BH075

The balanced scorecard, competitive strategy, and performance

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Different product-market strategies have different requirements for success. Just as organizational structures and processes are tailored to assist in implementing a chosen strategy, so too should the performance emphases adopted by a firm. The logic of this approach underlies the reason why many managers have adopted a balanced scorecard approach to measuring performance. But balance implies that all measures are equally important in all settings. The authors endorse the multi-measure approach to understanding company performance, but challenge the idea that all measures are equally important irrespective of the product-market strategy adopted. The results from a survey of more than 200 businesses support this position.

The strategic management process comprises at least five related elements. The starting point is developing a mission that guides all subsequent efforts of the business. This leads to an analysis of the firm's situation, and on to the formation of a competitive strategy. That strategy is subsequently implemented and—at least in theory—performance is monitored with an eye toward fine-tuning the strategy and/or its implementation. Of these five elements, the one that has received the least amount of attention is the last one: the management control system.

According to Simons (1991), management control systems have three major elements: (a) setting performance standards, (b) measuring performance against the standards, and (c) taking corrective action if the standards are not being achieved. Thus, the systems provide feedback on the effectiveness of competitive activities, enable learning from internal and market-oriented experiences, and provide guidance for strategic change and renewal. Performance measurement is central to the management control process for any business.

Venkatraman and Ramanujam (1986) proposed that strategy-level performance measurement should include both financial and operating measures. Chakravarthy (1986) studied firms operating in the computer industry and concluded that financial performance measures are inadequate indicators of a broader construct, "excellence." This is partly due to the fact that financial indicators largely ignore the interests of stakeholders other than stockholders. Chakravarthy argued that future-oriented indicators, such as investment in R&D, should also be part of the measurement and control system.

These studies suffer from one or both of two shortcomings. First, they consider only a small number of performance indicators rather than a comprehensive performance evaluation system. A study by Ernst and Young's Center for Business Innovation (Daly 1996) found that investment analysts who considered nonfinancial as well as financial performance indicators were more accurate in their earnings estimates than those who just used financial indicators. This suggests that a comprehensive performance evaluation system has greater predictive validity than one that is purely financially oriented. Moreover, neither of the studies considered performance evaluation in the context of the business's strategy. Because different strategies have different requirements for success, it follows that performance evaluation should be tailored to strategic orientation.

Recently, the balanced scorecard (**Figure 1**) has generated considerable attention. It is comprehensive in that it considers the *customer perspective,* the *internal business perspective,* and the *innovation and learning perspective,* as well as the *financial perspective.* Its benefits include its ability to

1. be tailored to the business's strategy
2. communicate strategic objectives
3. enhance feedback and learning

Slater, Olson, and Reddy (1997) argue that the scorecard should be "unbalanced," based on the strategy of the business. Using Treacy and Wiersema's (1995) "value disciplines," they argue that *product leaders* should emphasize the innovation and learning perspective, *customer intimates* should emphasize the customer perspective, the *operationally excellent* should emphasize the internal business perspective, and all of the *value disciplines* should pay attention to the financial perspective. Their rationale was that each value discipline has a performance perspective that is a leading indicator of its financial performance.

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Although the balanced scorecard appears to be a widely adopted and powerful management tool, little research has been conducted to assess its usefulness. This paucity in the literature is consistent with the surprise that Zahra (1999) expressed when, as the guest editor of a special issue of the *Academy of Management Executive,* he discovered that no papers had been submitted that dealt with how the balanced scorecard can be used effectively. The purpose of our study is to determine whether benefits can be derived from matching an emphasis in the scorecard to strategy type. From among four competitive strategy archetypes, described below, we will suggest the most appropriate balance for each.

Competitive strategy and performance emphasis

Competitive strategy is concerned with the patterns of choices managers make over which markets to serve and how the business creates more value for buyers than its competitors. The Porter (1980) and Miles and Snow (1978) typologies of strategy are the frameworks that have most often been shown to effectively represent managerial choices.

