

## LIMITATIONS OF BALANCED SCORECARD

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The objective of this article is to follow certain aspects of Balanced Scorecard that have proven problematic and have demonstrated that the initial model elaborated by Kaplan and Norton is not as flawless as during the last ten years the most authors have claimed. Also some aspects of possible reduction of these problems are shortly analysed.

### **Short introduction of Balanced Scorecard**

The objective of Balanced Scorecard is to translate organisational vision and strategy into a specific objectives and measures in four main perspectives: finances, customers, internal business processes and learning/ growth.

Managers today are acting in such a complex environment that setting right objectives and following them appropriately is absolutely vital to ensure the sustainability and development of any organisation. It has also been discussed that in order to follow the objectives accurately, it is very important to monitor the achievement of those objectives by using as optimal and as strategy-focused measurement system as possible.

During 1985-90 leading theorists in this field reached the conclusion that the measurement systems that to the date were concentrating mainly on financial information, were not sufficient any more to fulfil the control function. One of these groups that were active in Harvard Business School under the guidance of Robert S. Kaplan and David P. Norton published in 1992 their proposals to the problems that they analysed during two years project that lead to introduction of Balanced Scorecard concept (Kaplan and Norton, 1992).

Kaplan and Norton explain (ibid) that individually no measurement can establish clear guidance for action. As the organisations' set-up is in most cases very complex and needs to follow several factors simultaneously, then it is necessary to pay attention to both financial and non-financial data.

We may argue that already several organisations had started to use non-financial data already way before Kaplan and Norton had published their opinions then Balanced Scorecard was, indeed, the first to capture the organisation's entire strategy and established methodology according to which the measures are derived by logical cascade from organisation's vision and mission and are implemented from top management to the lowest effectively measured level possible into one holistic set.

Many international research projects have shown that Balanced Scorecard concept is a very popular tool around the world. At the same time together with numerous success stories there have been also several cases where the implementation project is

not finalised at all. Therefore the author of the article decided to research whether there are any possible ways to summarise the shortcomings of the method in order to facilitate further research where these shortcomings might be overcome.

To facilitate this, the author analysed several theoretical concepts focusing on implementation of Balanced Scorecard. Additionally he examined several alternative performance measurement methods to verify whether some of their aspects could be used in managing Balanced Scorecard. In addition the author also used his practical experience in Balanced Scorecard projects, during his lectures and using his Internet www-address at <http://www.rillo.ee/> forum to discuss the other possibilities to map the problems related to Balanced Scorecard and to solve open questions.

The author proves with his practical experience and with literature review that the Balanced Scorecard has plenty of aspects where there are deficiencies that need to be taken into account.

### **Cause-and-effect relations are not time-wise connected**

One of the most important strengths that the Balanced Scorecard is claimed to possess is the strong causal interrelations between the different elements that are mapped using the core strategy of an organisation as a source as the financial measures have been considered merely a reflection of past activities already taken place. Non-financial enablers or leading measures that are shown in logical cause-and effect relationship with financial measures should allow to pay attention to future potential of organisation.

However, this aspect of the Balanced Scorecard method has been also thoroughly criticised. Nørreklit (2000) claims that in the reality Kaplan and Norton have not discussed the causal relationships in their publications (1992, 1996a, 1996b) with the level of detail necessary. Nørreklit considers the Hume criterion for cause and effect relationship as a base, which is defined as *one activity precedes another in time, they are logically independent, and according to empirical observation it is possible to establish the causal connection between those two activities.*

In criticising Kaplan and Norton, Nørreklit argues that the Balanced Scorecard is a static model without dimension of time that would establish or follow sequential set-up of measures of Balanced Scorecard, and therefore, the causal relationship does not follow the definition by Hume. Furthermore, in building up strategy map according to method presented by Kaplan and Norton, cause-and-effect relations are built up in a subjective way that does not necessarily refer to time factor. In spite of the piece of evidence that Kaplan and Norton state that strategic objectives should be divided into budgetary measures that may be followed on a time-related basis (1996a, lk 224), it can be said that observation of different objectives may be carried out according to Balanced Scorecard model only after different intervals and the method of measurement just as such does not provide a statistical proof of cause and effect, succession of supposedly related measures.

