

# STRATEGIC MANAGEMENT ACCOUNTING

## SMA

### LECTURE 4\_1

# BALANCED SCORECARD: CONCEPT AND APPLICATIONS

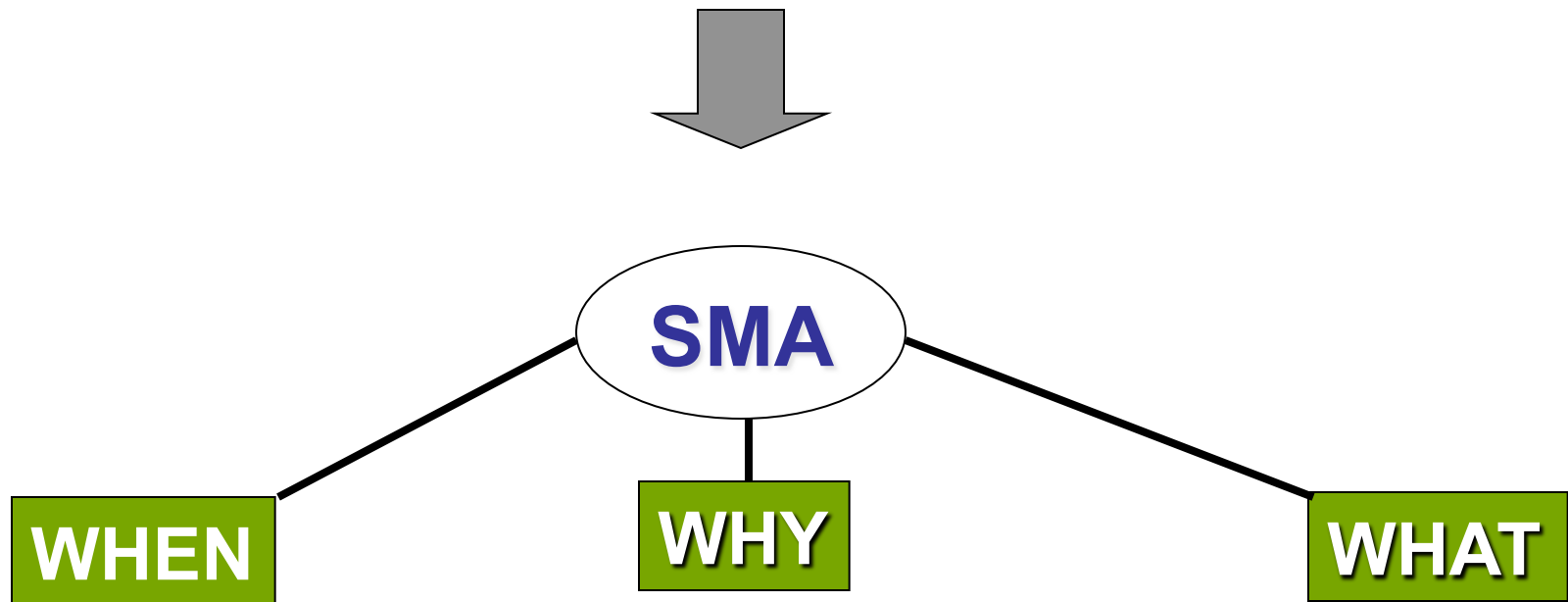
Dr. M. Contrafatto

# OUTLINE PRESENTATION

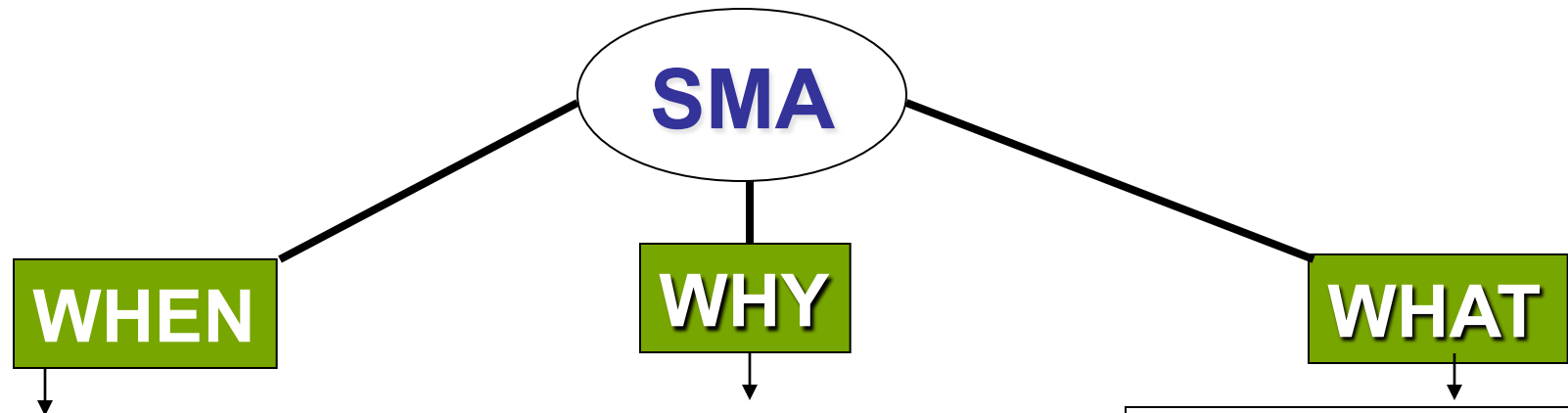
- A) Introduction: SMA and Balanced Scorecard (BS)
- B) BS: definition and conceptualization
- C) BS: perspectives
- D) BS: benefits and limitation

# A) INTRODUCTION: SMA & BS (1)

To understand BS we need to consider the discipline within which it has emerged: i.e. Strategic Management Accounting.



# A) INTRODUCTION: SMA & BS (2)



- 1980s: debate about role and future of MA.

- SMA developed within this context.

- Simmonds (1981, 1982) first coined the term.

- Traditional MA practices and theory were criticized

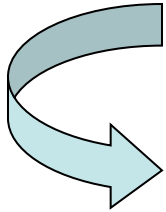
- New “ways” were advocated.

- S M A w a s considered as a “new way”.

- There is no comprehensive framework as to what constitutes SMA.

- Many definitions exist. Each emphasize different aspects.

# A) INTRODUCTION: SMA & BS (3)



## SMA: WHAT IS IT?

- Many definitions of SMA have been provided. Some of them have emphasized either an external focus or an internal one.
- Drury (2008, p. 570) defines SMA as: “*a form of management accounting in which emphasis is placed on information which relates to factors external to the firm, as well as non-financial information and internally generated information” (CIMA, 2005, pag. 54). Innes (1998) defines SMA as the “*provision of information to support the strategic decisions in organizations*”*

# A) INTRODUCTION: SMA & BS (4)

An omnibus definition is provided by [Hosque \(2006\).](#)

**MANAGEMENT  
ACCOUNTING**



**STRATEGY**

# A) INTRODUCTION: SMA & BS (5)




## SMA: SO WHAT?



### Process

The term comes from the latin “*procedere*”, i.e. something that is not static but in a continuous change



Identifying  
Gathering  
Choosing  
Analysing

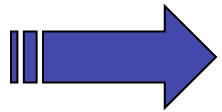
Accounting information could be both financial and non-financial. These have an internal or external focus.



Help  
Support

Information has a function: i.e. to support management to take specific choices.

# A) INTRODUCTION: SMA & BS (6)



Strategic choices

Information will be provided for the formulation, implementation and management of organization's strategy.

To stimulate behaviour that is consistent with an organization's strategy, attention is devoted to designing and implementing an integrated framework of performance measurement that can be used to clarify, communicate and manage organizational strategy.

