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# The Balanced Scorecard: To adopt or not to adopt?

*The Balanced Scorecard (BSC) has quickly become recognized as an important management tool with the potential to improve organizational performance. The authors report on their research-among the first of its kind-which examines the critical factors that increase the likelihood that a firm will adopt the BSC. In examining the association between BSC adoption and the firm's performance, the authors also point to the need for greater understanding of BSC formulation and implementation issues. (Note: A sidebar that offers six lessons for managers considering a BSC can be found at the end of this article.)*

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Over the past decade, the Balanced Scorecard (BSC) has become a widely advocated management tool associated with "best practices." As a management tool, the BSC provides an enhancement to the traditional management planning and control system by looking beyond financial measures to incorporate non-financial measures. According to Kaplan and Norton, the developers and staunch

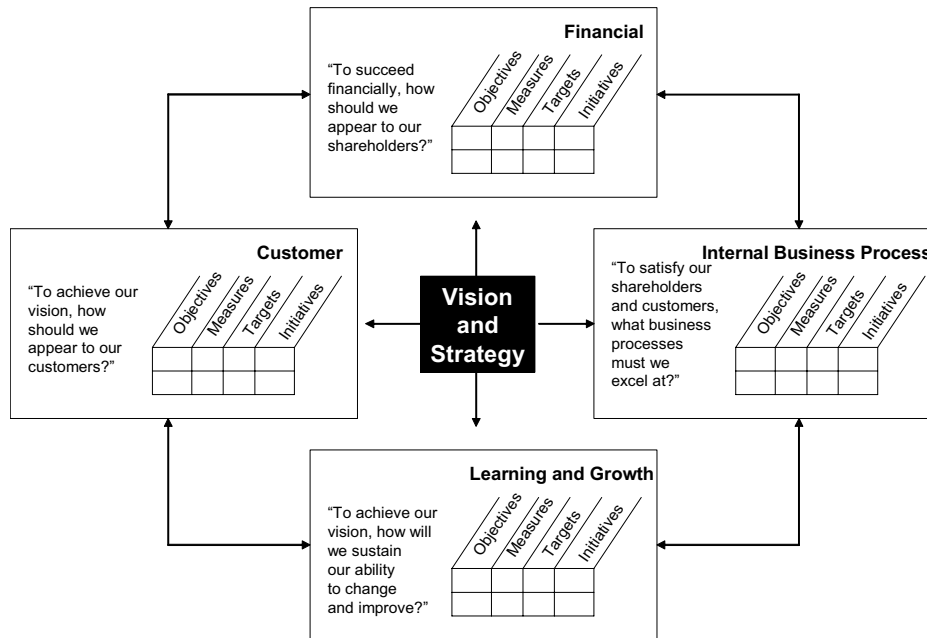
advocates of the BSC:

"The name reflected the balance between short- and long-term objectives, between financial and non-financial measures, between lagging and leading indicators, and between external and internal performance perspectives." (Robert S. Kaplan and David P. Norton, *The Balanced Scorecard*, Boston, MA: Harvard Business School Press, 1996 p. viii.)"

The first BSC-type system, developed by General Electric in the 1950s, was designed to be a performance measurement system, but the BSC has now evolved into a strategic management tool critical to an organization's planning process. The BSC requires that senior management translate the firm's vision and strategy into four performance perspectives: financial, customer, internal business, and learning and growth (see Exhibit 1).

A recent Bain & Company survey of more than 708 companies on five continents found that the BSC was used by 62 per cent of responding organizations, a higher adoption rate than some other well-known management tools like Total Quality Management, Supply Chain Integration or Activity Based Management. Key informants from these organizations ranked the BSC 8th overall in satisfaction (again, higher than any of the management tools mentioned above). (Darrell Rigby, "Management Tools Survey 2003: Usage Up As Companies Strive to Make Headway in Tough Times," *Strategy & Leadership*, 31:5, 2003.) The appeal of the BSC is also reflected in the widely reported estimate that more than 50 per cent of Fortune 1000 firms

## Exhibit 1: The Balanced Scorecard



Source: Kaplan and Norton (1996)

have used it in some form. Indeed, a number of Canadian companies, from a broad range of industries, have adopted the BSC approach including, among others, Royal Bank of Canada, Molson Inc., Aliant Inc. and Nova Scotia Power Inc. (Balanced Scorecard Collaborative, [www.bscol.com](http://www.bscol.com)).

