# Building a Balanced Performance Management System

**Bonnie P. Stivers,** *Coles College of Business, Kennesaw State University*

**Teresa Joyce,** *Coles College of Business, Kennesaw State University*

## Introduction

With the shift from the industrial age to the information age, businesses are faced with new rules of competition and the need to respond quickly to changes in the marketplace. Increasingly, competitive success is being achieved by acquiring and leveraging intangible assets — skills, systems, and values. Companies are finding that many management systems that worked well in the past are not effective in this new environment. In particular, the performance measurement systems of yesterday, designed to capture measures keyed to financial and physical capital, do not provide timely clues as to the company's management of skills, systems, and values critical for competitive success today and in the future.

Managers must play a major role in helping firms design and implement new performance management systems. Specifically, managers can: (1) educate coworkers about the importance of performance management systems, (2) assist the management team in gaining consensus on strategic goals, (3) identify the financial and nonfinancial performance measures that are linked directly to strategic goals, (4) aid in the implementation of new performance management systems, and (5) review and update their performance management systems as necessary.

This article provides a broad overview of performance management systems that will be helpful to managers as they prepare their redesign efforts. Specifically, the article: (1) describes the environmental changes that are occurring with the information age, (2) describes a balanced performance management framework, (3) provides guidance for starting the design stage, (4) reports the results of an international study to identify important nonfinancial performance measures, (5) provides an illustrative case example, and (6) shares lessons learned in practice.

## Why Focus on the Performance Management Systems?

The performance management system is a powerful behavioral tool. What you measure is what you get. When the system includes the right measures, linked to the organization's strategy, people are provided guidance for their actions. This is especially important when the organization faces environmental challenges, implements improvement programs, or alters its strategy.

The information age environment requires businesses to leverage a new cache of assets and capabilities. Strategists James Quinn, Thomas Doorley and Penny Paquette argue that maintainable competitive advantage will derive increasingly from "outstanding depth in selected human skills, logistics capacities, knowledge bases, or other service strengths that competitors cannot reproduce" (1990, 60). In fact, a firm's ability to exploit these intangible assets has become more critical than managing its physical, tangible assets (Itami, 1987).

To exploit these intangible assets, companies are attempting changes in their operating assumptions to include the development of closer value chain relationships, customization of products and services, reliance on knowledge workers, and an intense focus on innovation. In an effort to accelerate change, a number of improvement initiatives have been popular: faster product development, increased customer service, total quality management, continuous improvement, employee empowerment, reengineering, and activity-based costing. In many cases, the results have been disappointing — particularly when the initiatives have been attempted without a link to corporate strategy and without making changes in the "old" performance measurement systems.

Consultants frequently are called in when improvement initiatives have been attempted but the desired results have not been achieved. What the consultants with Arthur Andersen uncover is that the control framework frequently is out of sync with the goals of the organization. The challenge is to clarify and communicate the strategy and then design and implement a performance management system that is clearly linked to the strategic objectives. The trick is to identify the critical resources and capture related measures that drive performance (Waller, 1994).

## A New Model for Performance Management: The Balanced Scorecard

Many consultants to business and academic researchers advocate the practice of supplementing traditional financial measures with nonfinancial measures of performance. Kaplan and Norton (1992, 1993, 1996a, 1996b) have developed the notion of a "balanced scorecard" and suggest including focusing on finances, customers, internal business processes, and learning and growth. Others have also advocated more balanced measurement systems. For example, Peter Drucker (1992, 263-267) suggests the use of five "gauges" to tell how the business is doing and allow managers to control their operations: market standing, innovation, productivity, liquidity, and profitability. Reichheld (1996, 217-247) insists that the measurement system is a key to success and defines what a company will become by tracking the flow of value to and from a firm's customers, employees, and investors. These authors argue that a balanced set of measures can provide short-term feedback on operations and also critical information about strategy achievement.

• *A balanced framework for short-term and strategic feedback.* This notion of a balanced set of measures keeps the financial measures of the traditional system and adds nonfinancial measures that target outcomes and drive future performance. All measures included in the scorecard framework are derived from the company's vision and strategy and are focused on the interests of customers, employees, and investors. Kaplan argues that the balanced scorecard is more than an ad hoc collection of financial and nonfinancial performance measures. The key in design of the scorecard is that the financial and nonfinancial measures must be part of the information system for employees at all levels of the organization, from front-line employees to top executives. Each business unit must translate their mission and strategy into tangible objectives and measures. In this design, the scorecard represents a complete framework for tactical feedback and control of short-term operations (Kaplan & Norton, 1996b, 8-10).

