

# INTRODUCING BALANCE SCORECARD



The majority of Armenian companies are as young as 15 years old and less. Alike humans – this is the crucial age for formation of the further growth path. The age, when the companies need to make tough choices: whether to transform to professionally managed companies by instituting sound management systems or to continue to operate based on intuitive management, as natural to all emerging market companies.

This, by no means, is not to say that all companies lack the professional management approach in Armenia. There are many best performers that are the leaders in their sector and the major share of their success can be attributed to their timely realization of the need for professional management tools. However, there is still the vast majority of companies that is on the edge of that understanding. A lot depends on their ability to quickly learn and adapt to the future complications in the management of their company in order to stay competitive.

On top of all the “regular” difficulties of management, many Armenian companies are “blessed” with the dual accounting and all the mess that it implies. For example, the majority of local companies will have several answers to the question on what their profit was, not talking about more sophisticated financial indicators...

Having to operate in an “emerging” messy environment like this, the importance of having a sound management system is ever more substantial.

In search for tools to support the challenges of management - turning to international best practice can be of valuable use. The Balanced scorecard is one of those tools developed based on the rich experience of the international companies and evolved to become a comprehensive management system over time.

The Balanced Scorecard, a management system that is used by many leading companies worldwide (Microsoft, Marriot, Volkswagen, HSBC international branches, to name a few), can be as efficiently adopted by local companies.

The Balanced Scorecard, developed in early 1990s, was first introduced as a performance measurement system. It gradually evolved to become a management system that can serve as an integrating platform for the numerous management tools used within a company.

More than 50% of the companies surveyed by Bain&Company worldwide have introduced balanced scorecard system.<sup>1</sup>

The Balanced Scorecard is essentially a strategy execution system. It provides with clear links of operations to company strategy that are measurable and have a distinct set of underlying initiatives to be carried out in order to achieve the targets set by the company.

The main components of the Balanced Scorecard can be seen in the exhibit:

**Exhibit 1.**  
The components of the Balanced Scorecard

	Objectives	Measures	Targets			Initiatives
			y1	y2	y3	
Financial	Maximize growth	Revenue growth	20%	15%	10%	
	Maximize profitability	Net profit margin	5%	7%	10%	
Customers	Increase customer loyalty	NPS (net promoter score)	80%	85%	90%	Customer loyalty program
Internal processes	Efficient and optimized processes	% rework	5%	4%	3%	Quality inspection program
Learning and Growth	Motivated and strategy driven employees	Organizational engagement index	70%	80%	90%	Staff motivational programs

A simple approach of this provides the executives with a hands on tool for the executives for performance management and strategy execution.

The methodology of the Balanced Scorecard implies developing the performance measures with cause and effect linkages to support strategic objectives of the company. Thus, the performance management system of the company is put in a framework that allows seeing a holistic picture. Whereas, having a set of KPI-s for each functional unit makes it difficult to get a holistic view and understand, where exactly the problems arise.

<sup>1</sup> See Darrell Rigby and Barbara Bilodeau, "Management Tools and Trends 2009," Bain & Company, Inc., 2009.


The Balanced Scorecard as a management system provides a framework for the whole cycle of company management – starting from strategy development, planning the strategy and aligning the company, to the final stage of monitoring and review.

Balanced scorecard provides a balance on several perspectives of the company's operations. It helps to balance the company's long term objectives with the short term operations, the external forces (customers, market, etc) – and the internal forces (employees, etc), the financial measures (of more objective nature) – and the qualitative and other measures (of more subjective nature).

### Focusing only on financial metrics can be misleading

Measuring performance only based on financial indicators is as bad as managing an airplane based on one indicator only.<sup>2</sup>

It can divert the management's attention to misleading direction, who will, as a consequence, fail to detect the real “health” issues of the company.



