

## The importance of Balanced Scorecard in business operations

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### **Abstract**

The aim of this paper is that to explore the role and importance of applying strategic management tools known as Balanced Scorecard in a comprehensive, concise and understandable way. The subject of the research is the elaboration of the basic assumptions of Balanced Scorecard model in its essential elements and displays the possibilities of its application, as well as showing the importance of methodology of Balanced Scorecard to translate company's strategy into initiatives, measures and effects. With clear indicators and measures it is possible to develop and improve the organization. The tasks and standards observe the results of the organization through four perspectives: finances, customer, internal business processes and learning and development. These four perspectives provide a framework for the Balanced Scorecard. The aim of the implementation of Balanced Scorecard is to significantly improve the business. BSC model combines financial and non-financial measures into a single system to provide managers with sufficient and relevant information about the activities they manage.

The usage of BSC method should start with a clear idea of its long-term application and with the aim of the process to learn as much as possible about how the organization should work in order to satisfy customers, stakeholders and employees.

Balanced Scorecard is extensively used in the business sector, governmental and nongovernmental organizations around the world, to synchronize operations with the vision and strategy of the company, to improve internal and external communication and monitoring of organizational performance in relation to its strategic goals.

Benefits of the Balanced Scorecard include increased financial returns, greater coordination of activities with the goals of employees, improved cooperation and continued focus on strategy.

Balanced Scorecard is a set of instruments that provides simple and concise overview of the company and provides answers to questions where it is and where it should go.

**Key words:** perspectives of BSC, the strategic map, performance measure, implementation of BSC

### **Introduction**

Business strategy, to which every company that wants growth has to pay deserved attention comes from the vision and mission of the company and must be clearly defined, with the goals and tasks that are recognizable and conductible. For the successful implementation of the strategy objectives must be measurable.

In today's environment it is proved that it's not enough to rely only on the purely financial indicators. Modern business has set the task for managers to monitor and measure not only financial, but also other indicators of value and success of an organization. In modern companies big part of the market value is consisted of intangible value and intellectual capital (people, brand, processes ...), which create the need for developing measurement systems that will identify and assess other indicators of the value of companies such as relationships with customers, business performance process, the ability to develop and so on.

Starting from the vision, mission and strategy Balanced Scorecard has developed as a tool which taking into account the value of the company exceeds the main problems of the organization: a successful measurement of company's performance. This paper aim to show the introduction of Balanced Scorecard and the implementation of appropriate management of related processes can bring good results, mainly through increasing the quality of the strategic management process.

Balanced scorecard provides a concise overview of the company and answers questions where it is and where to go. The main feature of this method is that it is rational and profitable because it is focused on the optimal number of key characteristics which choice is the result of the vision and strategy.

Clear benefits that companies realize with the application of the Balanced Scorecard are improved strategic planning, improved communication strategies and execution, better information of the management, improved reporting of performance, better compliance of the strategy and better coordination of the organization. It is expected that changes in the way of observing the different segments of the business through Balanced Scorecard significantly affect the quality of the organization's business and thus contribute to the business, primarily the company's development and rapid achievement of strategic objectives and vision of the company.

Starting hypotheses are:

- Balanced Scorecard is a modern multi-dimensional method of measuring the performance of companies in modern market conditions, which can significantly improve the operations of companies that are applying it.
- One of the reasons of failure or poor results of the company is certainly insufficient management attention on strategic issues. With the appliance of the Balanced Scorecard method the quality of strategic management process is increased and the conditions for the growth of the company are created.
- The very presence of the company's strategy is not enough. Even the best strategy will have no value if it isn't applied. Balanced Scorecard application method significantly improves the performance of companies in implementing strategy.

The intention of this work is to review the basic parts of the model.

### **Basis of *Balanced Scorecard***

Managers must determine how the company will compete with its competitors in order to realize the benefits that can be sustained for an extended period of time.<sup>1</sup> The main role of

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<sup>1</sup>Dess G., Lumpkin G.T., Eisner A., *Strategijski menadžment*, 2007, str. 10

managers is to manage the processes: planning, organizing, managing and controlling. The implementation of each of these processes, managers is constantly faced with different problems that need to be solved. Modern managers, in order to effectively manage any process, necessarily have to use management tools and methods and techniques.