Performance  
measurement system

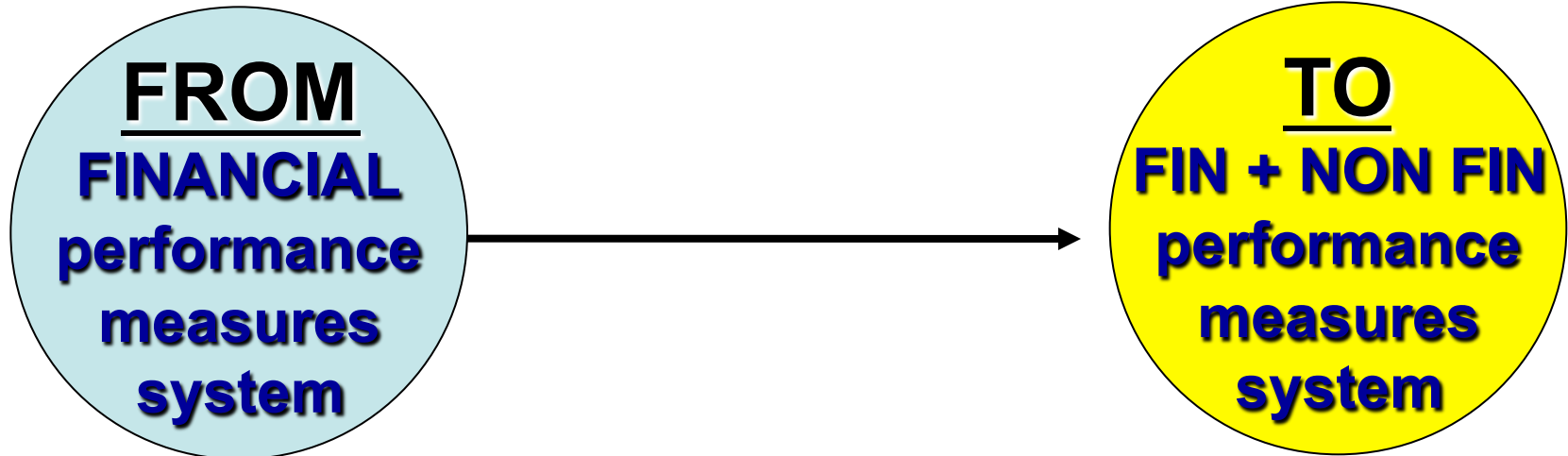


Strategy

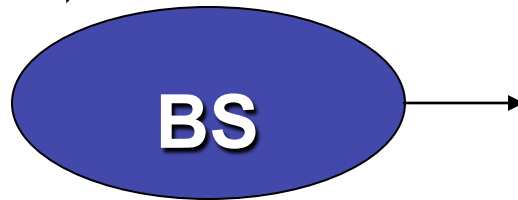
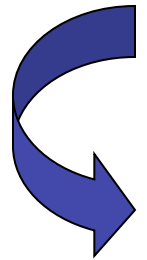


## B) BS: definition and conceptualization (1)

- Prior to the 1980s MAS tended to focus mainly on financial performance.
- Over the last decades more emphasis was given to considering those non-financial performance measures that provided information about key variables of competitive advantage.



## B) BS: definition and conceptualization (2)



It has been defined as an “integrated set of performance measures derived from organizational strategy that gives top management a view of the organizational unit”. It is a strategic technique for communicating and evaluating the achievement of the mission and strategy of the organization (Drury 2004, p. 1001).

## B) BS: definition and conceptualization (3)

To understand BSC we could start from its terminology.



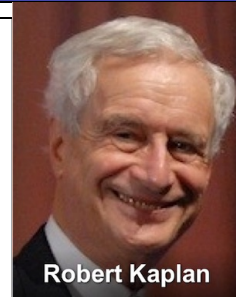
**SCORECARD**

It a system or procedure that is used for checking or testing something (English Dictionary of Advanced Learner's)

**BALANCED**

It means that measures should take into account “all” different aspects of organizational life

## B) BS: definition and conceptualization (4)



- A) Introduced in the early 1990s (Kaplan and Norton)
- B) Balanced scorecard implies that financial measures are supplemented with non-financial measures
- C) It can be described as a collection of ideas regarding how company strategies and visions can be linked into a companies operations
- D) Balanced scorecard has been compared to a the **dashboard** in airplanes: companies need a dashboard to navigate its operations

## C) BS: PERSPECTIVES (1)

BS is based on the assumption that an organization's vision and strategy is best achieved when organizational operations are seen from 4 balanced perspectives:

