An Examination Of The Use Of The Board Balanced Scorecard By Large Public Corporations

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ABSTRACT

While the Balanced Scorecard (BSC) developed by Norton and Kaplan has gained global prominence as a management tool and there is qualitative accounting literature that discusses the benefits of the Board BSC, there is limited empirical evidence that examines the use of the Board BSC. We surveyed Chairs of large public companies to determine the extent to which they use the Board BSC and the reasons why. Our findings suggest that the Board BSC is currently not a widely used technique by Boards of Directors. We also found that the Sarbanes-Oxley Act of 2002 wasn’t an influencing factor for those boards that are using the Board BSC.

Keywords: Balanced Scorecard, Boards, Corporate Governance

INTRODUCTION

Frequently, corporate management, auditors, and rating agencies have been accused of failing shareholders and other stakeholders when corporate financial disasters have taken place. As the top authority of corporate governance, Boards of Directors also come under fire. To restore public confidence, the Sarbanes-Oxley Act of 2002 mandates a series of reform to strengthen corporate governance. New York Stock Exchange (NYSE) further requires the Board of Directors to conduct self-assessment at least once a year (See Listed Company Manual, Section 303A.09 by NYSE, 2003).

Boards of directors cannot afford to be ineffective. Security laws, Sarbanes-Oxley and SEC regulations hold Boards of Directors accountable for corporate governance. Boards of directors play a major role in reducing the principle-agent problem. First, the Board sets strategic goals for the corporation. While not developing specific plans, the board points out a clear direction in which it wishes management to pursue. Second, the Board monitors the implementation of the strategic plan. The Board ensures that management makes the best use of its resources. Third, the Board selects, guides, and motivates top management and oversees how management serves the long-term interests of shareholders and other stakeholders. Meanwhile, Directors support top management by sharing their knowledge, insights, and experience. Finally, the Board ensures the corporation’s compliance with the law and high ethical standards.

Kaplan and Nagel (2003) suggest that Boards of Directors can use a board Balanced Scorecard along with an Enterprise Balanced Scorecard and Executive Balanced Scorecard to effectively and efficiently meet their responsibilities. The accounting literature contains several examples of how organizations have successfully implemented Balanced Scorecard and articles that discuss the merits of a Board Balanced Scorecard (see Certified Management Accountants of Canada, 2002; Epstein and Roy, 2004; Kaplan and Nagel, 2003; Kaplan, Palepu and Heimbouch, 2003) but we didn’t find any studies that examined the extent to which the Board BSC is used by the Boards of large public companies. The first section of this paper briefly recaps the use of the Balanced Scorecard as a management tool followed by a discussion of Board and Director Evaluations. The fourth section examines our
survey study of Boards of large public companies while the final section provides concluding thoughts and observations.

BALANCED SCORECARD: USE AS A MANAGEMENT TOOL

The Balanced Scorecard has gained popularity with corporate management. Recent research indicates that approximately half of the Fortune 1000 companies (both manufacturing and service companies) and 40% of European companies have developed some version of the BSC (Krumwiede et al. 2007, 1). Unlike traditional evaluation systems, BSC focuses on the key value drivers of the corporation. Corporate vision and strategy are first translated into operational objectives. Next, performance metrics are carefully designed for each objective. Each measure gets a target attached to it, and initiatives are specified to achieve the goals.

EVALUATIONS FOR BOARDS AND DIRECTORS

Prior to the passage of the Sarbanes-Oxley Act of 2002, research (CMA, 2002, p. 20) indicates that Boards realized the importance of Board evaluations and individual Director evaluations. However, only 40% of North American companies conducted formal evaluations and individual director evaluations were less frequent. Sarbanes-Oxley requires self-assessment by Boards of Directors. Self assessment is only useful if the process provides feedback to improve performance and efficiency. The Board BSC is a tool that provides such feedback and enables Boards to articulate priorities. Since Boards use performance targets for management, the Board BSC also requires performance standards for the board and for individual directors. Follow-up evaluations would provide valuable feedback for future improvement of Board performance. Further, using the Board BSC for evaluating Board performance will help the Board to understand the BSC for the corporation. Hopefully, the use of Board BSC for one Board will lead more Boards to use it, thus improving the overall effectiveness of Boards. Accountable and vigilant Boards can use the Board BSC to effectively protect shareholders’ and other stakeholders’ interests. Kaplan and Nagel (2003, p. 6) indicate three specific benefits of the Board BSC as follows: 1) defines the strategic contributions of the Board; 2) provides a tool to manage the composition of the Board and its committees and 3) clarifies the strategic information required by the Board.