In addition to providing information on current operations, the balanced scorecard may be used as a strategic management system to accomplish the following management processes: (1) clarify and translate vision and strategy, (2) communicate and link strategic objectives and measures, (3) align departmental and personal goals to the strategy, (4) identify and align strategic initiatives, and (5) enhance strategic feedback and learning (Kaplan & Norton, 1996b, 10-19, 291-292).

The balanced scorecard provides a critical process for implementing and obtaining feedback on strategy, focusing the organization on the long-term. This moves the scorecard from a performance measurement system to a strategic management system for the information age environment.

## Designing a Balanced Scorecard: Getting Started

Managers need a performance management systems that provide guidance in moving their companies in the direction of future success. The key is to translate the organization's strategy into the right, integrated set of measures. Only then can the performance management system provide control by monitoring financial results and provide guidance by reporting on the drivers of future performance — employee know-how, innovative internal processes information systems, values, and customers. Kaplan and Norton (1996b) describes initial steps in the critical design stage of a balanced performance management system.

• *Translate strategy into action.* The design process starts with the top management team and their effort to translate the strategy into specific objectives. Long-run financial objectives must be set, and the management team must agree on the customers, internal processes, and core competencies necessary to achieve targeted financial performance. Specific operational measures should be selected after there is consensus on long-run objectives. In this stage of the design process, communication is key; top managers often have very different perspectives of how to translate strategy into action.

• *Select linked measures.* Every measure selected for the scorecard should be linked to a specific strategy. This means that there should be a cause-and-effect relationship in the chain from learning and growth, to processes, to customers and, finally, to financial performance. In this way, the balanced scorecard explains how the business strategy will be achieved and is much more than an ad hoc set of measures.

• *Link financial objectives to life cycle.* Financial objectives for a business are different in each stage of an organization's life cycle. Therefore, the design of the scorecard must start with the recognition of the business stage and identification of the corresponding financial objectives.

• *Select a mix of customer measures.* To be successful, companies must focus on customer needs, and the best way to monitor performance in this area is to select a mix of generic and custom measures. Most companies use generic measures such as market share, customer retention, customer acquisition, customer satisfaction, and customer profitability. However, these outcome measures do not tell the whole story; it is also important to understand the drivers of performance in the customer arena. The firm can develop a set of custom measures that focus on product/service attributes, customer relationship, and image and reputation. Attention to these measures may ensure that the firm is providing top value to their customer.

• *Focus internal processes on meeting expectations.* Although every firm has a unique chain for creating value for customers, there are common business processes such as innovation, operations, and service. Traditional performance measurement systems usually include ad hoc measures aimed at improving performance in existing processes; this focus may not insure success. It may be that new and innovative business processes are necessary to meet the expectations for customers and shareholders. The focus must be on customers and shareholders — not on making incremental improvements to current operations. The selection of related operational measures for the scorecard follows process identification. In this way, the firm is able to link internal processes to financial and customer objectives.

• *Focus on investments for the future.* Today, organizations must invest in people, systems, and procedures if they are to achieve long-term success in the financial, customer, and internal process areas of the balanced scorecard. These are the critical drivers of performance. In the employee area, many companies capture measurements such as employee satisfaction, employee retention, and employee productivity. However, firms are finding that measures of skill may identify a gap between future needs and present competencies — a gap that must be filled. Firms must invest in systems to ensure that employees have accurate and timely information about customers. Procedures must be in place to ensure a positive organizational climate, where employees are motivated to act in the best interests of the organization. Since these intangible assets are the drivers of future success, it is imperative that measures in the learning and growth area focus on these assets — people, systems, and procedures.

A good balanced scorecard explains the business strategy by linking measures in four perspectives: financial, customer, internal processes, and learning and growth. By following these design suggestions, management can develop a balanced performance system that provides control of critical processes and guides action to carry out the strategies of the firm.

### What Nonfinancial Performance Measures are Important?

Companies typically have little trouble in identifying financial measures, since the long-term goals of most organizations include financial returns on capital. Common financial measures include profitability, return on capital, economic value-added, revenue growth, cost reduction, and cash flow. The actual measures and variables selected should be customized to the industry, the environment, and the strategy of the unit.

