

Integrated Approach: the Balanced Scorecard and EVA

Amnon Danzig

Preface

The Balanced Scorecard (BSC) is a well-known management tool to which many firms have sworn their allegiance. In recent years, however, there have been too many unexplained failures of this tool.

Examples are everywhere. Just look around and ask yourself: why have these companies adopted the concept? What is their aim? Is the implementation effective? In my experience, implementing the Balanced Scorecard is often part of the CEO's agenda to leave his mark or develop his own brand as the "up-to-date" CEO. One CEO I observed went into too many implementations simultaneously: ERP, Lean Manufacturing, processes documentation, and, of course, Balanced Scorecard.

In order to understand what is preventing a well-established management concept from achieving its potential, we need to look beyond the symptoms. We need to "lift the hood" and find the source of the problem. This article will explore the most common failures of BSC, and suggest possible alternatives.

A Short History of the BSC

Kaplan and Norton sought to construct a framework that would translate strategy into action--by no means an easy task.

Because the BSC is a popular framework, attempts have been made to adapt it for purposes other than those for which it is intended. These added features impair its effectiveness. The following are two frequent misuses of the BSC:

1. Some believe that the BSC can be used to implement stakeholder theory in a single comprehensive framework

- Stakeholder theory claims that the aim of the firm is not limited to increasing shareholder value; rather, equal preference must be accorded to other stakeholders such as employees, suppliers, customers, and society at large. As noble as this approach may seem, it is a sure way of missing the mark. By way of clarification: even if one thinks that the aim of the firm is to satisfy the entire stakeholder community, a governing criterion for decision making is still necessary in order to consider tradeoffs: only by focusing on the shareholder value will decisions take into account the economics of the

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firm, thereby benefiting all stakeholders.

2. Some diminish the effectiveness of the BSC by using it as a technical tool, attempting to add it to the organization's measurement system through the use of Key Performance Indicators (KPIs)
 - Measurement is not a "stand alone" process. It is an integral part of a comprehensive managerial system that also includes compensation, communication and training. When any of these phases is carried out by one department without including the other constituents, the system is likely to fail. All constituents must understand the system and must oversee the proper representation of their interests.

The first example is a perfect illustration of "more is less". The second example is more a case of "less is less," merely giving an impressive title to activity that uses some of the characteristics but neglects the broader context of the "Balanced Scorecard" approach.

We would like to give the Balanced Scorecard its legitimate place as a framework used to translate strategy into actions, and as a tool for transforming the "big words" of strategy into day-to-day activities, processes and decisions.

The Concept

Managing an organization is not easy. Organizations must be competent in multi-tasking. They must manage the current situation while simultaneously preparing for the future. Sadly, very few organizations are really good at both. Some do better in the execution phase by running efficient operations, while others excel in preparing for the future, by efficiently investing in R&D, marketing, and human capital.

The integrated approach will be an invaluable process management tool for firms engaged in intense preparations for the future.

Measurement of current operations is an accepted and familiar undertaking, tirelessly pursued in organizations. Managing for the future, on the other hand, is a more complex task [\[1\]](#).

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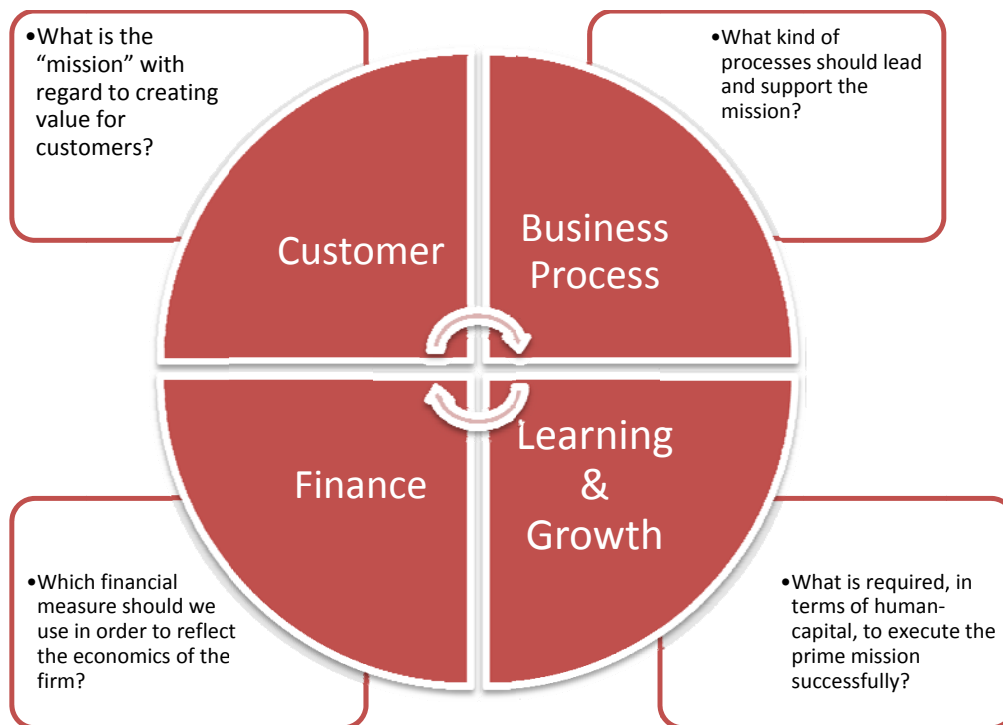
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We argue that the BSC is the best framework for managing the future of the firm. The BSC should encourage the firm to run processes and activities that will increase its intangible assets. In other words, the BSC will assist in creating new strategic opportunities and in building strategic capabilities that will enable the firm to harvest both existing and new opportunities.