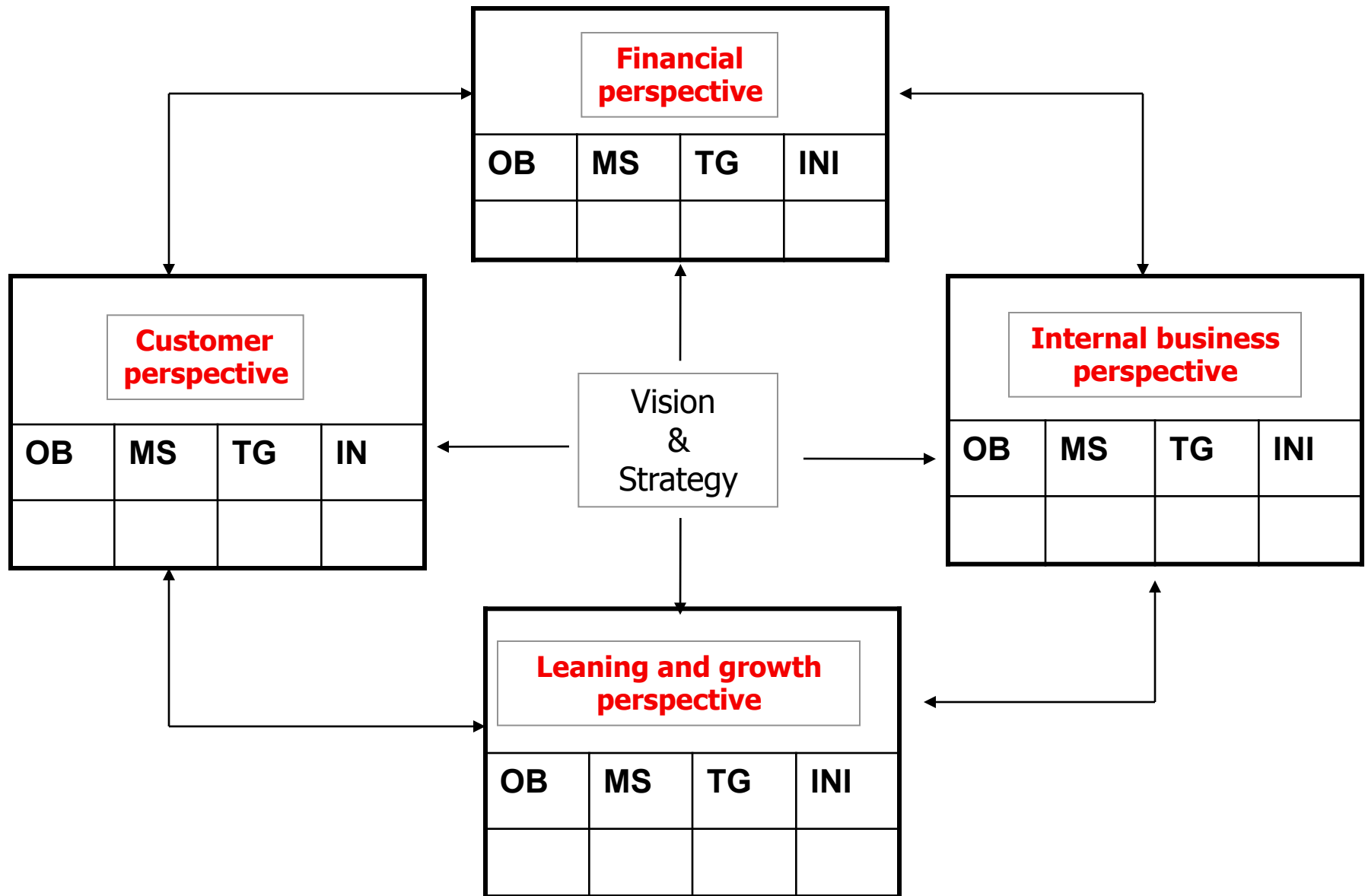
A) CUSTOMER PERSPECTIVE: how do customers see the organization?