According to BSC proponents, adopting organizations that also successfully implement an integrated BSC should anticipate a number of benefits, including:

- Better management understanding of the linkages between specific organizational decisions and actions, and the chosen strategic goals;
- A redefinition of relationships with customers;

- Re-engineering of fundamental business processes; and
- The emergence of a new corporate culture emphasizing team effort among organizational functions to implement the firm's strategy.

These benefits, while widely touted, have only just begun to be rigorously examined. (Steven Salterio and Alan Webb, "The Balanced Scorecard", *CA Magazine*, 136:6, 2003.) In contrast, the managerially critical question of whether or not to adopt the BSC has yet to be rigorously examined.

Belief that the BSC represents one of the most significant developments in management accounting, and deserves rigorous research attention, is widespread. However, our review of the extant practitioner and research literatures

indicates that (1) there has been little examination of the factors associated with the adoption of the BSC, and (2) there still is the need to demonstrate that the adoption and implementation of the BSC is associated with improved financial performance. We recently completed research specifically examining these two BSC issues.

### BSC contingency factors

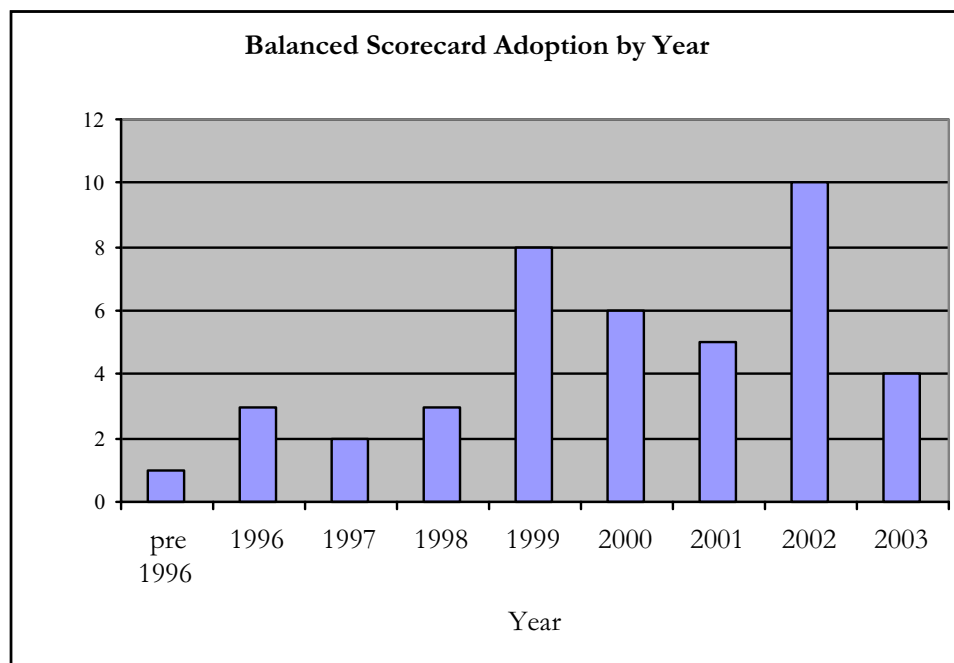
Our BSC investigation was motivated by an observation made in a review of the accounting performance measurement literature:

“...the use and performance consequences of these [BSC] measures appear to be affected by organizational strategies and the structural and environmental factors confronting the organization. Future research can make a significant contribution by providing evidence on the contingency variables affecting the predictive ability, adoption and performance

consequences of various non-financial measures and balanced scorecards.” (Christopher D. Ittner and David F. Larcker, "Innovations in Performance Measurement: Trends and Research Implications", *Journal of Management Accounting Research*, 10, 1998, pp. 223-224.)”

Specifically, we examined contingency factors including business-level strategy, firm size, environmental uncertainty, and investment in intangible assets. Why do we examine these contingency factors? Our discussions with Canadian business executives who were intimately involved with the adoption and implementation of a BSC at their respective organizations highlight the criticality of many of these factors to the adoption decision. Further, most of these factors have been highlighted in the academic literature as being general considerations underlying decisions to adopt a management control system. (Robert H. Chenhall, "Management Control Systems Design Within its

Exhibit 2



Organizational Context: Findings from Contingency-based Research and Directions for the Future", *Accounting, Organizations and Society*, 28, 2003.)

### Scope of survey

We surveyed senior executives (primarily CEOs and CFOs) from Canadian organizations to identify whether their firms had adopted the BSC, when they decided to adopt the BSC, when they began using the BSC and whether or not they have since discontinued its use. The final cross-industry sample of organizations in our survey consisted of 579 Canadian firms, chosen from PC Compustat, with annual sales greater than \$10 million. We obtained key informant responses from 179 firms, of which 42 (or 23.5 per cent) reported that they had adopted the BSC approach. The BSC adoption year ranged from 1996 through 2003, with the highest number of adoptions (10) occurring in 2002 (Exhibit 2). BSC adoption also covered a wide range of industries, with significantly higher than expected representation in the SIC code range 4000-4999, namely, transportation, communication and utilities.

