Research Paper

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Possibilities of Balanced Scorecard Application in Commercial Banks

Economics

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ABSTRACT

Efficiency measuring of commercial banks is an important aspect of banks' management. This paper is about Balanced Scorecard as a tool or methodology of managerial accounting which helps to achieve harmony and mutual maintenance of key banks' processes. The aim of this paper is to contribute to the understanding of how Balanced Scorecard is developed but also applied in banks, i.e. in their performance measurement. Achieving goals of one perspective enables the achievement of goals of other perspectives. That means that results show a relationship between non-financial and financial dimension of Balanced Scorecard. Implementation of BSC model in banks isn't simple because of existing tradition which focuses just on financial indicators. Because of lack of research in this specific area, the contribution of this paper is in knowledge on how banks may apply Balanced Scorecard.

I. INTRODUCTION

Balanced Scorecard is strategic management approach developed by Robert Kaplan and David Norton in early nineties of last century. They defined that approach as a method for explanation of mission and strategy in clear, comprehensive, detailed and carefully chosen set of measures which ensure building the system for strategic measurement and management machine (Janković, 2007). BSC methodology of managerial accounting is intended to management for achieving coordination and assistance to key processes in bank. Earlier performance measurement systems were based on traditional financial indicators which weren't sufficient for quality business decision making (Renko, 2000). But BSC is also a management tool which enables explanation of bank's vision and strategy and it's execution in practice. Results of their execution must be measurable (Pavlek, 2006). Also, this model ensures feedback of internal business processes and external results in order to enable continual improvement of strategic performance and bank's business result. Implementing Balanced Scorecard in banks can be very tricky because there is a temptation to focus only on financial indicators.

II. Balanced scorecard methodology

The purpose of Balanced Scorecard isn't to develop a brand new performance measurement system, but to add emphasis on updating of financial indicators with indicators of organizational, marketing and internal variables which will influence on bank's success. Balanced Scorecard model is balanced system of bank's business result. That is carefully chosen set of measures derived from strategy of certain banks which can be quantified. By applying this model information base for decision making process is ensured with emphasis on balanced measurement of success through internal and external influences. In context of banks Balanced Scorecard model represents four perspectives, metric development, data collection and data analysis for every following perspective (Osmanagić Bedenik, 2002):

- Financial perspective – the way bank observe its shareholders
- Client perspective – how clients see the bank
- Perspective of business processes – what a bank should accent in order to make success
- Perspective of growth and development - can bank's success be continued.

Information that management have to collect, analyse and report is minimized by limiting performance measures to the number of four, In that sense management is measuring right things and is not creating to many measures which wouldn't be possible to monitor. So it is suggested to see the bank from four perspectives. It is not easy to say which perspective is the most important but implementation of financial goals depends on other three categories.

This approach was designed in order to detect weaknesses of other management systems that tend to create conflict goals in bank.

Following figure shows the above mentioned perspectives in Balanced Scorecard model (Kaplan, R.S. & Norton, D.P., 1996).