Porter proposed that the product-market decision should be viewed in terms of how the business creates value (differentiation or low cost) and how it defines its scope of market coverage (focused or market-wide). Miles and Snow identified four archetypes of how firms address product-market strategy decisions. *Prospectors* continuously seek to locate and exploit new product and market opportunities. Their primary capability is innovation in product and market development. *Defenders* attempt to seal off a portion of the total market to create a stable set of products and customers. They invest heavily in the development of a system for the most efficient production of goods and services. *Analyzers* occupy an intermediate position between the two extremes and simultaneously seek to minimize risk and maximize the opportunity for profit. Thus, they follow prospectors into new product market domains after their viability has been demonstrated, while protecting a stable set of products and customers. A key capability of analyzers is flexibility, the capability to respond rapidly as new opportunities become apparent. A fourth type, the *reactor*, does not have a consistent response to the product-market problem.

Walker and Ruekert (1987) synthesized these typologies of product-market behavior by discriminating between *low-cost defenders* and *differentiated defenders.* Our study makes use of that distinction. In other studies, we validated the distinctiveness of the prospector, analyzer, low-cost defender, and differentiated defender strategy types.

Prospectors evaluate performance in terms of effectiveness. They emphasize measures such as new product success, percentage of revenues derived from new products or new customers, market development, and sales or market share growth—characteristics of the innovation and learning perspective (which we prefer to characterize as the *innovation and growth perspective*) in the balanced scorecard. Prospectors have also been found to be oriented toward marketing, which implies an emphasis on customer satisfaction/retention and product quality/image. These are all characteristics of the customer perspective, which com-

Figure 1
The balanced scorecard

Performance emphasis in the balanced scorecard

Please indicate the degree of emphasis you place on the following measures when assessing the effectiveness of your product-market strategy. Note that this is the *emphasis* you place on each measure, *not* the actual performance for that measure.

Not applicable 0	Not evaluated 1	Little emphasis 2	Some emphasis 3	Moderate emphasis 4	Heavy emphasis 5

Customer perspective
___ Customer satisfaction
___ Customer retention
___ Number of customer complaints
___ Service/product quality
___ Image or reputation

Internal business perspective
___ Time from order to delivery
___ On-time delivery
___ Stock-out %

Innovation and growth perspective
___ Sales or market share
___ Sales growth or market share growth
___ % of sales from new products
___ # of suggestions from marketing employees
___ % of sales from new customers

Financial perspective
___ Return on investment (consider ROI, CFROI, ROA, ROIC, and RONA to be equivalent)
___ Return on sales

prises indicators such as customer satisfaction, customer retention, number of customer complaints, service/product quality, and image or reputation.

Because of their inherent duality, performance evaluation for analyzer businesses is more problematic than for other strategy types. Analyzers grow by introducing new products or by entering new markets after viability has been demonstrated by prospectors. They are also likely to place a strong emphasis on an innovation and growth perspective. However, they typically generate the majority of their revenues and profits from a fairly stable set of products and customer groups. This suggests that high-performing analyzers would also be apt to emphasize performance measures similar to defenders. However, given the distinction in types of defenders, this becomes somewhat problematic, because low-cost and differentiated defenders are not expected to emphasize exactly the same set of performance measures. The one perspective they are both expected to share is financial. It subsumes traditional profitability measures such as return on sales and return on investment. Consequently, we expect that high-performing analyzers will also emphasize the financial perspective.

Low-cost defenders attempt to maintain a stable base of customers and products by competing primarily on price, supported by their focus on efficient operations. The development of efficient operations is guided by the internal business perspective, which comprises indicators such as time from order to delivery, percentage of on-time deliveries, and stock-out percentage rate. Efficiency is also stimulated by a financial orientation. Thus, we expect that high-performing low-cost defenders will place greater emphasis on the internal business and financial perspectives than will low-performing ones.

In contrast, differentiated defenders attempt to maintain a stable base of customers by differentiating their product or service offerings with attributes that address unmet needs. This requires a closeness to the customer that reveals its perceptions of the value of offerings, unmet needs, and customer problems, all characteristic of the customer perspective. This attention to superior products or customer service also indicates the opportunity for premium pricing and an emphasis on profitability. Consequently, we expect that high-performing differentiated defenders will emphasize the customer perspective more than will low-performing ones.