Employing reliable and valid measures for each of our contingency variables, and controlling for industry effects and the firm's operating performance, we used probit regression to estimate the propensity to adopt a BSC. Our findings are discussed below.

### Business strategy

While it has long been argued in the accounting literature that accounting control systems should be designed according to the business strategy of the firm, this premise has yet to be examined with the BSC. We utilized Miles and Snow's comprehensive, business-level strategic typology that interrelates organizational strategy, structure and process. (Raymond E. Miles and Charles C. Snow, *Organizational Strategy, Structure, and Process*, New York: McGraw-Hill, 1978.) This typology, which

distinguishes distinct firm strategies vis-à-vis the competitive environments in which organizations operate, provides a distinct competitive response to the question "How should we compete in a given line of business?" The typology identifies four organizational strategies:

- **Prospectors** who continually search for innovative market opportunities and experiment regularly with new responses to emerging trends;
- **Analyzers** who operate routinely and efficiently through formal structures and processes, while simultaneously watching competitors for promising new ideas which they then rapidly adopt;
- **Defenders** who, given their narrow product-market domains, are highly expert in their organization's area of operation but do little to seek out new opportunities outside their primary domain; and
- **Reactors** who are unable to respond effectively to known change and uncertainty in their organization's environment.

Given the broader scope and inclusion of non-financial, forward-looking measures in the BSC, we posited that the use of the BSC would more likely benefit firms that followed a Prospector or Analyzer strategy, and likely not benefit firms that followed a Defender or Reactor strategy. Therefore, we hypothesized that the propensity to adopt the BSC is positively related to the organization's choice of a Prospector or Analyzer strategy. We found that BSC adoption was significantly associated with strategy: firms that followed a Prospector or Analyzer strategy were more likely to adopt the BSC than other firms. One interpretation of this finding is that the BSC may be more useful for some strategy types.

### Firm size

Like business strategy, previous accounting research has suggested that a firm's size can affect the design and use of management control systems.

As firms grow, problems in communication and control increase, so these organizations are more likely to adopt complex administration systems. As a result, larger organizations will likely depend on more sophisticated information and control systems that use diverse measures. The BSC represents an integrative management tool that is useful for coordinating cross-function and cross-level decisions and activities. Therefore we hypothesized that the propensity to adopt the BSC was positively related to the firm's size. We found that BSC adopters were significantly larger than non-adopters. The mean total assets of the adopters was \$3.6 billion, compared to mean total assets of \$460 million for the non-adopters.

### Environmental uncertainty

Environmental uncertainty has long been viewed in practice and research as a central problem for organizations. Previous accounting research has found that the uncertainty was related to greater usefulness of broad-scope information, and that the demand for broad-based information systems incorporating non-financial measures was positively associated with perceptions of environmental uncertainty. The BSC, which incorporates both non-financial and future-oriented information, would be particularly critical for firms where environmental uncertainty is high. Therefore, we hypothesized that the propensity to adopt the BSC was positively related to the firm's environmental uncertainty. We found that BSC adopters had significantly higher demand volatility (measured as the coefficient of variation in annual sales changes) than non-adopters.

### Investments in intangible assets

While a definitive classification of intangibles remains to be offered, there is agreement on the importance of effectively managing these assets from a control perspective. Indeed, the effective management of intangible assets-which includes, among others, product innovation, company brand, structural assets, and monopolies (see Baruch Lev, "New Math for a New Economy", *Fast Company*, 31

(January), 2000.) - can be an important driver of business value. The BSC is a notable management tool, since it specifically requires the use of non-financial measures directly reflecting the organization's learning and growth decisions, activities and outcomes. Therefore we hypothesized that the propensity to adopt the BSC was positively related to the firm's investment in intangible assets. However, we did not find support for this hypothesis when we measured intangibles as the ratio of intangible assets to total assets. Given that the financial accounting model is criticized as being overly conservative with regard to the measurement of intangibles, we are currently considering other metrics that might better capture the importance of intangibles to a firm.