HOW DOES BOARD BSC WORK?

The Board BSC, developed by Kaplan and the Balanced Scorecard Collaborative, Inc., focuses on enhancing long-term stakeholder value. Boards contribute to this goal by working from four perspectives: financial performance, stakeholder satisfaction, internal processes, and learning and growth. Performance in each perspective is driven by the performance in the perspective following it. For each perspective, four elements are defined: objectives, measures, targets, and performance initiatives. Objectives lay out the Board’s role and responsibilities. Initiatives are actions that the board should take to achieve these objectives. Every objective is monitored with measures. These measures combine financial measures with non-financial measures, lead measures with lag measures, objective measures with subjective measures, and internal measures with external measures. Accordingly, the Board establishes currently attainable specific targets.

STUDY: BOARD BSC IN PRACTICE

We conducted a survey study of large public companies to determine the extent to which the Board BSC is used by Boards, the objectives Boards have specified, and what measures they have adopted. In developing the survey instrument (Appendix A), we considered the four areas of the Board BSC developed by Kaplan and the guidelines developed by the Society of Management Accountants of Canada (“Measuring and Improving the Performance of Corporate Boards” by CMA Canada, 2002). Two Board Directors reviewed and tested the questionnaire before mailing.

We mailed the questionnaire (please refer to Appendix A) to the chairs of the Boards of the top 662 public companies. We received 20 replies, which is a three percent response rate. Out of the 20 replies, ten respondents stated that they could not participate in the study due to company policy. Eight indicated that they do not use BSC.
to assess board performance. Only two respondents stated that they use the Board BSC. One Board uses BSC for self-assessment and another Board uses a version of a Board BSC.

On average, the respondents have 14.6 years of experience as a director and 9.1 years of experience as the chair of the Board. They serve on 2.1 Boards at the same time. Two of the respondents also sit on the Audit Committee.

Respondents cited three reasons for not adopting Board BSC: (1) implementation of BSC would require training, (2) questionnaires are a better method of evaluating Board performance, and (3) peer evaluation is a better method of evaluating Board performance. None of these respondents are currently considering the use of Board BSC. By contrast, the two Boards with BSC have used the system for more than five years. This finding suggests that the Boards considered BSC prior to the passage of Sarbanes-Oxley and is supported by the reason for adopting BSC as follows: (1) to evaluate company and CEO performance, and (2) to serve as a communication tool for focusing Board activities, both of which are consistent with Kaplan and Nagel’s (2003) reasons for using the Board BSC.

Financial

Along the financial dimension, boards have objectives to ensure both long-term and short-term financial success. Measures capturing long-term success are the trend of earnings growth and returns on investment/equity/assets. Supplementing these two measures are other measures, such as sales growth, stock price, and performance against a peer group. For short-term success, earnings are still the key measure, with additional information from cash flow or return on equity.

Stakeholders

Both of the responding Boards identify the following objectives to satisfy stakeholders: (1) having the Board behave ethically, and (2) holding the Board accountable for corporate governance. For these purposes, the common measures are adherence to code of conduct and keeping communication channels open with the Board. One Board also considers these other measures important: ethical violations, level of compliance with governance guidelines, voluntary disclosures, and complaints from employees, customers, and community. The other Board has credit rating and frequency of meetings with stakeholders as additional measures.

Internal

Boards share the same objectives for internal processes: identifying and managing risk and crisis, making effective performance evaluation, having an effect review of corporate strategic plans, and improving board effectiveness. Measures such as compensation linked to performance, attendance of Board meetings, number of meetings without CEO, and having committees, are believed to be helpful for achieving the objectives. One Board also assesses the review and approval process of annual operating plans and budgets, information provided to the board to evaluate projects, time spent on strategic planning, number of days in advance that material is sent, board’s input in agenda for meetings, percentage of independent directors, and nomination of chairman of Board. The other Board is interested in the following additional measures: performing risk audits, having directors visit company sites, including nonfinancial, external and objective data in the evaluation system, linking compensation to nonfinancial performance, and linking compensation to stock ownership.