Organizations in today's highly competitive environment, full of changes, have to devote considerable time, energy and human and financial resources, measuring performance in achieving its strategic goals. Financial performance measures which correspond to the business activities were based on tangible assets, but they are not adjusted for the value creation mechanisms of modern business organizations. Intangible assets like knowledge of employees, customer and vendor relationships, and innovative culture are the key to the production values in a modern economy. Nevertheless, the role of different strategies is now more important than ever. Effective implementation of the strategy is very important in today's era of globalization, the power of clients and rapid change. The disturbing fact is that about 9 out of 10 organizations fail to implement its strategy.<sup>2</sup>

Because of the different views on the development of performance measurement and evaluation of business operations, several different methods of measuring business performance have developed. Nowadays the most used method is the Balanced Scorecard, which tracks the optimal number of key features whose appointment was derived from vision and strategy for the company.

Financial measures are inadequate for predicting and evaluating the path which information age companies must go through in order to create future value through investment in customers, employees, processes, technology and innovation. Balanced Scorecard complements financial measures based in the past with the scale drivers of future performance.

Balanced Scorecard is a relatively new concept. It was introduced for the first time in 1990 by Kaplan and Norton. Kaplan and Norton talk about the organization that is completely devoted to implementing the strategy.

Balanced Scorecard is a set of instruments that provides simple and concise overview of the company and provides answers to questions where it is and where it should go. The methodology of Balanced Scorecard turns the company's strategy into initiatives, measures and effects. Benefits of the Balanced Scorecard include increased financial returns, greater coordination of activities with the goals of employees, improved cooperation and continued focus on strategy.

It represents a carefully selected set of benchmarks derived from the strategy of an organization that can be quantified.<sup>3</sup> The selected criteria may be used to help employees and external stakeholders in presenting the results and performance drivers by which organizations are trying to achieve its mission and strategic goals. Balanced Scorecard provides for the vision and strategy to be turned into a system of specific goals and measures, whose implementation is systematically monitored and measured. It also allows for all business functions to subordinate their actions to the realization of the unified vision and strategy.

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<sup>2</sup>Niven P.R., *Balanced Scorecard – Korak po korak*, 2007, str. 12

<sup>3</sup>Niven P.R., *Balanced Scorecard – Korak po korak*, 2007, str. 33

Balanced Scorecard helps organizations to cope with three major issues: a successful organizational performance measurement, monitoring and exploitation of an intangible assets and challenges of strategy implementation. Approximately 75% of the value created in the organization is made of intangible assets. The ability of the company to mobilize and exploit its intangible or invisible trumps becomes more important than investing and managing physical, tangible assets.

Balanced Scorecard emphasizes that financial and nonfinancial measures must be part of an information system for employees at all levels of the organization. Innovative companies are using Balanced Scorecard as a strategic management system to manage its strategy in the long run.

To support simplicity and usefulness of the measurement, the number of measures in the Balanced Scorecard is limited, and all criteria were classified into four groups. In fact, one of the key activities is just selection, filtering and grouping criteria (the companies already have much more standards than is required to put in the Balanced Scorecard feature). Balanced Scorecard model suggests the implementation of the vision and strategy in four key performance prospects of success:

A. *financial perspective* - provides information on the overall financial operations and position of the company;

B. *customer perspective* - means measuring market performance, delivered value and user's satisfaction;

C. *internal business process perspective* - measures the performance of different processes and activities that focus on delivering value to target users;

D. *perspectives of learning and development* - refers to the infrastructure that the company must build in order to ensure long-term growth and improvement.

Balanced Scorecard is a tool for change. Building a successful team, creating support and enthusiasm for the initiative changes, efficient collection and exchange of information and training, are just some of the exciting and challenging tasks to be faced.

Balanced Scorecard model is developed for a specific purpose in accordance with the set concept. Developing elements of a Balanced Scorecard should first determine the basic values, mission, vision and strategy of the organization, because the indicators measuring the four perspectives of achievement choose exactly the purpose of their achievements. Balanced Scorecard provides executives comprehensive framework that translates a company's vision and strategy into a coherent set of criteria found.

The fact about which most authors agree is that the execution or implementation of the strategy is much more important than strategy formulation. In support of this claim is the study of 'Fortune' in 1999. which found that 70% of top managers failures is not the result of bad strategy, but of not being able to implement it.<sup>4</sup> In order for the organization to succeed in today's business, the strategy must be "revived" with great clarity, so that everybody in the organization can understand it and act in accordance with it on a daily basis.