The study

To test these propositions, we sent questionnaires with preaddressed return envelopes to 1,000 senior managers in service and manufacturing firms across the country. Over the course of two mailings we received back more than 200 responses. After accounting

Table 1
Differences between high performers and low performers by strategy type: Mean/standard deviation

		Number of cases	Customer perspective	Internal business perspective	Innovation & growth perspective	Financial perspective
Prospectors	Total sample	53	4.31/.71	3.75/.90	3.64/.67	3.86/.96
	High performers	23	4.65§/.37	3.73/.77	3.53/.70	4.04/.83
	Low performers	30	4.04/.79	3.78/1.1	3.73/.65	3.71/1.1
Analyzers	Total sample	36	3.81/.84	3.16/1.3	3.03/.64	3.65/1.2
	High performers	18	3.97/.68	3.70†/1.0	3.27*/.60	4.17†/1.1
	Low performers	18	3.64/.97	2.61/1.0	2.79/.60	3.14/1.1
Low-cost defenders	Total sample	52	4.00/.80	3.38/1.0	3.11/.70	3.97/.89
	High performers	12	3.58*/.86	3.63/.99	2.68†/.53	4.33/.86*
	Low performers	40	4.13/.75	3.31/1.0	3.24/.70	3.68/1.1
Differentiated defenders	Total sample	67	4.32/.55	3.72/.87	3.32/.64	3.97/.89
	High performers	28	4.52†/.39	3.67/.88	3.60†/.56	4.34†/.53
	Low performers	39	4.16/.60	3.75/.86	3.13/.63	3.71/1.0

*$p<.05$ †$p<.01$ §$p<.001$

for undeliverables, this constituted a 23 percent response rate, which is considered well above minimal thresholds for management studies. We asked each participant to consider either the largest business unit or the one they were most familiar with when responding to the survey's questions. By choosing to rely on the responses of a single informant, we followed the advice of Huber and Power (1985), who found that the response of a single knowledgeable informant was more accurate than the average of responses from informants with a range of knowledge.

The survey measured the competitive strategy type adopted by the firm, the emphasis placed on each dimension in the balanced scorecard, and the overall perceived performance of the firm. Strategy type was assessed using the self-typing paragraph approach that is commonly used in research on both strategic management and marketing strategy research. Overall perceived performance of the firm was assessed on a five-point scale ranging from 1 = "much worse than competitors" to 5 = "much better than competitors." Firms were subsequently categorized as either *high performers* (overall performance of 4 or higher) or *low performers* (overall performance of 3 or lower). We adopted this conservative demarcation point to clearly identify the top firms. Out of the 208 responses, 81 were subsequently categorized as high performers—39 percent of the total sample.

Prospectors, analyzers, and differentiated defenders all demonstrated a rate of 40 percent or higher for high-performing firms. Only low-cost defenders, with just 23 percent, demonstrated significantly lower than expected performance distributions by competitive strategy category. We can only speculate as to why this group yielded a lower percentage of high-performing firms than did the others. However, as the results will show, even with reduced numbers significant differences were demonstrated between high- and low-performing low-cost defenders with regard to the emphasis each applied to alternative components of the management control system.

The results of this study are presented in **Table 1**, which shows the degree of emphasis low and high performers place on each dimension in the scorecard. As a group, prospectors emphasize the innovation and growth perspective more than do any of the other strategy types. However, there is no significant difference between high and low performers regarding emphasis on the innovation and growth perspective. This finding suggests that the need for innovation is well understood among prospector firms. However, as predicted, high-performing prospectors place greater emphasis on the customer perspective than do low performers. Thus, what truly separates high- from low-achieving prospectors is the attention they pay to their customers.