Although we know much about the use of financial measures in organizations, little is known about how nonfinancial performance measures are identified and used. As part of our efforts to assist companies in developing performance management systems that include nonfinancial measures, we conducted a study of the use of nonfinancial performance measures in Fortune 500 firms in the United States and Post 300 firms in Canada. The objective of the study was to provide a comprehensive picture of the process of non-financial measurement. Specifically, the study examined the degree to which top executives identify nonfinancial performance factors as important and provides examples of nonfinancial measures that companies might include in a balanced performance management system.[1]

**Exhibit 1**

**Nonfinancial Performance Factors**
**Comparison of U.S. and Canadian Firms**

Scale: 1=not at all important, 5=extremely important.

| | Canada mean | U.S. mean |
|---|---|---|
| **Customer service** | | |
| Customer satisfaction | 4.61 | 4.73 |
| Delivery performance/customer service | 4.61 | 4.58 |
| Product/process quality* | 4.15 | 4.51 |
| Service quality | 4.29 | 4.16 |
| **Market performance** | | |
| Market effectiveness | 4.01 | 4.00 |
| Market growth | 4.02 | 4.07 |
| Market share | 4.21 | 4.26 |
| **Innovation** | | |
| New product development* | 3.55 | 4.14 |
| Manufacturing flexibility* | 3.09 | 3.82 |
| Technological capability | 3.80 | 4.04 |
| R&D productivity* | 2.93 | 3.67 |
| Innovation | 3.67 | 4.04 |
| **Goal achievement** | | |
| Productivity* | 4.20 | 4.42 |
| Environmental compliance | 3.86 | 3.96 |
| Strategic achievement | 3.98 | 3.98 |
| **Employee Involvement** | | |
| Employee satisfaction | 3.91 | 4.05 |
| Employee turnover | 3.39 | 3.57 |
| Employee education/training | 3.96 | 3.99 |
| Core competencies | 4.04 | 4.18 |
| Internal recognition | 3.64 | 3.65 |
| Morale and corporate culture | 4.05 | 4.10 |

*Indicates a statistically significant difference between Canadian and U.S. responses.

[1] Questionnaires were mailed to the top executives of Fortune 500 firms in the U.S. and Post 300 firms in Canada. The names and addresses of study participants were compiled from two data bases: Compact Disclosure and CANCORP Canadian Financials. One hundred and two of the Fortune 500 U.S. firms and 151 of the Post 300 Canadian firms responded to the mail survey, providing an overall response rate of 31.625%. Respondents were chairmen of the board (70), chief executive officers (85), and chief financial officers (98).

Study participants were asked to rate 21 non-financial performance factors on a scale of one to five according to their importance in company goal setting. The 21 factors are grouped into five categories: customer service, market performance, innovation, goal achievement, and employee involvement (see Exhibit 1).

Results indicate that top executives perceive customer service factors as most important, followed by measures of market performance and goal achievement. Factors in the innovation and employee involvement categories were perceived to be less important.

The results of the study have important implications for managers who are designing effective performance management systems. Kaplan and Norton, Drucker, and Reichheld have indicated that market standing, innovation, productivity, customer service, and employee involvement are critical measures for inclusion in a balanced performance management system. Although the responding executives in our study did identify customer service, market performance, and goal achievement as highly important, they perceived innovation and employee involvement measures to be less so. This is clearly an area of concern as we are seeing the increased importance of innovation and human capital to organizational success. Performance management starts at the top — executives should be made aware that the management system must include indicators that monitor targeted outcomes and drivers of performance.

## Implementing a Balanced Scorecard: A Case Example

This section summarizes the process of developing a balanced performance management system for a small community health center in a major U.S. city. An academic consulting team led the efforts to develop the balanced scorecard during the spring of 1997.

• *Introduction*. Healthcare, Inc. is a small not-for-profit community health center employing 200 individuals. The organization was established about 30 years ago to provide comprehensive, primary health care to vulnerable populations: uninsured, unemployed, poor, and patients on Medicaid and Medicare. The organization has an annual budget of $20 million. For many years, the organization relied on federal grants for funding, but later they were able to attract a core of paying Medicaid patients and to negotiate contracts with managed care organizations. The U.S. medical market in general is experiencing rapid change, with health maintenance organizations (HMOs) and preferred provider organizations (PPOs) attempting to gain market share. Although Healthcare had a captive patient population for years, the organization recently began to feel competitive pressures. Many providers have found that Medicaid pays better and more quickly than other payers, and this has increased the competition for patients covered by Medicaid.

Healthcare's governing body is an eleven-member board of directors. The chief executive officer is hired by the board and assumes responsibility for day-to-day activities. Department heads report directly to the medical director, the chief financial officer, or the operations officer, all of whom report to the CEO.