### BSC and financial performance

Kaplan and Norton propose that the BSC can be used as a strategy map to create value within an organization, through the customer value proposition, internal business processes and the alignment of intangible assets with enterprise strategy. This value should be reflected in improvements in accounting measures such as improved cost structure and increased asset utilization, and ultimately through increased long-term shareholder value (Robert S. Kaplan and David P. Norton, "The strategy map: guide to aligning intangible assets", *Strategy and Leadership*, 32:5, 2004, 10-17.) Research can add insight to this area by examining the relation between BSC adoption and implementation and financial performance.

One potential motivation for adopting any new management control system is that the firm's current performance is not meeting the existing expectations of the management team or its shareholders. This was the case in the Group Insurance division of Canada Life in the late 1990s, according to Sandy Richardson, the individual who spearheaded the BSC initiative for the division (see sidebar at the end of this article.). The Casualty division had adopted the BSC in 1996-in part because of poor performance-and the Group Insurance division adopted the BSC one year later. The

division embraced the BSC for all parts of the management control system. Richardson noted, "It becomes the way you work." While developments and refinements to the BSC were ongoing, Richardson could nevertheless see improvements. Employees better understood linkages between business activities and the unit's strategic objectives, and the BSC encouraged cross-functional communication. Overall, the BSC effort was evaluated as being highly successful.

To examine pre-adoption performance for our sample of 42 BSC adopters, we measured and tested the abnormal financial performance over a three-year period ending in the year of the BSC adoption. Performance was measured as both return on assets (ROA) and return on sales (ROS). For the BSC adopters that we had the necessary data to perform statistical tests, our results indicated that the mean and median abnormal performance over the three-year period up to the year of the decision to adopt the BSC was negative for both ROA and ROS. However, the statistical significance of these findings was marginal, implying weak evidence that poor performance (measured in terms of increasing costs or declining margins) may be a factor in the decision to adopt the BSC.

We also considered performance following the implementation of a BSC. We measured and tested the abnormal financial performance for adopters up to three years after the BSC was implemented. Our preliminary tests on a subset of the overall sample did not reveal significant performance improvements in ROS or ROA after implementation. However, because a number of adopting firms began implementation after 2003, there was insufficient data to draw any firm conclusions about post-implementation performance. We leave this important question for future research.

### **BSC management - From Adoption To Implementation**

We believe that the adoption of the BSC will continue to grow in the foreseeable future as managers in organizations continue to search for management tools that will spur ongoing improvements in internal and

external organizational performance. The practitioner and academic BSC literature continues to grow, as does the list of companies reportedly using the BSC. Our research has begun to address an important shortcoming in the study of management control systems, namely the empirical examination of contingency variables associated with BSC adoption. Focusing on Canadian firms, we provide intriguing evidence about which factors motivate firms to adopt the BSC, and also provide a better profile of the type of organization most likely to adopt a BSC. That said, while we were motivated by the need for a better understanding of BSC adoption, we believe that there has not been enough research effort focused on understanding BSC implementation and performance issues. Our BSC adoption and organizational performance analysis suggests the importance of further examining BSC implementation, as the adopters in our sample may not yet have achieved an effective implementation of their BSC.

A number of guides related to BSC formulation and implementation have been offered in the practitioner literature. Recommendations for effective BSC formulation and implementation include:

- Obtaining senior leadership involvement;
- Articulating the firm's business vision and strategy;
- Identifying the performance categories that link vision and strategy to results;
- Cascading the scorecard to team, division and functional levels;
- Developing effective measures and meaningful standards (both short- and long-term; leading and lagging);
- Deploying appropriate budgeting, IT, communication and reward systems;
- Viewing the BSC as a continuous process, requiring maintenance, reassessment and updating;
- Believing in the BSC as a facilitator of organizational and cultural change.

Some of these recommendations are based on anecdotal observations developed during the adoption and implementation of the BSC at specific, individual firms. While there still is little agreement about what constitutes effective BSC implementation, there is consensus around the view that not all BSC tools are created equal. Our continued research efforts will focus on the usage of the BSC following the decision to adopt such a system, developing a more rigorous understanding of formulation and implementation issues. ■

## The KEY elements of Balanced Scorecard success

By Sandy Richardson

*Sandy Richardson is Managing Consultant for Strategy Focused Business Solutions Inc. She recently designed and implemented a BSC at Canada Life. Below, she offers her suggestions based on her experience with Canada Life and other organizations. She can be reached at [sandyrichardson\\_bsc@yahoo.ca](mailto:sandyrichardson_bsc@yahoo.ca).*

Balanced Scorecard (BSC) initiatives have a mixed track record. However, when you study organizations that have had success, you will notice several recurring themes. These provide six lessons for success for all balanced scorecard practitioners.

### **Success Element 1:**

Understand that the balanced scorecard is part of a bigger process that starts with strategy.