As predicted, high-performing analyzers place greater emphasis on both the innovation and growth perspective and the financial perspective than do low-performing analyzers. No difference between high and low performers with respect to the customer perspective was observed. However, high-performing analyzers also place greater emphasis on the internal business perspective than do low performers. Thus, an emphasis on three out of the four performance perspectives helps distinguish between high- and low-performing analyzers.

Also as predicted, high-performing low-cost defenders place greater emphasis on the financial perspective than do low-performing ones. High performers that have adopted this competitive strategy also place significantly *lower* emphasis on both the customer perspective and the innovation and growth perspective than do low performers. This suggests that attempting to get close to their customers and pursuing innovation and market growth detract from low-cost defenders' quest for efficiency.

Finally, high-performing differentiated defenders emphasize the customer perspective more—again, as predicted. This serves to reinforce the importance of strong customer relationships for firms following this strategy. High-performing firms following this competitive strategy also emphasize the innovation and financial perspectives more than do low performers. This finding suggests it is highly important for differentiated defender firms to continuously search for ways to improve their offerings and commit resources to that end.

These results provide additional insight into the nature of strategy types by demonstrating that the performance measures businesses emphasize are related to the firms' overall success. It is worth noting that 10 of the 16 differences examined are statistically significant. So if we accept the general concept that what gets measured gets done, the behaviors encouraged by these performance emphases are important contributors to business success.

Before progressing to our conclusions, we need to consider two additional observations about the data generated in this study. Up until this point we have focused our observations within strategic groups rather than between groups or within the larger context of all the firms, irrespective of competitive strategy. The first observation worth noting from the data in Table 1 is that, as groups, prospectors, analyzers, low-cost defenders, and differentiated defenders all place the highest emphasis on customer and financial perspectives. This suggests that the ideas of market orientation and customer relationship management have become well-established principles of good management, and that all firms recognize the need to generate sufficient profits so as to maintain investors' confidence. However, whereas in all cases the firms with the highest performance place greater emphasis on the financial perspective, the same is not true for the customer perspective, which the highest-performing low-cost defenders actually stressed less than did their low-performing counterparts. Thus, we see evidence that firms do not—and more important, *should* not—necessarily place equal weight on all four of the managerial control perspectives.

Are there competitive strategies in which a balanced scorecard approach actually represents the best management standard? Perhaps the closest example can be seen in the case of prospector firms, in which all four management control perspectives demonstrate moderately high to very high scores. Indeed, prospectors must, by definition, be innovative in such a manner that the resulting product and service offerings actually address customers' needs and wants. These firms must also be able to generate sufficient profits to justify investors' confidence. Perhaps most surprising is the observation that these firms also place a moderately high level of emphasis on the internal business perspective. Still, as the data reveal, the one factor that more than any other correlated with high performance for prospectors was the customer perspective. Despite prospectors' strong need for innovation, it appears that this drive for innovation and growth must be conducted within the framework of clearly understanding consumers' wants and needs.

In marked contrast to the fairly balanced approach of prospectors is the distinctly unbalanced approach of low-cost defenders, in which the highest-performing firms actually placed less emphasis on the innovation and growth and customer perspectives. Of course, a balanced effect could still be generated in a negative condition if the two remaining management control perspectives had also demonstrated significantly lower numbers for the top-performing firms in this strategy category. But this was not the case; indeed, high-performing low-cost defenders placed significantly greater emphasis on the financial perspective and greater (though not statistically significant) emphasis on the internal business perspective.

If we accept the general concept that what gets measured gets done, the behaviors encouraged by these performance emphases are important contributors to business success.

The study reported here provides new insight into the performance evaluation requirements of the different strategy types and, as such, the associated requirements for their successful implementation. These findings should be particularly important to business unit managers. In a turbulent environment, learning and responsiveness are essential to achieving and sustaining competitive advantage. However, this study is only a first step toward understanding how performance emphasis facilitates the achievement of superior performance. What are the intervening steps between measuring performance and excelling? Does strategy-consistent performance measurement manifest itself in more effective motivation and reward systems or in more effective planning systems? What steps does an organization take to move from analysis to action? These are questions that managers and academics should seek to answer. ❍

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