### **Cause and effect relations are not related in reality**

It is also questionable whether the causal interrelations between the classical perspectives of *learning and growth* → *processes* → *client* → *finances* also exist in all the circumstances. Kaplan and Norton claim that more loyal and satisfied customers generate more revenues. Nørreklit (2000, lk. 73-74) disagrees that using critical reasoning such connection may not be established. Using an example from practical life he illustrates just the opposite. When organisation is trying to satisfy very loyal clients who possess abnormally high quality expectations and make very small purchases that generate no profit for the organisation. Typically they are individual clients of higher age and moderate budget who demand high quality service.

Likewise it is questionable whether the linkage exists between processes and client satisfaction as also here it is possible to bring the opposite examples. Olve et al (1998) have demonstrated examples of several Swedish companies where the cause and effect relations are not proven.

As a solution to the both proposed problems would be to use coherent measures: to try to figure out the inputs and outputs of each and every measure and to look at them from the continuous process view. One of such methods that has provided solutions is process analysis. Another is activity-based costing. The both of them are process-centred approaches to analysing activities of organisation. Nørreklit also recommends analysing coherence during both formulation of strategy and later during following activities (2000, lk. 83-86).

### **External environment and several interest groups are out of picture**

Different from many other strategic management and strategy analysis methods (such as Benchmarking, Porter 5F analysis, SWOT analysis, PEST analysis etc), the Balanced Scorecard does not take into consideration any important interest groups but shareholders and clients. Also no attention is paid to daily activities of competitors.

Kaplan and Norton have discussed that any organisation has to use double-loop learning process in establishing the Balanced Scorecard in the first place, but if we take into consideration so rapidly changing external environment, then this is definitely not enough. It is definitely possible to comment that it is quite critical in many cases that the external environment should be scanned more frequently.

We may argue that measurement of certain factors of external environment may be complicated, but certain added value factor might definitely be beneficial. In case of public sector organisations, for instance, the measures important to voters or specific interest groups might be taken into consideration already by the methodology proposed by Kaplan and Norton (1996a, 179-188), where additional fifth perspective is added into traditional framework of Balanced Scorecard.

Neely (2002) also argues that the most difficult problem of Balanced Scorecard is that it lacks several important interest groups in its structure: such as suppliers, co-operation partners and close neighbours. He recommends that instead it would be feasible to use a performance prism methodology as a possible source for adding new interest groups to the framework of Balanced Scorecard.

Simons et. al (2000, p. 58) recommends that it might be worthwhile to go beyond that point and add specific feature to every Balanced Scorecard where specific task force or a certain person(s) will be assigned in every organisation who is directly responsible for collecting information about external opportunities and threats.

### **Hierarchical top-down set-up creates problems in implementation**

Many practical examples have demonstrated that the top-down approach used by Balanced Scorecard methodology is not ideal for several reasons.

Kanji (2002) has noted, that first of all, it is not advisable to construct the strategic objectives in a hierarchic set-up as the main accent is thereby concentrated on establishing not based on internal needs of people working in the organisation but rather on building up just a result-driven centralised programme, where employees are more expected to provide just buy-in decision and not as much giving their own contribution. The final elaboration might therefore be at a stake because of motivation problems that arise in any of the organisational improvement programmes that has made Dilbert so famous. Therefore it might be worth considering whether it is feasible to use bottom-up approach during the phase of establishment of measures. The same kind of bottom-up method is used in performance pyramid methodology (Lynch, 1995).

Secondly the hierarchic set-up of both objectives and measures brings about the potential threat that organisations where the work is built up as a process between several departments in the organisation, the top-down hierarchy may generate local optimums in these individual departments. If according to the theory of constraints the attention is not paid to top-down hierarchy but rather follow the elaboration of value chain then the problem might be solved. Laitinen (1998) has provided solution as dynamic system for performance measurement to overcome this problem by alternative methodology.

### **Unsuitability to unique or unhealthy enterprises**

Kaplan and Norton have used in every methodological description on introduction of Balanced Scorecard that consists of series of management meetings, meeting of project management groups and establishing large control systems within the framework of these preparatory tasks. In quite many cases the practice has proven that such methodology is suitable for big companies where there is enough human resources available to carry out the projects in these scales. Toivanen (2001) has commented that many Small and Medium-Sized companies in Finland have used

individual approach to implementation of Balanced Scorecard projects in order to achieve more rational result.