The Framework

The BSC considers four perspectives:

1. *The customer*
2. *Business processes*
3. *Learning and growth*
4. *Finance*



In order to translate strategy into action, we must deal with two sets of measures:

1. Leading measures that reflect future performance, e.g. processes and in-

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itiatives

2. Lagging measures that reflect past performance, e.g. finance and operations

The first set of measures is for managing processes, creating new prospects, and building new capabilities -- all of which enable the firm to harvest both existing and new opportunities. The second set enriches the overall understanding of the firm's performance, and serves as the source for paying bonuses for extraordinary achievements.

Processes within the organization should be assessed using leading measures, while lagging measures should be employed to evaluate the results of the execution of strategy: the operational and financial health of the organization. The finance perspective should be the only lagging measure, used as a way of keeping score -- a way of distinguishing between victory and defeat, so to speak. To summarize, the Balanced Scorecard is suitable ONLY for process management, and only for those processes that will impact the future of the organization.

The starting point of the BSC process should be in senior management. The executive team must translate its over-arching strategy into major processes. Subsequently, each C-level person should cascade it down to the lower levels, making sure that the entire staff is exposed to the master BSC. It is important for each unit/level to have its own BSC; however, it is essential that all scorecards follow in the footsteps of the master scorecard. Failing to ensure this will guarantee the collapse of the program.

Required steps

The organizations that will most benefit from this approach are typically those that are looking for new markets and are investing in huge R&D efforts. We cannot fail to appreciate that most companies in the 21st century MUST think this way. In my experience, however, such companies lack the sufficient tools to manage these processes.

The following order must be followed. All steps should commence from the

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customer perspective, and should be judged by the same criterion: whether they create short-, medium-, or long-term value for the customer.

Step #1:

Customer Perspective

What is “the mission” with regard to creating value for customers? The answer to this question will determine the entire framework; it will be the foundation upon which the firm creates value for its customers in the future. Hence, maximum intellectual effort should be invested here. Brainstorm many options and try to crystallize the ONE that reflects THE proposition for the market place. Once this has been done, the other steps will be fairly straightforward.

Step #2:

Business Processes Perspective

What kind of processes should lead and support the mission? Only processes that contribute to achieving the mission should be included in a BSC. Here, senior management must screen all business processes and set priorities: only those that serve Step #1 will be included within the framework. All others should be given lowest priority, or be disregarded altogether.

Step #3

Learning and Growth Perspective

What is required, principally from a human-capital perspective, in order to execute the prime missions successfully? Again, ONLY initiatives that support Step #1. Others should be given lower priority or disregarded.

Steps #2 and #3 are intended to signal to the entire organization which actions are to be taken and how, and what should be omitted. The priorities should be declared clearly and emphatically to reflect their importance and instill a sense of urgency in the entire organization. This will make the strategy a common language. It will create the focus for major efforts and activities.

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Step #4

Finance

Which financial measure should we use in order to reflect the economics of the firm? We recommend EVA or Δ EVA, as they measure true value creation. Employee bonuses for outstanding contributions in preparing the organization for the future are important; however, the financial measure should reflect the availability of sources for rewarding bonuses. This refers to the residual profit after paying all the stakeholders.

The Process

The above exercise must be performed at the C-level. When concluded, it will serve as the master BSC, and the difficult task of cascading it throughout the organization begins. To ensure buy-in, each C-level person should go through the exercise with his or her team.

At this point, it is important to provide a word of caution: the process should be kept simple and unencumbered, and should be completed quickly. Why? Because any drawn-out organizational process will lose momentum and credibility. It is preferable to “aim low” initially, raising the bar each year.

A Final Word

Creating sustainable shareholder value can only be achieved if the company is able to adapt to the changing world. Creating new opportunities and building new capabilities are the bedrock of the adaptive firm. The firm must own a framework that will assist in managing these processes. The BSC can successfully become this framework.

The firm must distinguish between leading measures, which go along with the BSC, and lagging measures, which serve to evaluate results and learn from past operations.

There is room for only one lagging measure within a BSC. This measure should accurately portray the economic profitability of the firm. We believe that EVA is the best tool for the job.

With regard to compensation, it makes good sense for EVA to determine the amount, while the measures within the BSC can serve as a threshold. In other

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words, successfully mastering the BSC will grant an employee access to an EVA bonus, while failing to achieve the objectives proposed in the BSC will lock the employee out of any EVA-based variable compensation.

This combination will focus employees on making the firm economically profitable, while at the same time ensuring that the firm will have new opportunities and capabilities needed for long-term success.

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[1] Gary Hamel's book: *The Future of Management* (2007) provides a good clue on how to handle the task of managing for the future