BALANCED SCORECARD APPROACH TO MEASURE PERFORMANCE OF BANKS

S.Visalakshi

PhD Scholar, Department of Management Studies, Pondicherry University, Pondicherry-605014;

Asst. Professor, Manipal University Bangalore Campus, Chokkanahalli, Bangalore – 560064

Dr. R. Kasilingam

Associate Professor, School of Management, Pondicherry University, Pondicherry- 605014

In today's global scenario, banks have to devise strategies to keep them ahead in an intensely competitive scenario. Relying on financial measures alone does not give a clear picture of the banks' performance. Moreover, financial measures like ROE, ROA are lagging indicators and do not give feedback for holistic corrective action. The Balanced Scorecard is a performance measurement tool which integrates financial and non-financial measures of performance essential for long term success of a bank thereby providing a comprehensive approach to such measurement. It helps to relate organizational performance with the vision and the strategy of an organization. It gives due weightage to intangible inputs like innovation, creation of a value chain, skills and knowledge level of employees, customer relationships and retention strategies which are critical to giving a competitive edge to banks. The success of the balanced scorecard depends on proper identification of both the financial and non-financial variables.

Keywords: *Bank performance measurement, balanced score card, strategy, strategic competitiveness*

INTRODUCTION

The Indian Banking System has witnessed major changes in the last two decades. A globalized and extremely competitive environment has brought about new global challenges to the Indian banks. It has experienced gradual deregulation which has opened up new opportunities and fresh challenges. Banks are constantly required to design new products, adopt new technologies, enhance customer relations and diversify their product mix to meet these challenges. Banks have had to redefine their objectives and spell out effective strategies to meet these objectives. The necessity of effectively executing the strategy becomes very crucial. "Strategic competitiveness is achieved when the firm successfully formulates and implements a value-creating strategy" [1].

The banks need to change their strategic priorities to create value for their customers and shareholders if they want to remain ahead in competition. Banks are becoming exceedingly "customer-centric" in their approach. Measuring a bank's performance under such dynamic conditions and changing industry requirements can pose a challenge.

PRESENT EVALUATION APPROACH

Presently, performance management systems such as Return on Equity (ROE), Return in Investment (ROI) and Earnings per share (EPS) are being used to measure the performance of banks which largely measure cost efficiency and effectiveness. These systems are more in tune with the shareholders' requirements of good financial performance of the organization. The risk-adjusted capital adequacy guidelines, poor profitability over long term, and conceptual and practical failure of measures such as asset growth often lead bank management to focus on ROE as the ultimate performance scorecard [2]. The performance of a bank was considered to be good if it earned huge profits. This result was not indicative of what would be the future position of the bank. In the context of a globalized setup, the usefulness of such methods is limited. The use of financial measures alone has serious limitations because of their inherently backward-looking nature, their limited ability to measure operational performance and their tendency to focus on the short-term [3]. The profit-based performance measures do not take into account the processes and quality improvements brought about by a bank and as seen by a customer. To ensure long term success, organizations must adopt new methods and technologies. Instead of concentrating only on profits by cost management, banks need to bring about process and product changes which add value to their service thus making them sustainable in the long run. An organization's performance must reflect the value it has added to its stakeholders in the form of improvements in processes, products and services.

ALTERNATIVE EVALUATION APPROACH

In this changing scenario, one would be curious to know how banks are performing and what would be the tools for measuring performance. Performance can be defined as "a state of competitiveness of the organization, reached through a level of efficiency and productivity which ensures a sustainable market presence" [4]. A performing organization has to be efficient, competitive and productive. A performance measurement tool must reflect the strategies of an organization and measure its outcomes. Various questions like "what indicators must be chosen to evaluate performance – profits, efficiency, achievement of budgets, etc." must be answered. A diversity of factors must be taken into account which influences both individual and organizational behaviors. The old yardsticks of financial measures would no longer be suitable as they measure historical information and do not have any future perspective. According to Carmeli "the real source of competitive advantage is underlined by the organization's ability to consistently meet environmental changes […] intangible, more than tangible, resources have potential for competitive advantage creation" [5]. The impact of intangibles like innovations in products, processes and services on customer satisfaction and employee and customer retention leads to long term value creation. Many more new and dynamic variables have been brought into the competitive system, the effect of which need to assessed. The performance management and measurement systems in banks have to undergo transformations to measure the outcome of these new variables. A more holistic approach of measuring the effect of tangible and intangible factors on a bank performance is the need of the hour. We need to look at a measurement system that would incorporate measurement of all factors which measure performance - the tangible and the intangible.

Many systems were developed to overcome the inadequacies of the traditional measurement systems like the Performance Prism, Data Envelope Analysis, CAMELS, SMART Pyramid, Balanced Scorecard and such others. The focus of this paper is to understand the effectiveness of performance measurement using the Balanced Scorecard.