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<sup>4</sup>Niven P.R., *Balanced Scorecard – Korak po korak*, 2007, str. 29

Using the Balanced Scorecard, organizations have an excellent chance of winning the difficulties in successfully implementing its strategy in its constituent parts through the four perspectives. Balanced Scorecard is the ideal generated by a common understanding and implementation of strategies for the purposes of the organization, standards, goals and initiatives in each of the four perspectives. Using the Balanced Scorecard as a framework for the implementation of the strategy, these organizations are creating a new language of measurement that serves as a guide for all staff activities aimed at achieving this objective. A key attribute of formulating strategy is to perform a set of activities that is different from those performed by their competitors. These activities must reflect the Balanced Scorecard which must go along with the strategy. By dividing the strategy into its elements, through goals and measures in each perspective, Balanced Scorecard gives the organizations the opportunity to move along from 'deciding' to 'enforce' the strategy.

Balanced Scorecard makes it possible to define the cause-effect relationships within a single strategy. In defining the strategic hypothesis, the initial step is the perspective of owners and consumers. The basic question is "Who are financial targets in terms of revenue growth and increased productivity? What are the main sources of growth?". Once the objectives of the financial perspective are defined, the next question would be "Who are the target consumers that will ensure revenue growth and profitable mix of products and services? What are our objectives in this perspective and how to measure success in achieving them?". Consumer perspectives include the definition of "value proposition" (value proposition). Value proposition defines the way in which the company will differentiate itself in terms of unique products mix, prices, services, customer relations and image to attract and retain target customers and deepen relationships with them. Financial and consumer objectives are desired outcomes, but they do not specify the ways in which they are reached. The prospect of internal processes, which for example, include product design, brand and market development, sales, service, production and logistics - defines the activity that is needed to create the desired value proposition and differentiation and consequently desired financial outcomes. The fourth perspective, the perspective of learning and development reveals capabilities and conditions which are necessary to conduct internal business processes. This refers to the organizational infrastructure, skills, abilities and knowledge of employees, technology used by them, and the climate in which they work.

### **Perspectives of *Balanced Scorecard***

Classic Balanced Scorecard consists of four perspectives through which we observe the strategies: financial perspective, customer perspective, internal process perspective and the perspective of learning and development. The financial perspective is about how to appear before the shareholders, clients and prospects, how to perform in front of customers if we want financial success. Internal business perspective answers the question which venture should we go beyond in order to satisfy shareholders and customers. The prospect of learning and development shows how much are we willing to change and improve if we are to achieve our vision.

Practice has shown that the Balanced Scorecard can be used for different purposes, and can be greatly modified. The architecture of the Balanced Scorecard has four perspectives which are not necessarily supported, but the logic of strategic mapping must be maintained.

Balanced Scorecard implements the vision and strategy of the tasks and measures across a balanced combination of perspectives and viewpoints. Balanced Scorecard includes

measures of desirable achievements and processes which will encourage that kind of achievements in the future.

### **Financial perspective**

Creating value for the owners is the outcome that any strategy of the company should achieve. The financial perspective is essentially the most important aspect of business, because achieving profit is the goal of each company. The other three perspectives are the only support weapon that is used to achieve the main goal.

The criterion of financial performances is shown by the contributions or the company's strategy and its implementation to the greater financial profit. The financial perspective shows us how we dispose of the money invested in the company. Financial performance indicators are related to profits and operations incomes. Balanced Scorecard should tell the story of the strategy, starting with long-term financial objectives, and then connecting them with a series of activities to be undertaken in respect of financial processes, customers, internal processes, as well as staff and systems to achieve long-term economic benefits. For most organizations financial topics such as increasing revenue, improving productivity and cost images, improved use of assets and risk reduction may be associated with all perspectives of the Balanced Scorecard.

Financial objectives and measures must play a dual role: they should define the expected financial performance and strategy should serve as the ultimate goal for the tasks and standards of all other perspectives. The goals and measures in this perspective tell us that the implementation of our strategy leads to improved financial results.

### **Perspective of customer**

When choosing measures for customer perspective in the Balanced Scorecard, organizations must answer three key questions: 'Who are our target customers?', 'What is our added value for them when they provide services?' and 'What our clients expect and demand from us?'

In the customer perspective, managers identify the customer and market segments for which the business unit is about to fight. Key measures of the achievement include: customer's satisfaction, customer's retention, new customer's acquisition, customer's profitability and market share of the budget and target segments. Key drivers of client achievements, which are linked each to their own segment, present facts that are critical to customers in the decision whether to change the supplier or remain loyal to him.

The customer perspective allows the managers of the business unit to articulate the customer's and market's strategy that will lead to future financial returns. Eg. clients can appreciate the short intervals of production and timely delivery, innovative products and services, can appreciate a supplier that is able to anticipate their emerging needs and being able to develop new products and methods of access that correspond to these needs.