• *Mission and Strategy*. The stated mission of Healthcare, Inc. is "to provide affordable, high-quality, comprehensive, primary healthcare and related services to the medically underserved in the local area." With this mission in mind, and in response to increasingly competitive market conditions, the top management of Healthcare developed a new strategy to retain current patients and attract new ones. The long-term strategies involved the following:

- finding a capital partner to generate funds necessary to remodel facilities
- improve image
- provide a seamless, integrated-care delivery system
- enroll in HMOs and managed care contracts
- increase diversity of payer mix
- improve management systems
- decrease costs by outsourcing

• *Data Collection Process*. The consulting team based the development of the balanced scorecard for Healthcare, Inc. on data collected from a combination of literature review, documentation review, site tours, and interviews. Interviews conducted with top executives, employees, and patients yielded the most critical information for the balanced scorecard. Sample interview questions follow:

**Executives**

- What financial performance measures are being reported?
- How are financial objectives linked to strategy?
- What metrics are used for tracking growth, cost reduction/productivity, and for asset utilization?

**Employees**

- What percentage of suggested improvements get developed?
- How does information flow from top management?
- Has top management empowered employees?
- Are employees challenged to develop new job skills?
- Have you been trained in the use of the information systems?

**Patients**

- What factors would cause you to switch to or from Healthcare, Inc.?
- Does Healthcare provide quality service?
- Should Healthcare continue to focus on preventive medicine?
- How would you describe the appearance of the facilities?

• *Balanced Scorecard.* Top management of Healthcare, Inc., with the assistance of the consulting team, developed and implemented the balanced scorecard shown in Exhibit 2.

**Exhibit 2**

| Healthcare, Inc. Balanced Scorecard | |
|---|---|
| **Financial Perspective** | |
| **Goals** | **Measures** |
| Increase grant income | Number and income per grant |
| Decrease operating expenses | Cost per patient visit per service |
| Increase collections with service | Average collections at time of service |
| Increase new patient revenue | New patient revenue |
| **Customer Perspective** | |
| **Goals** | **Measures** |
| Patient satisfaction | Satisfaction survey scores |
| Patient retention | Number of patients transferred |
| Patient acquisition | Number of new patients by payer |
| Service accessibility | Number of services provided |
| **Internal Processes** | |
| **Goals** | **Measures** |
| Patient visit efficiency | Throughput time for service |
| Collection efficiency | Collection rate at time of service |
| Physician productivity | Patients seen per month per physician |
| Administrative efficiency | Percentage of revenue for administration |
| **Learning and Growth** | |
| **Goals** | **Measures** |
| Employee empowerment | Percentage of suggestions implemented |
| Employee development | Dollars invested in employee training |
| Embrace technology | Number of technological enhancements |

## Lessons Learned in Implementation

Based on our experience and literature review, the following are important lessons we have learned in the actual implementation of a balanced performance management system:

**Dynamic nature**. The performance system is a dynamic, behavioral tool. What you measure is what you get. This is the system that provides guidance to individuals — to ensure that their actions are consistent with the strategic goals of the organization. The performance management system should be reviewed and updated when the organization faces new challenges, introduces intervention programs, or changes its strategy. Top executives must keep a watchful eye on the system to ensure that measures are linked to the current strategic objectives.

**Start at the top**. The development of the management system must start at the top of the organization; this is not a job for middle managers. The executive team must reach consensus on the organization's strategy. This is the critical starting point. In addition, top management must sell this system as a management system, not just another measurement system. The performance management system can and should be viewed as the basic framework for managing the business. The major advantage of the system is the link between short-term results and the long-term objectives — key to strategy implementation.

**Get the right measures**. The performance management system must be customized for each organization, keyed to its strategy. Adopting a generic framework will not work for an organization. Measures must provide specific guidance to individuals telling them what they must do well for the organization to achieve its objectives. Most organizations find that four to five measures for each of the perspectives (financial, customer, internal processed, and learning/growth) works well.

**Get buy-in and commitment**. It is essential that everyone in the organization understands and supports the corporate strategy. Business unit objectives and personal objectives must be consistent with the stated strategy of the organization. Alignment of individuals can be achieved by linking the incentive system with the performance management system. Providing this motivation is one key to success.

**Measurement gaps**. During the implementation phase, most companies identify measurement gaps, where processes are not in place to specify, measure, and audit critical factors of performance. The new framework sheds light on these gaps and requires managers to develop the necessary processes.