THE BALANCED SCORECARD

The Balanced Scorecard (BSC) is an extensive and thorough performance evaluation tool to adequately plan and control an organization so it can attain its goals [6]. The concept of the Balanced Scorecard was conceptualized by David Norton, the CEO of Nolan Norton Institute, and Robert Kaplan, a professor at Harvard University [7]. Balanced Scorecard is an outcome of the strategy formulation process. It is an effective tool which helps to align the activities of the business with the strategy. The top management plays an important role in devising the strategies of the organization. More often than not, this information is not communicated to the employees at the execution levels. The employees do not understand the organization's strategy and are unaware of their role in meeting the organization's objectives. Kaplan and Norton were of the opinion that most companies fail to execute strategies because only 5% of the workforce understands their company's strategy; only 25% of managers have incentives linked to strategy; 60% of organizations don't link budgets to strategy; 86% of executive teams spend less than one hour per month discussing strategy [8]. The Balanced Scorecard helps to draw a strategy map breaking down the broad strategies into actionable points for achievement at various levels in the organization. It measures the performance of the bank with reference to the business strategy adopted.

The Balanced Scorecard measures four different perspectives of an organization i.e. financial, customer, internal process and learning and growth. It provides a more balanced view of the organization's performance taking into consideration both the financial and non-financial parameters. The parameters like customer satisfaction, improvement in internal processes in a bank, employees' motivational levels, employee welfare, the satisfaction of their training needs and such others are non-financial in nature but yet contribute to the growth of the organization. They become important metrics for measurement of performance.

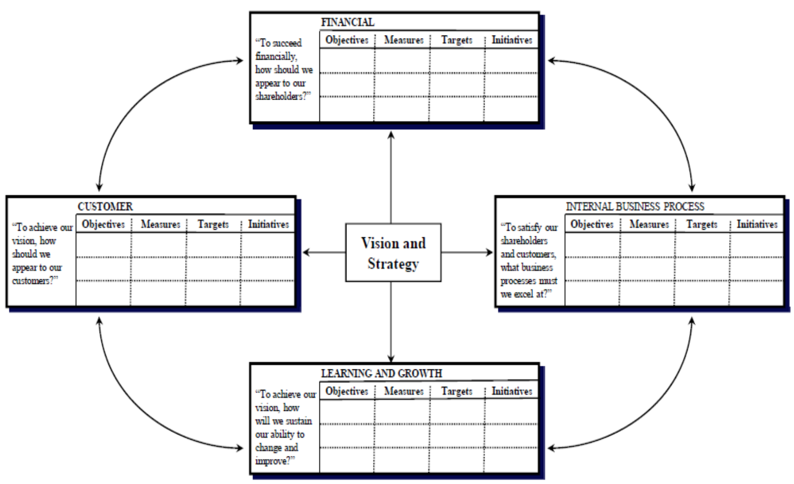

Figure 1: Translating Vision and Strategy: Four perspectives (*Courtesy: Kaplan, R.S., & Norton, D. P. (1992)*)

THE CUSTOMER PERSPECTIVE:

Customer behavior is a major indicator of bank performance. The most important aspects from a customer perspective are satisfaction, time, quality and costs of service. It should reveal how value is reflected in the eyes of the customer. The banks must offer innovative products, timely service and technological excellence at a satisfactory cost failing which customers will look at alternative sources for products and services. This is a leading indicator of future business performance. A satisfied customer will bring in more business to the bank. The metrics for measurement of customer satisfaction is customer satisfaction index, retention ratio, improvement in market share of the bank, improvement in turn-around-time for service and minimization of complaints.

INTERNAL PROCESS PERSPECTIVE:

This perspective focuses on the most important processes in the organization that drive the business. By focusing on the internal processes required to create and deliver value to the customer, the focus of the company is on how to improve these processes so that the customer satisfaction levels are not only maintained but enhanced. By constantly reviewing and improving the processes, the bank could achieve reduction in turn-around-time for the customer, provide better quality service, thereby increasing profitability of the bank. A decline in the quality of service would lead to adverse effects on profitability.

A few of the metrics for measurement of this perspective would be innovation rates, improvement in quality, speedier service timelines, cost reductions and such others.

LEARNING AND GROWTH PERSPECTIVE:

Banking is a knowledge-and-skilled-based service industry which is constantly in need of improved and a sophisticated employee skill set. Employees are required to constantly acquire new knowledge and skills because of changing products and technology. This perspective of the Balanced Scorecard is concerned with the human capital of the organization. The organization looks at the key competencies, attitudes and values of its employees which will translate into better delivery of its products and processes and in turn lead to the customer satisfaction and required financial outcomes. On-the-job enhancement of their skills and capabilities is necessary to generate value and to provide opportunities to the employees for self-development to ensure that they are able to constantly innovate and deliver value to the customers.