In order for the finance indicators to be successful, it is important that product or service is well received by the client. By analyzing the indicators, we can conclude that the quality is the strategic objective on the market. Besides quality, many things have an essential role in influencing customers such as delivery time, meeting deadlines or product prices. Good

knowledge of the customer perspective and skills to recognize market needs allow managers to properly choose a strategy that will bring good financial results.

### **Perspective of internal business process**

The internal process perspective of the Balanced Scorecard identifies the key processes in which the company must be excellent in order to continue to add value for customers and for shareholders. Each of the disciplines for clients will withdraw with itself the effective functioning of specific internal processes in order to serve customers and meet the additional value for them. The task is to identify these processes and develop the best possible goals and measures that track progress. This perspective can include product development, production, delivery and after sales service.

Indicators of internal business processes are focused on internal processes, whose effect has the greatest impact on customer's satisfaction and achievement of the financial goals. This perspective answers the question of how to place the individual business processes, as we point to those responsible for that part and what kind of improvements in this direction should be undertaken (improving service or performance). Through this perspective managers identify the key internal processes in which the organization must be excellent.

### **The perspective of learning and development of employees**

The goals and measures in this perspective are the drivers of the other three perspectives. They are the basis on which the Balanced Scorecard is constructed. In this perspective there is a place for the skills of employees, their satisfaction, availability of information and coordination, together with the specific drivers of these original criteria, such as detailed, specific indices of specific skills needed for the new competitive environment. Measures that are determined in this perspective run all the other criteria.

The prospect of learning and development recognizes the infrastructure which the organization must build in order to create conditions for long-term growth and improvement. Such skills and attitudes must be continuously developed, strengthened and reinforced,. Each employee must be motivated and focused on the goals and objectives of the organization. In the modern organization the balance of power has changed due to the importance that a well-trained worker and people with knowledge (knowledge worker Eng.) have for the organization. Knowledge workers consider their professional development and advancement and personal enrichment (financial and any other kind) more important than loyalty to the company. Poor efficiency of selected employee impairs the development and preservation of human capital.

### **Cascading of the Balanced Scorecard overcomes the obstacles with people**

Cascading of the Balanced Scorecard means its implementation at all levels of the organization, as well as providing opportunities for all employees to demonstrate how their activities contribute to the strategy of the company.<sup>5</sup> Cascading creates a line of employees at the facility all up to the level of board members. Instead of incentives and rewards associated with achieving short-term financial goals, managers now have the opportunity to directly link the rewards of their team or business unit, with areas that have an impact.

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<sup>5</sup>Niven P.R., *Balanced Scorecard – Korak po korak*, 2007, str. 42

All employees can be involved in the process of Balanced Scorecard. For the cascading process to proceed successfully, each company must understand the operational and strategic importance of goals and measures that appear on the scorecard of the highest level.

### **Strategic map**

Strategic map are communication tool used to tell a story of how value is created for the organization. They show a logical, step-by-step connection between strategic objectives (shown as ovals on the map) in the form of a cause-and-effect chain. A properly designed Balanced Scorecard should describe the objectives of the strategy that are on the strategic map and the measures that were chosen for them. The strategic map is a clear graphical representation of what we do well in each of the perspectives in order to implement the strategy. If there is any problem in achieving a goal, strategy map will indicate it and so act as a warning system for the organization's strategy. The first question that must be taken into account when making strategic map is whether the four perspectives are correct for the organization. Perspectives selection at the end should be based on what it takes to tell the story of your strategy and create competitive advantage for your organization. The strategic map answers the question: 'What should we do well in order to implement the strategy?'

### **Conclusion**

Studies have shown that the Balanced Scorecard, compared to many other methods, is aimed at the immediate results of the user, and in addition, is easily linked to other tools for measuring performance that are used in enterprises. Balanced Scorecard provides strong and clear arguments in favor of the importance of intangible assets, enabling organizations to fully exploit their potential.

This method is extensively used in the business sector, governmental and nongovernmental organizations around the world, to synchronize operations with the vision and strategy of the company, to improve internal and external communication and monitoring of organizational performance in relation to its strategic goals.

Effective implementation of the Balanced Scorecard helps an organization in many ways, bringing with its application:

- Increased focus on strategy and results instead of tasks;
- Improved communication among business units;
- Understanding and responding to customer's needs;
- Improvement of organizational efficiency by measuring what matters;
- Helps leaders to make better decisions based on leading indicators, not based on outdated financial data ;
- Indicates leaders and staff to priority work tasks from day to day.

Creation of a strategy map is also very important, one might say, critical, selection of key stakeholders that contribute to the success of organizations, which need to include a map. The strategic map is a display of what must be done well in each of the prospects for its effective implementation.



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