**Resistance to change**. The performance management system is not about measuring performance, but rather is about providing feedback to individuals for directing action. If the culture of the organization is one that embraces change and encourages innovation, resistance to change may not be a major barrier. However, performance management does force individuals to become more accountable for their actions, and individuals who have not been held accountable in the past may find the system threatening.

**Start with a pilot site**. The implementation of a successful performance management system for one business unit allows the design team to develop necessary skills and to use the pilot site as a model for the entire organization. Starting with a pilot also provides the consulting team with an opportunity to learn about issues that may help or impede implementation of the performance management system throughout the organization.

## Conclusion

To be effective in today's information age environment, performance management systems must include a balanced set of measures that are linked to the organization's strategic objectives. A maintainable, competitive advantage in today's marketplace is based more on intangible assets such a skills, systems, and values than on physical and financial capital. This shift to an increased reliance on intangible assets has created an information gap for managers. Managers need timely "gauges" to control operations and get feedback on strategy achievement. These gauges should be provided in a balanced performance management system that includes both financial and nonfinancial measures.

Managers can play a major role in the design and implementation of new performance management systems or review and update of current systems. The manager can educate coworkers about performance management systems, assist in clarifying strategy, identify critical financial and nonfinancial measures, aid with implementation, and help in keeping systems up to date.

This article has reviewed: (1) reasons for the increased importance of performance management systems, (2) a description of a balanced framework of measures, including financial and non-financial factors, (3) suggestions for starting the design phase of a performance management system, (4) the results of a study to identify important non-financial factors used in the U.S. and Canada, (5) a case study that illustrates the development of a balanced scorecard for a health center, and (6) a list of lessons learned in the implementation of balanced performance management systems. This information should prove valuable to managers as they help organizations design systems to monitor strategic achievement.

---

*Dr. Stivers focuses teaching and research — including many published articles — on managerial accounting, knowledge management, and performance measurement. As a CPA, she has experience in both public accounting and private industry. Dr. Joyce's particular interests are organizational change and human resource management. She has published or presented over 60 papers and is co-author of Corporate Transformation: Revitalizing Organizations for a Competitive World (Jossey-Bass, 1988).*

**REFERENCES**

Drucker, P. F. (1992). *Managing for the Future*. New York: Truman Talley Books/Dutton.

Itami, H. (1987). *Mobilizing Invisible Assets*. Cambridge, MA: Harvard University Press.

Kaplan, R. S., & Norton, P. (1992, January-February): The Scorecard — Measures that Drive Performance. *Harvard Business Review*, 71–79.

Kaplan, R. S., & Norton P. (1993, September-October): Putting the Balanced Scorecard to Work. *Harvard Business Review*, 134–147.

Kaplan, R.S., & Norton P. (1996a, January-February): Using the Balanced Scorecard as a Strategic Management System. *Harvard Business Review*, 75–85.

Kaplan, R.S., & Norton D. (1996b). *Translating Strategy Into Action: The Balanced Scorecard*. Boston, MA: Harvard Business School Press.

Quinn, J.B., Doorley L., & Paquette, P. (1990). Beyond Products: Services-Based Strategy. *Harvard Business Review*, 90(2), 60.

Reichheld., F. (1996). *The Loyalty Effect*. Boston, MA: Harvard Business School Press.

Waller, Carl, Arthur Andersen, Interviewed by authors, Atlanta, Georgia, May 1994.

---

**(continued from page 21)**

Ramchandran, J. (1986). Postindustrial manufacturing, *Harvard Business Review*, 64(6), 69–76.

Riggs, & Bracker, (1986). Operations management and financial performance, *Entrepreneurship Theory and Practice*, 10(3), 17–23.

Rishel, T.D, & Burns O.M. (1997). The Impact of Technology on small manufacturing firms, *Journal of Small Business Management*, 35(1), 2–10.

Safizadeh, M.H., Raafat. F., & Davis, C.H. (1986). On the implication of information processing tools for small business, *International Journal of Management*, 3(3), 73–80.

Schroeder, D.M., Gopinath, C., & Congden, S.W. (1989). New technology and the small manufacturer: Panecea or plague?, *Journal of Small Business Management*, 27(3), 1–10.

Voss, C.A. (1986, September). Managing new manufacturing technologies, *Operations Management Association*, Monograph No. 1, Michigan State University, 1–68.

Wiarda, E. (1987). *Frostbelt Automation: The ITI Status Report on Great Lakes Manufacturing*, Industrial Technology Institute, Ann Arbor, MI.

Zairi, M. (1993). Competitive manufacturing; Combining total quality management with advanced technology, *Long Range Planning*, 26(3), 123–132.