Learning

In terms of learning and growth, both Boards aim to have a plan for the succession of CEO and senior management. They also want to improve the composition of the Board. One further aim is to improve the skills and knowledge of the Board. Both Boards evaluate skills and qualifications of directors, examine the diversity of the Board in terms of race and gender, and establish training programs. One Board goes further to require a job description for CEO, prepare an annual report on succession planning, identify an interim CEO, examine Directors’
financial literacy, use executive search firms to identify potential board nominees, and have new Board members evaluate programs.

Table 1: Balanced Scorecard Software Information

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**Source**

http://www.som.cranfield.ac.uk/som/research/centres/cbp/products/BScorecard.asp

**Other Software**

i-nexus Balanced Scorecard www.i-nexus.com

**Report**

Automating Your Scorecard: The Balanced Scorecard Software Report
The report evaluates Balanced Scorecard application market through 2003

**Source**

http://www.som.cranfield.ac.uk/som/research/centres/cbp/products/BScorecard.asp

**WHAT WE HAVE LEARNED**

We expected to see a spillover effect from corporate management’s use of BSC to using BSC for the boards on which these managers serve. The extremely low response rate for our survey may indicate that this effect has not yet taken place or that the Chairs of the Boards were too busy to respond to the survey. The low response rate is a limitation of our study and accordingly, we can’t generalize our findings. Based on the responses, Board members seem to be unfamiliar with the BSC system which would suggest that further educational efforts are necessary for board members to understand how Board BSC can make them more efficient and effective. Table 1 provides information (companies and products) that boards can examine in evaluating whether to implement Board
BSC. Another reason for the non-use of the Board BSC may be the significant amount of time that is demanded for reaching consensus on Board objectives and measures as part of the BSC process. However, Board BSC facilitates the translation of board responsibilities into actions. Implementing BSC enables Boards to stay focused on what should be done to be effective, guarding stakeholders’ interest and protecting boards from potential litigation.

A review of the implementation management accounting techniques over the past 50 years, such as variable costing (contribution-margin statement), activity-based costing, just-in-time inventory systems, and BSC as a management tool, shows that it took time and organizational change for these techniques to gain acceptance and become operational within organizations. Similarly, based on the results of our study, we believe it will take time for the Board BSC to become a more widely used tool by Boards of Directors. Educational efforts will also be necessary. Inexpensive, training materials for BSC and BSC software are now available.

AUTHOR INFORMATION

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Dr. Don E. Giacomino, CPA is Professor of Accounting and the Donald and Beverly Flynn Chair Holder at Marquette University. He earned a DBA from the University of Kentucky and the MBA from the University of Montana. Giacomino has published a Management Accounting text and over 50 refereed articles in academic and professional journals, including Advances in Accounting, Journal of College Teaching and Learning, Journal of Accountancy, the CPA Journal, Issues in Accounting Education, International Business and Economics Research Journal and Journal of Managerial Issues. He serves on the Board and Executive Committee of the Wisconsin Institute of CPAs.

Michael J. Browne, MSA, CPA, CMA, CFM, CPIM is the founder of Advanced Financial. His business optimizes organization performance using cost, performance, and profitability management to help companies “make more money.” Michael has over 30 years of hands on experience and successfully completed hundreds of engagements globally. He has served as a Chief Financial Officer and was Partner In Charge of Consulting for a large CPA and Consulting Firm in the United States. He is an Adjunct Professor of Accounting in the MBA program at Marquette University. He can be reached at 262.369.0757 or michael.browne@marquette.edu.

Dr. Michael D. Akers, CPA, CIA, CMA, CFE, CBM is the Charles T. Horngren Professor of Accounting and Chair, Department of Accounting. He earned his doctoral degree at the University of Mississippi and his MBA at the University of Louisville. In addition to serving on the editorial advisory board of two journals, he has authored more than 50 articles in academic and professional journals. He currently serves on the Audit Committee and Board of Directors of two publicly traded companies.

REFERENCES

APPENDIX A

BOARD OF DIRECTORS BALANCED SCORECARD QUESTIONNAIRE

DEMOGRAPHICS

___ Number of years on the Board of Directors
___ Number of years as Chair of the Board of Directors
___ Number of Boards on which you currently serve

Other (check all that apply):
___ You are a member of the Audit Committee
___ Your company (employer) uses the Balanced Scorecard

*** Does the company for which you serve on the Board of Directors use the Balanced Scorecard (BSC)?
___ NO: Complete only question 1 and return this survey
___ YES: Please proceed to question 2, complete the survey and return it.