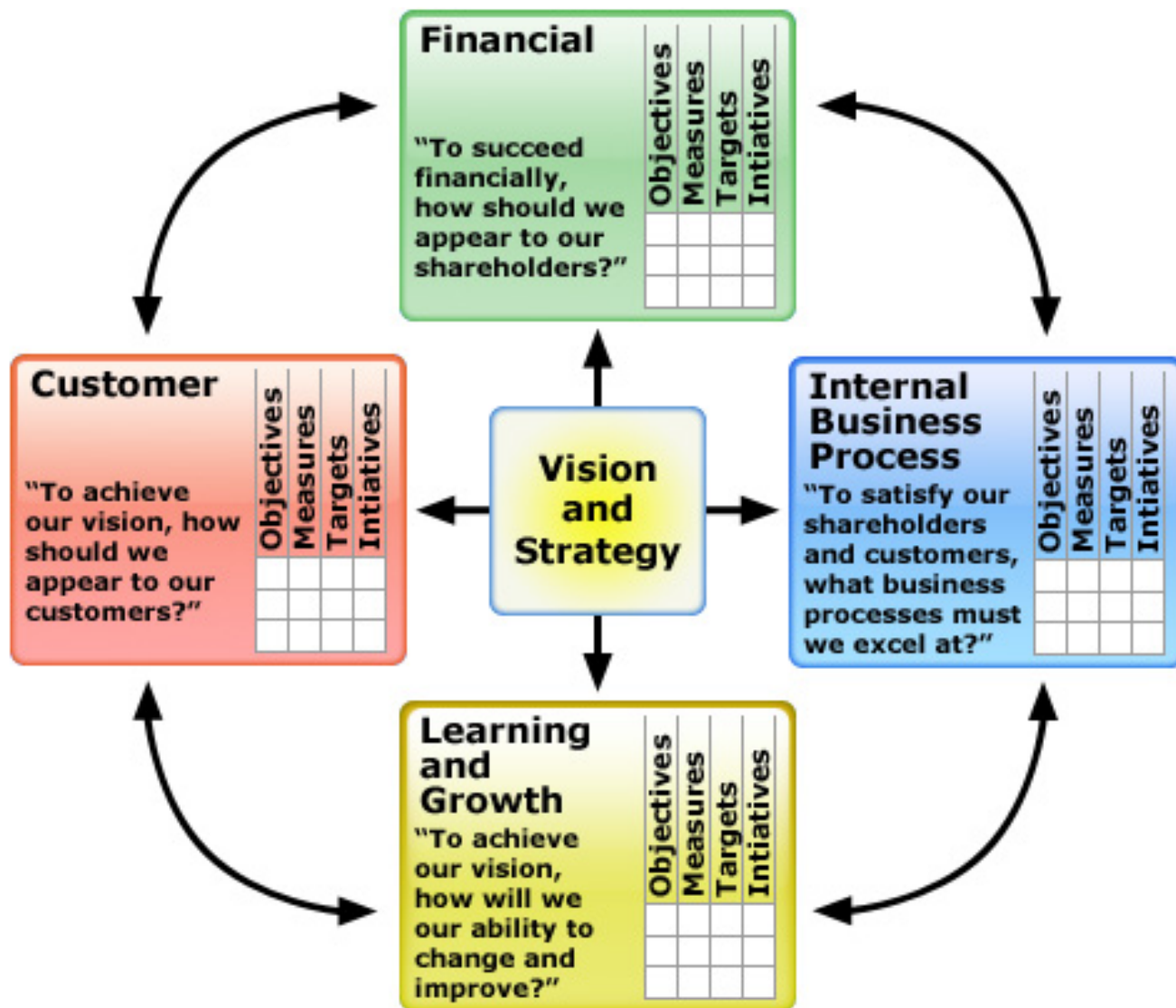
B) INTERNAL PERSPECTIVE: how well does an organization manage its operational activities?

C) LEARNING and GROWTH PERSPECTIVE: to achieve our vision, how will we sustain our ability to improve?

D) FINANCIAL PERSPECTIVE: to succeed financially, how should we appear to our shareholder?

## C) BS: PERSPECTIVES (2)





## **C) BS: PERSPECTIVES (3)**

BS is a framework that is constituted by four perspectives. To implement a BS the major objectives (strategic) should be articulated. These objectives should be then measured with specific indicators. Targets for each performance measure must be established. Further, the major initiatives for achieving each objective must be described. For feedback reporting actual performance measures can also be added.



## C) BS: PERSPECTIVES (4)

**A) VISION** represents "what the company wants to be". It states what : i) how the company wants to be seen by its customers; ii) the company's level of ambition for the future;

**B) STRATEGIC OBJECTIVES:** expresses what the company wants to achieve in future. Strategic goals should be set at a high, but achievable levels in order to create incentives for improvements. Strategic goals must be translated into objectives that have been identified within each perspective. These goals are not static but change in accordance to changes in the business context.

## C) BS: PERSPECTIVES (5)

**C) MEASURES** each objective must be measured with one or more performance measure. Only the critical measures are incorporated.

**D) INITIATIVES** the major initiatives undertaken for achieving each objective must be described.

**E) CAUSALITY:** the basic idea is the causality of the different parts of the scorecard. Each goal is part of cause-effect relationship involving a linkage from strategy formulation to financial outcomes.