FINANCIAL PERSPECTIVE

The primary management system for most companies, until the 1990s, was to use only financial information and to rely heavily on budgets to maintain focus on short-term performance [9]. Businesses have now moved from this concept of “profit maximization” to “wealth maximization”. The financial perspective measures the value that the organization has delivered to its shareholders. This perspective of the balanced scorecard helps us to analyse whether the banks’ strategies have translated into financial improvements. After a change in the perspective of what is “performance measurement” in recent times, the contribution from the intangible assets of an organization have also got to be evaluated. The effect of intangibles like knowledge of employees, the technology adopted by the bank is indirect and has an influence on the ultimate financial outcomes of the organization through a cause-and-effect relationship. For e.g. an organization investing in training and constantly updating the employees’ skills will see improvements in service quality which has an effect on customer satisfaction. Improved customer satisfaction leads to customer retention and loyalty ultimately generating improved business and revenues. Financial perspective is a lagging indicator as it reflects the outcome of the strategies employed by the organization and does not reveal the future performance of the organization. Financial measures like Return on Investment (ROI), Return on Capital Employed (ROCE) Earning per Share (EPS) are ultimately the outcomes of the performance of the company.

EXAMPLES OF INDIAN BANKS THAT USE BALANCED SCORECARD

It has been found that the adoption of the Balanced Scorecard in the Indian corporate world has been 45.28% [10]. Many organisations found difficulties in identifying key indicators, assigning weights to different perspectives and in establishing a cause and effect relationship between the perspectives which was a hindering factor in whole heartedly adopting the Balanced Scorecard [10].

Among the Indian banks, it was found that ICICI Bank and Axis bank have pioneered the process of implementation of Balanced Scorecard

IMPLEMENTATION IN ICICI BANK [11]

Excerpts from IBA -Cedar Consulting Jt. Seminar on Balanced Scorecard

Key Note Presentation by Ms.Chanda Kochhar, Executive Director, ICICI Bank Ltd.

Role of Scorecard

- Operationalize strategy
- Aligning employees' goals to that of the organization
- Ensure focus across multiple perspectives

- Enable flexibility

Key Learnings

- Performance measures should be output based rather than input based
- Scorecard need not be balanced for individuals, but for business units as a whole
- Need for scorecard templates

Conclusion

- The Balanced Scorecard can be a platform for sustained future growth & value creation

IMPLEMENTATION IN AXIS BANK

Excerpts from the Bank's Annual report [12]

The Bank follows the balanced scorecard approach in designing its performance management system. Adequate attention is given to robust goal setting process to ensure alignment of individual objectives to support the achievement of business strategy, financial and non-financial goals across and through the organization. The non-financial goals for employees includes customer service, process improvement, adherence to risk and compliance norms, self-capability development and behaviours such as integrity and team management.

CONCLUSION

Successful organisations have to constantly assess and rebalance themselves on various parameters to create differentiation from their competitors. The balanced scorecard is an excellent tool in achieving this objective. Designing the scorecard could be a time-consuming exercise and organisations may find it difficult to identify the key performance areas. But once designed it could be a very good tool for tracking performance of organisations. It also facilitates feedback for control and evaluation.

REFERANCES

[1] Strategic Management: Concepts: Competitiveness and Globalization By Michael Hitt, R. Duane Ireland, Robert Hoskisson.

[2] Karr, John; 1993; Performance Measurement in Banking: Beyond ROE; The Journal of Bank Cost & Management Accounting; Vol. 6, No. 1

[3] Kaplan, R.; and Norton, P. David (2001), The Strategy Focused Organisations: How Balanced Scorecard Companies Thrive in the New Business Environment", Boston: Harvard Business School Press.

[4] M. Boulescu, M. Ghi__, V. Mare_, ″Auditul performan_ei″, ed. Tribuna Economic_, Bucure_ti,
pg. 13, 2002.

[5] Carmeli, A. (2004) Assessing Core Intangible Resources, European Management Journal, Vol. 22, 1, pp. 110-122.

[6] Davis, S., & Albright, T. (2004). An investigation of the effect of the balanced scorecard implementation on financial performance. Management Accounting Research, 15(2), 135–153.

[7] Kaplan, R. S., & Norton, D. (1992). The balanced scorecard measures that drive performance. Harvard Business Review, 70(1), 71–79.

[8] Kaplan, R. S., & Norton, D. P. (2000). The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment. Boston: Harvard Business School Press.

[9] Robert S. Kaplan (2010). Conceptual Foundations of the Balanced Scorecard. Harvard Business School, Harvard University

[10] Manoj Anand, B S Sahay, and Subhashish Saha. Balanced Scorecard in Indian Companies. VIKALPA • VOLUME 30 • NO 2 • APRIL - JUNE 2005 11

[11] IBA -Cedar Consulting Jt. Seminar on Balanced Scorecard; December 17, 2004

[12] http://www.moneycontrol.com/annual-report/axisbank/notes-to-account/AB16