It is also worth noting that Kaplan and Norton have built up their model while bearing in mind organisations in relatively good health and in relatively stable development stage. However, in practice it is possible to see that several companies do not follow under the category of stable organisations. Therefore the practice has also proven that in many cases where the organisations need more thorough re-engineering the Balanced Scorecard traditional approach does not provide reasonable results.

Therefore it is necessary to consider that quite many aspects that Kaplan and Norton have used as generic models may have to be tailored in order to suit better to specific requirements of a particular organisation.

#### **Other minor limitations of Balanced Scorecard**

There are also few other limitations that other theorists have spoken about.

Kanji (2002) has noted:

- Balanced Scorecard is only a conceptual model and it is very difficult to elaborate this based on the methodology provided by Kaplan and Norton without previous thorough practical experience;
- The focus of traditional Balanced Scorecard tends to be too much on lagging indicators that show final results only. Many of the measurement systems, such as European Foundation for Quality Management are more balanced and provide equal attention to leading and lagging indicators;

We might note that people tend to be not balanced but rather focused: they are mostly concentrating on as few things as possible in order to manage these as well as possible. Therefore it might be unnatural to try to build a balanced set of measures to any person. However, this argument may be disputed by saying that people tend to be individually different and some of them may be much more effective in concentrating on a variety of different aspects than focusing just to a limited number of issues.

#### **Conclusions**

Many international research projects have shown that Balanced Scorecard concept is a very popular tool around the world. At the same time together with numerous success stories there have been also several cases where the implementation project is not finalised at all. Therefore the author of the article decided to research whether there are any possible ways to summarise the shortcomings of the method in order to facilitate further research where these shortcomings might be overcome.

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## Kokkuvõte

### TASAKAALUS TULEMUSKAARDI PUUDUSED

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Hiljuti oma 10. juubelit tähistanud tasakaalus tulemuskaardi (Balanced Scorecard) kontseptsioon on seni valdavalt saanud nii teoreetikutelt kui praktikutelt positiivset tagasisidet. Samal ajal on mitmed tasakaalus tulemuskaardi projektid ebaõnnestunud, mistõttu tuleb jälgida ka selle meetodi puudusi.

Erinevad uurimused on tõestanud, et tasakaalus tulemuskaardi projektid ebaõnnestuvad sageli, kuid samas peab valdav osa rakendanud organisatsioonidest enda organisatsioonile positiivselt mõjunuks sõltumata rakendamise lõplikust

tulemusest, siis tuli jälgida, et mis on põhilised probleemid tasakaalus tulemuskaardi rakendamisel ja kas ning kuidas oleks võimalik neid lahendada.

Selleks analüüsis autor läbi hulga teoreetilisi käsitlusi, mis analüüsivad tasakaalus tulemuskaardi rakendamist. Lisaks töötas autor läbi mitmeid tasakaalus tulemuskaardile sarnaste strateegiapõhiste juhtimisinstrumentide ülesehituse loogikat ja hindas võimalusi, kuidas oleks võimalik nende positiivseid aspekte ära kasutada tasakaalus tulemuskaardi parema rakendamise juures.

Kõigele lisaks analüüsis autor oma praktilise kogemuse põhjal erinevate tasakaalus tulemuskaardi rakendamise projektide juures, läbi viidud tasakaalus tulemuskaarti käsitlevate seminaride ja loengute raames ning enda koduleheküljel <http://www.rillo.ee/> asetsevates arvamusfoorumites peetud diskussioonide kaudu teisi võimalusi, mil viisil tasakaalus tulemuskaardiga kaasnevaid probleeme oleks võimalik kaardistada ja neid vähendada.

Autor tõestab oma praktiliste kogemuste ja kirjanduse põhjal, on Kaplani ja Nortoni poolt välja töötatud tasakaalus tulemuskaardi mitmeid põhjalikke puudusi, mis raskendavad selle rakendamist praktikasse:

- põhjuslike seoste sidumatus ajaliselt;
- põhjuslike seoste loogiline põhjuslik sidumatus;
- vähene arvestamine väliskeskonna ja erinevate huvigruppidega;
- ülalt-alla meetodika, mis tekitab lokaalseid optimume ning vähendab töötajate motivatsiooni;
- meetodika vähene sobivus erijuhtumitel ja
- teisi vähemtähtsaid tasakaalus tulemuskaardi puudusi.