## C) BS: PERSPECTIVES (6)

Higher sales implies better profitability



Higher customer satisfaction implies increase in sales



Greater efficiency in sales situations implies greater customer satisfaction

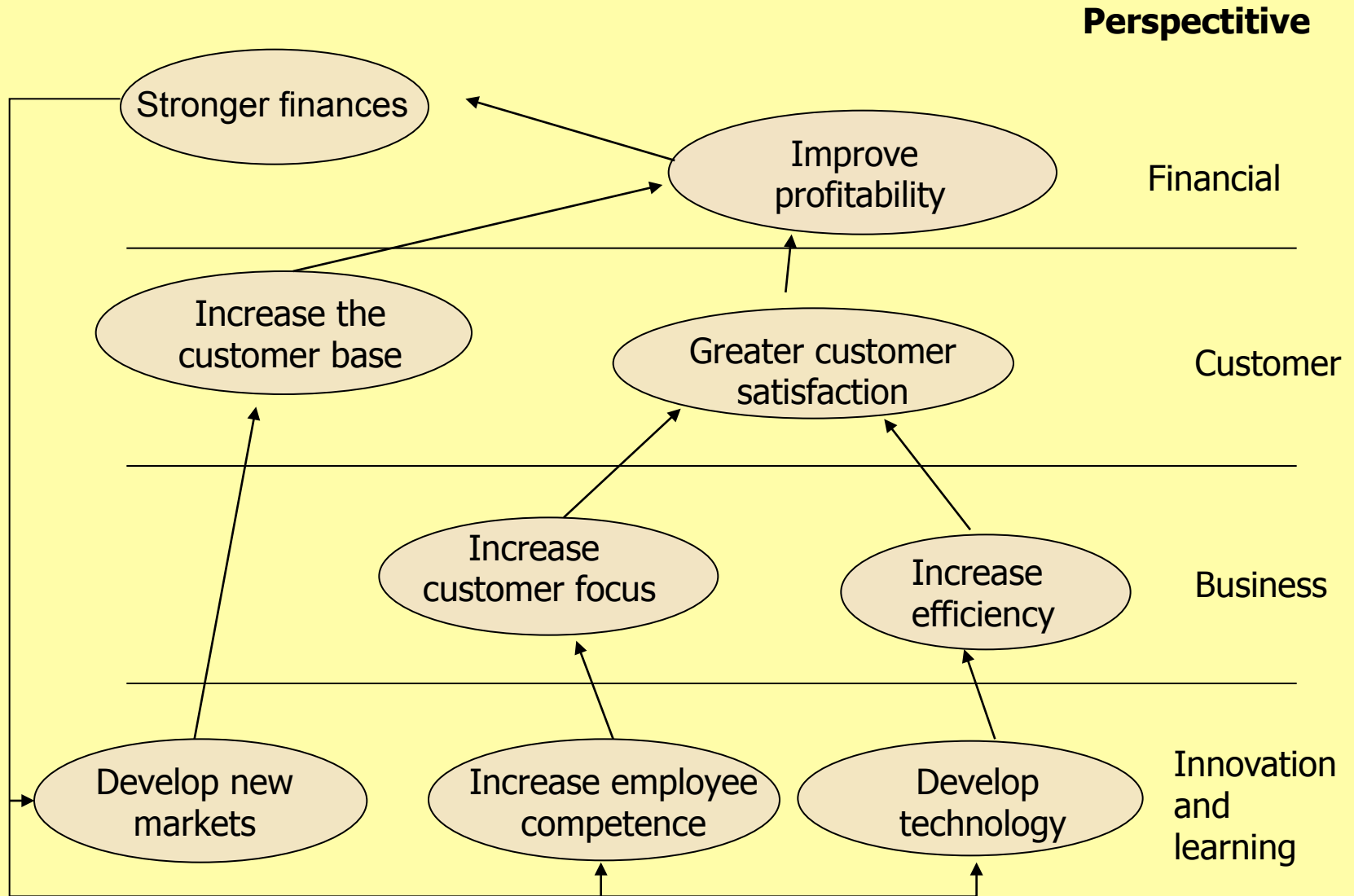


Greater employee knowledge regarding products and services implies greater efficiency in sales situations

## C) BS: PERSPECTIVES (7)

	Goal	Performance indicator
<b>Financial perspective</b>	<b>Increased profitability</b> Retained share dividend	<b>Return on equity</b> Return per share
<b>Customer perspective</b>	<b>Increased customer satisfaction</b>  Decrease in complaints and returned products	<b>Customer satisfaction index</b>  Number of returned products
<b>Internal business perspective</b>	Decreased cassations <b>Increased productivity</b>	Number of cassations Number of working hours per product/service
<b>Innovation and learning perspective</b>	Increase of new services  <b>Better staff policy</b>	New services share of overall sales  Employee satisfaction index