1 Please indicate why your Board does not use the Balanced Scorecard (check all that apply):
___ BSC is not useful for evaluating Board performance
___ Costs of implementing BSC exceed benefits
___ Implementation of BSC would require training (Board members are not familiar with BSC)
___ Questionnaires are a better method of evaluating Board performance
___ Peer evaluation is a better method of evaluating Board performance
___ We are considering the use of the BSC.

** Please return this questionnaire in the enclosed postage-paid envelope.

2 Please indicate why your Board uses the BSC to evaluate Board performance? (check all that apply)
___ Improves overall Board and individual Board Member performance
___ Evaluates Company and CEO performance
___ Useful as a communication tool focusing Board activities
___ Provides substantive evidence of effective Corporate governance
___ Generates Sarbanes-Oxley Act verification

3 How long has the Board used the BSC to evaluate Board performance?
   ____ 1 year ____ 2 years ____ 3 years ____ 4 years ____ 5 years ____ More than 5 years
GENERAL

4 Your Board uses (check all that apply):
   ___ Individual Board Member Scorecards
   ___ A Board Strategy Map
   ___ An individual CEO Balanced Scorecard
   ___ A commercially available software product for the Board BSC

FINANCIAL PERSPECTIVE

5 The Board's BSC uses these Long-term Financial Success Measures (check all that apply):
   ___ EVA
   ___ Stock price
   ___ Earnings growth trends
   ___ ROI, ROA, ROE, ROCE, etc.
   ___ Other (please indicate) __________________________

6 The Board's BSC uses these Short-term Financial Success Measures (check all that apply):
   ___ Stock price
   ___ Earnings
   ___ Cash flow
   ___ Other (please indicate) __________________________

STAKEHOLDERS PERSPECTIVE

7 Your Board's BSC includes objectives for (check all that apply):
   ___ Ethical behavior of the Board
   ___ Accountability of the Board for corporate governance

8 The following measures are used (check all that apply)
   ___ Adherence to code of conduct
   ___ Ethical violations
   ___ Level of compliance with governance guidelines (i.e. NACD)
   ___ Voluntary disclosures
   ___ Evaluation of external disclosures by stakeholders through the use of a survey
   ___ Evaluation of external disclosures by experts
   ___ Industry audit
   ___ Credit rating
   ___ Existence of communication channels with board
Meetings with stakeholders
Complaints from employees, customers, community, etc.
Market growth
Stakeholders satisfaction survey

INTERNAL PROCESSES PERSPECTIVE

9. Your Board's BSC includes objectives for (check all that apply):
   - Risk and crisis identification and management
   - Effective performance evaluation
   - Effective review of corporate strategic plans
   - Board effectiveness

10. Please indicate which of the following measures are used (check all that apply):
   - Risk audits performed
   - Crisis and evaluation of the reaction
   - Evaluation systems include the use of nonfinancial data
   - Evaluation systems include external and objective data
   - Compensation linked to performance
   - Compensation linked to nonfinancial performance (i.e. environment)
   - Compensation linked to stock ownership
   - Actions taken following performance evaluations
   - Evaluation of review and approval process of annual operating plans and budget
   - Evaluation of information provided to board to assess projects
   - Time spent on strategic planning
   - Visits to company sites by directors
   - Projects accepted by Board that met or exceeded projected ROI
   - Hours Board members spent on preparation for meetings
   - Days in advance that material is sent
   - Attendance of meetings
   - Board's input in agenda for meetings
   - Meetings per year
   - Average duration of meetings
   - Independent directors
   - Nomination of Chairman of Board
   - Meetings without CEO
   - Meetings with management other than CEO
   - Committees
LEARNING AND GROWTH PERSPECTIVE

11 Your Board’s BSC includes objectives for (check all that apply):
   ___ Succession of CEO and senior management?
   ___ Improving the skills and knowledge of the board?
   ___ Improving the composition of the board?

12 Please indicate which of the following measures are used (check all that apply)
   ___ Existence of a job description for CEO
   ___ Annual report on succession planning
   ___ Interim CEO identified
   ___ Evaluation of skills and qualifications of directors
   ___ Directors "financially literate"
   ___ Diversity of board by examining race and gender
   ___ Use of executive search firm to identify potential board nominees
   ___ Existence of training programs
   ___ Evaluation of programs by new board members

Thanks for your response. Please return this in the enclosed, postage-paid envelope.