**Experience highlight from Armenian reality – on financial metrics alone being not sufficient**

The management was so happy with the rising revenue and profit figures that loosened the tight belts of the cost policy, especially in the area of bonus payments to employees. The management hoped that the higher salaries and bonus payments would accelerate the company's growth by motivating employees. However, being not linked to the performance metrics and failing to monitor the deteriorating customer satisfaction with the products, the higher pay did poor job on motivation – instead it just inflated the costs of the company squeezing the profit margins down with no material impact on revenue growth at all. As this was only reflected on the financial results of the company's next year's financial reporting – it was rather late when the shareholders and the management decided to take action.

The **Balanced Scorecard supplemented traditional financial measures** with criteria that measure performance from three additional perspectives - those of customers, internal business processes, and learning and growth. It therefore enables companies to track financial results while simultaneously monitoring progress in building the capabilities and acquiring the intangible assets they would need for future growth.

In other words, the Balanced Scorecard enables to focus the management's attention to measures that drive the performance of the company. This way the management is better positioned to make decisions on performance improvement for better financial results of the company.

<sup>2</sup> See Robert Kaplan and David Norton, *The Balanced Scorecard: Translating Strategy into Action*, (Harvard Business Press, 1996), p. 1.

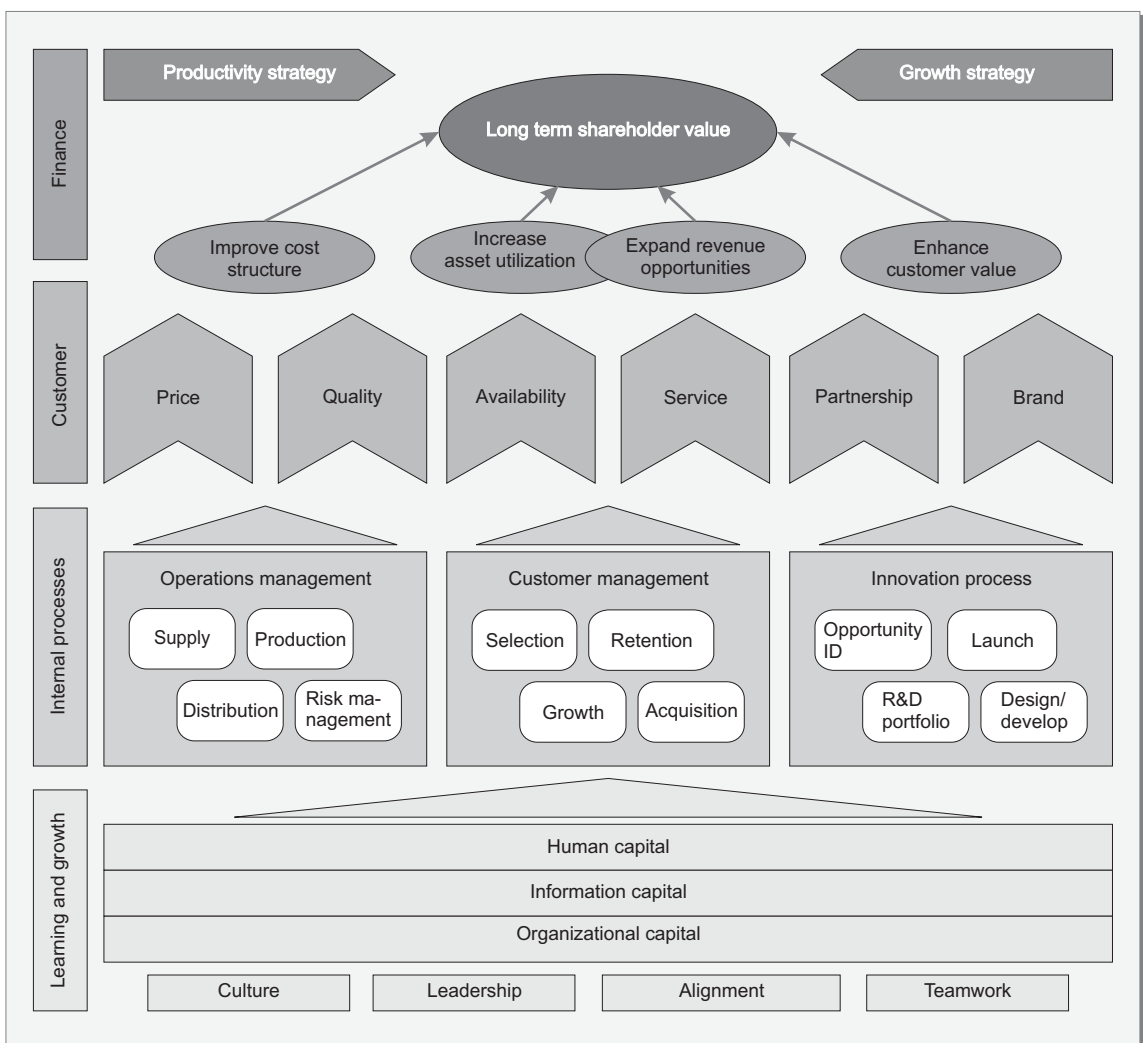
Briefly summarized, balanced scorecards tell you the knowledge, skills, and systems that your employees will need (their learning and growth) to innovate and build the right strategic capabilities and efficiencies (the internal processes) that deliver specific value to the market (the customers), which will eventually lead to higher shareholder value (the financials).

