporate



SBU

# Incentive Compensation for Executives with the Balanced Scorecard

- Executive Bonus Pool is designed as a percentage of Base Salary
- The bonus pool represents potential earnings from the bonus for an executive if all performance measures are achieved
- Partial success with meeting performance measures results in the allocation of a bonus representing a lesser amount of the total potential bonus.
- Example: The bonus pool for a CEO equals 100 percent of salary. Range of bonus equals 0 to 100 percent of salary depending on success of CEO performance.

# Example: Automobile Company Balanced Scorecard Reward Matrix for Bonus

Category	Measure	Weighting
Financial (50%)	EVA	25%
	Unit Profit	15%
	Market Growth	10%
Customer (20%)	Customer satisfaction survey	10%
	Dealer satisfaction survey	10%
Internal (20%) Process	Above average rank on industry quality survey.....	10%
	Decrease in dealer delivery cycle time.....	10%
Innovation (10%) and Learning	Suggestions/employee	5%
	Emp. satisfaction survey	5%

# The Balanced Scorecard

## Critical Thinking Questions

1. What happens to the balanced scorecard when the strategy changes? (example: moving from a “growth” to an “extract profits” strategy)
2. How should resistance by executives or managers to new measures be handled?
3. What if executives or managers sub-optimize and only focus on categories in the reward matrix with the largest payoff – such as EVA (Economic value added) and Customer Satisfaction?