# C) BS: PERSPECTIVES (8)



## C) BS: FINANCIAL PERSPECTIVE (9)

This perspective is concerned with the shareholders view of performance. Shareholders are concerned with many aspects of financial performance. Amongst the measures of success are:

<ul style="list-style-type: none"><li>• <b>Market share</b></li><li>• <b>Revenue growth</b></li><li>• <b>Profit ratio</b></li><li>• Return on investment</li><li>• <b>Economic value added</b></li><li>• Return on capital employed</li></ul>	<ul style="list-style-type: none"><li>• Operating ratios and loss ratios Corporate goals</li><li>• Profitability</li><li>• <b>Growth</b></li><li>• Process cost savings</li><li>• Increased return on assets</li><li>• Profit growth</li></ul>	<ul style="list-style-type: none"><li>• Cash flow</li><li>• Net profitability ratio</li><li>• <b>Sales revenue</b></li><li>• <b>Growth in sales revenue</b></li><li>• Cost reduction</li><li>• Share price</li><li>• Return on shareholder funds</li></ul>
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## C) BS: CUSTOMER PERSPECTIVE (10)

This focuses on the analysis of different types of customers, their degree of satisfaction and the processes used to deliver products and services to customers. Potential goals for the customer perspective could include:

Particular areas of focus would include:	Potential goals for the customer perspective could include:	The following metrics could be used to measure success in relation to the customer perspective:
<b>Customer service</b> New products <b>New markets</b> Customer retention Customer satisfaction	<b>Customer satisfaction</b> <b>New customer acquisition</b> Customer retention Customer loyalty Fast response Responsiveness Efficiency Image	<b>Customer satisfaction index</b> Repeat purchases <b>Market share</b> On time deliveries Number of complaints Average time to process orders Returned orders Response time

## C) BS: INTERNAL BUSINESS (11)

***This perspective is concerned with assessing the quality of people and process***

It seeks to identify:	Potential goals for the internal perspective include:	The following metrics could be used to measure success in relation to the internal perspective:
<b>How well the business is performed</b> Whether the products and services offered meet customer expectations. The critical processes for satisfying both customers and shareholders. Activities in which the firm excels? And in what must it excel in the future?	<b>Improve core competencies</b> Improvements in technology Streamline processes Manufacturing excellence Quality performance Inventory management Quality Motivated workforce	Efficiency improvements Reduction in unit costs Reduced waste Improvements in morale Increase in capacity utilisation <b>Increased productivity</b> % defective output Amount of recycled waste Amount of reworking



## C) BS: LEARNING PERSPECTIVE (12)

<p>This perspective is concerned with issues such as:</p>	<p>Potential goals for the innovation and learning perspective include:</p>	<p>The following metrics could be used to measure success in relation to this perspective:</p>
<ul style="list-style-type: none"> <li>- Can we continue to improve and create value?</li> <li>- In which areas must the organisation improve?</li> <li>- <b>How can the company continue to improve and create value in the future?</b></li> <li>- What should it be doing to make this happen?</li> </ul>	<ul style="list-style-type: none"> <li>- New product development</li> <li>- Continuous improvement</li> <li>- Technological leadership</li> <li>- <b>HR development</b></li> <li>- Product diversification</li> </ul>	<ul style="list-style-type: none"> <li>- Number of new products</li> <li>- % sales from NP</li> <li>- <b>Amount of training</b></li> <li>- Number of strategic skills learned.</li> <li>- Value of new product in sales</li> <li>- R&amp;D as % of sales</li> <li>- Number of employee suggestions.</li> </ul>

## D) BS: BENEFITS AND LIMITATION (1)

### **BENEFITS:**

- A) BS synthesizes in a single report 4 different perspectives on a company's performance that relate to the company's competitive agenda;
- B) It provides a comprehensive framework for translating a company's strategic goals into a coherent set of performance measures;
- C) It helps managers to consider all the important operational measures together;
- D) BS approach improves communications within the organization and promotes the active formulation and implementation of organizational strategy.

## D) BS: BENEFITS AND LIMITATION (2)

### ***LIMITATIONS:***

A) the cause-and-effect relationship assumption is questioned on the grounds that it is too ambiguous and lack of theoretical underpinnings;

B) Omission or not consideration of other important perspective.