### Balanced scorecard includes a convenient toolbox

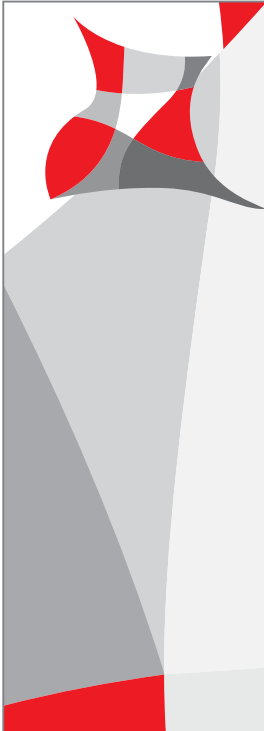
Among those are the strategic initiatives. These are all projects linked to strategic measures and objectives, and all linked to company budget with a dedicated expense line that can be referred to as stratex (strategic expenses).

Strategy maps are one of the key concepts introduced by the Balanced Scorecard methodology. These are designed to present the company strategy on one page in a form of linked objectives. Each of these objectives is then assigned a performance metric or a KPI to assess its achievement.

Exhibit 2.  
A strategy map



Strategy maps show the cause-and-effect links by which specific improvements in the lower levels create desired outcomes in the higher ones. The map has a roof structure, with the higher strategic objectives supported by the lower standing objectives.



**Experience highlight from Armenian reality on the strategy execution difficulties**

The marketing department of the company used to carry out an extensive competitive analysis, compile a comprehensive one year strategy document, which although without a long-term focus, however was a rather “serious” document. The document used to be discussed and approved by the management of the company at the end of the year and generally was never referred to throughout the next year ever again as the real life changes were hard to be included in the document and were even meaningless to do so. Thus, the strategy of the company, the development of which was a rather resource intensive undertaking -was most often left unexecuted.

The shift of the strategy documentation to one page strategy map radically changed the situation: the document was easy to communicate and to execute, as the linkages with everyday operations were clearly marked, in addition – the document was easy and flexible to adjust to real life change needs of the company.

Most companies implement their first balanced scorecard not with the intention of developing a new strategic management system. However, as the experience suggests, by building the scorecard, the senior executives start a process of change that goes well beyond the original idea of simply broadening the company's performance measures.

By developing a tailored management system with the Balanced Scorecard methodology, the managers will obtain tools necessary for setting clear strategic goals, planning and allocating resources, monitoring and timely spotting the problems arising, and updating and improving, where necessary. The Balanced Scorecard allows to balance all major aspects of the company, most importantly - the long-term development strategy and the daily operations.