The balanced scorecard framework forms one (key) component in an integrated business performance management process that revolves around business strategy. This process is really a system where the balanced scorecard plays a critical role in translating business strategy into measurable action. With this in mind, successful BSC organizations define a solid business strategy prior to BSC development. While this may appear obvious to BSC practitioners, many "war stories" exist about organizations that threw themselves into a measurement initiative without spending time on strategy first. Generally, the result of these initiatives is sub-optimization with results that may or may not support business strategy achievement.

When cascaded from strategy, the BSC framework provides an important connection between strategic business performance and individual employee performance. In addition, the BSC helps close the feedback loop in the business-performance management system by providing a means for the business to: monitor and actively manage progress towards the achievement of business strategy, further explore and understand the cause and effect relationships within the business, and manage/change business

strategy dynamically based on internal insights or shifts in the external operating environment.

**Lesson 1: Embedding the BSC in a business-performance management process that begins with business strategy creation starts building strategic alignment from the start.**

**Success Element 2:**

Senior Leadership involvement in **critical!**

Visible and genuine senior leadership involvement is critical to the success of any BSC initiative. That is, you must secure hands-on executive participation in the balanced scorecard development, implementation and management. Commitment at the top is so important that successful BSC organizations treat it as a "show stopper" - focusing on resolving support issues before moving forward.

The issue of gaining leadership support is the most frequent concern faced by new balanced scorecard practitioners. Most BSC journeys don't begin with executive support from the start - very frequently, the push for a balanced scorecard initiative begins at a grass roots level. The key to "selling" the BSC to executives is to take an individualized approach. That is, first look for the burning platform or key business improvement opportunity that could be addressed by the successful application of a business performance management approach like the balanced scorecard. Then, complete your BSC research (note: there is information out there that can help support your situation!) and build a balanced scorecard business case that clearly demonstrates the benefits required to solve your organization's critical business issue. Keep at it until the executives in your organization get the message.

**Lesson 2: Lack of leadership support can destroy your balanced scorecard initiative so: DO NOT PROCEED ON YOUR BALANCED SCORECARD JOURNEY WITHOUT IT.**

**Success Element 3:**

Start with a clear vision for your balanced scorecard.

A balanced scorecard vision or philosophy is simply a clear statement that describes what your BSC will look like, how it will operate, how it will be built, and how the organization will use it. When created early in the balanced scorecard development process, your BSC vision provides a valuable touchstone going forward providing focus and facilitating quick consensus when critical balanced scorecard decisions are required.

**Lesson 3: Establish your BSC vision early and use it to guide your business performance management road map.**

**Success Element 4:**

Maximize balanced scorecard utilization by fully deploying it at all levels of the organization.

Successful BSC organizations make their balanced scorecard widely available so that everyone can "make strategy their job." Fully deploying a balanced scorecard across an organization helps develop

strategic awareness amongst employees. This is important because successful strategy implementation requires the active contribution of every employee as they make decisions in their day to day work - decisions that can either contribute to or take away from the business strategy. Many business leaders voice concern about sharing their business strategy so broadly across the organization. Worries include the disclosure of critical strategic information to competitors. While these are valid concerns, successful BSC organizations know that the benefits of a broad deployment philosophy and in building employee satisfaction and loyalty levels far outweigh the risk of serious information leaks.

**Lesson 4: Implement the BSC at all levels of the organization to maximize organizational alignment and execution.**

**Success Element 5:**

COMMUNICATE-COMMUNICATE-COMMUNICATE!

To support BSC implementation and its ongoing use, successful BSC organizations view communication and education on their business strategy and the balanced scorecard as an important internal marketing campaign. As a result, few of these organizations use only a single mode of communication to do the job. In fact, they use almost every type of communication method available, from general communication modes (e.g. large group meetings and mass distribution e-mails) to those that are very personalized with customized messages (e.g. face to face discussions) to ensure communication success.

**Lesson 5: Be sure to plan and budget for BSC communication activities because experience shows that these activities are critical, they need to happen, and they won't without a solid plan and dedicated funding.**

**Success Element 6**

Extend the balanced scorecard and make it "the way we work"

Successful BSC organizations deepen alignment by mirroring their balanced scorecard framework and categories in as many business activities as possible: reward and recognition programs, individual goal plan formats, incentive compensation plan formats, strategic plan categories and format, and almost anything else they can think of! They maximize alignment with the balanced scorecard until it becomes so integral to the business that it is automatic and embedded in everyday work.

**Lesson 6: Enhance your integrated business performance management system until the BSC changes from just a measurement framework to the framework by which the business operates.**