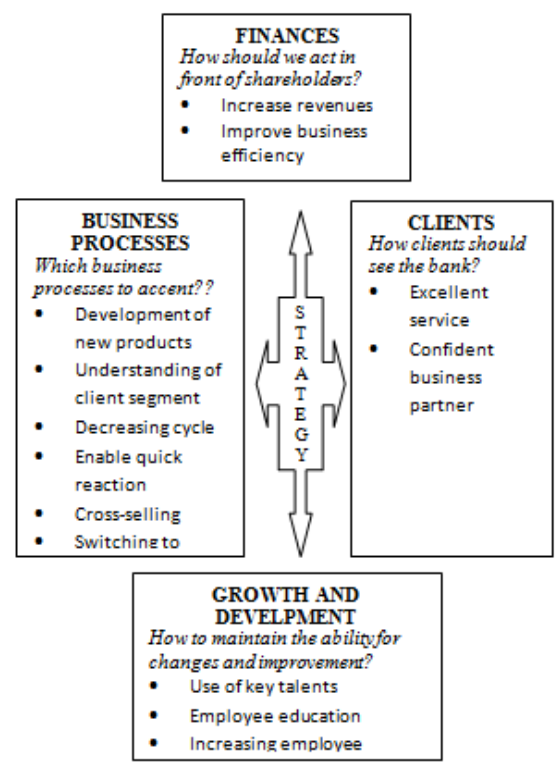

Figure 1. Balanced Scorecard model

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A. Financial perspective

Timely and accurate information has big advantage for decision making in certain moment. Financial measurements apply to economic consequences of past bank's activities. In order to realize the goals of this perspectives successfully, the strategic accounting is used and is of crucial importance to choose optimal number of financial indicators. Of course, chosen financial measures depend on bank's strategy but also on bank's life cycle. Under this perspective most commonly ROI (return on invest-

ment), cash flow, net operating income, revenues growth etc. are considered.

Despite the fact that financial indicators are the most important for banks, focusing only on those indicators is not a real indicator of what is happening inside the bank. That is the reason why it is important to monitor financial indicators but having in mind that those are realized through the implementation of other non-financial measures.

B. Client perspective

If this perspective is weak it can bring to decreased use of services form clients regardless good financial perspective. From that reason this perspective measures acceptability of products and services from the side of clients. Bank should demonstrate the differences from competition when retaining existing and attracting new clients of target markets. In that sense it is necessary to ensure information about target market, trends, clients' structure and their satisfaction, products and services and their quality. Usually clients' satisfaction, clients' complaints, selling of new service or product are used as measures.

The higher the clients' knowledge about bank's products and services, the higher possibility that bank's employees will meet clients' needs. Elimination of mistakes in this field refer to all procedures and transactions as well as on communication with clients.

C. Perspective of business processes

This perspective enables insight into banks' business. Metrics for this perspective should be carefully designed from employees that know business processes in details. That means that this metrics should not be outsourced. Usually the goals of this perspective are designed after client perspectives because such order enables the system to concentrate on processes which contribute to banks' and clients' goals realization. The core of this perspective is a result of internal business processes which leads to financial success and satisfied clients. Measures of this perspective that are usually used are quality cost, time savings, process innovation and similar.

D. Growth and development perspective

This perspective includes employees' education. In organization of knowledge employees are the main resource but sometimes it is difficult to identify and recruit new qualified staff while in the same time there is a poor education of existing staff. That is a typical indicator of brain drain. In practice this perspective is known as human resources management. It is important to ensure lifelong education, to set motivation system and similar. Measures by this perspective are difficult to be identified but mostly refer to motivation and employees' abilities.

Maintaining competitive advantage is defined by getting and using the information. This process consists of two phases:

- collecting information and their analysis
- decision making about the usage of certain information.

All mentioned is possible with permanent IT assistance. The above explained four perspectives should function in synergy as they represent the system which connects and adjusts dependent areas of banks competition. Resources should be allocated in fields which enable the highest profitability.

As it is explained above, Balanced Scorecard consists of financial but also non-financial measures. Traditional performance measurement tools consider just financial part and went under criticism recently. That includes lack of predicting power, sacrifice of long-term decision making, some financial measures are not relevant for all organization levels etc.

III. advantages and disadvantages of Balanced scorecard model

As many other methods of performance measurement and this Balanced Scorecard model has advantages and disadvantages.

A. Advantages of Balanced Scorecard model

One of the advantages of this model is connection of numerous areas that are on first segregated as well as combination of nonfinancial and financial indicators by which the gap between short-term and long-term success measurement is eliminated. This model attempt to eliminate disadvantages of traditional performance measurement systems based only on financial indicators. Also, one of the most important advantages is help when detecting achieved improvements in certain segment, but also eventual losses of other segments.

Balanced Scorecard model perspectives represent balancing between short-term and long-term goals. By combing measures form four perspectives managers can prevent that improvements of one segment cause losses to other segment(s). In other words, managers focus on nonfinancial indicators which influence bank's profitability in long run.

As most important advantages of Balanced Scorecard model following can be emphasized (Hočevar, 2007):

- correlation and connection,
- combination of financial and nonfinancial indicators,
- strategy achievement and
- usability.

The main assumption is that by acting on one segment also results in other segment(s) can be achieved.

B. *Disadvantages of Balanced Scorecard model*

The main critics or disadvantage of BSC model is that its' perspectives don't take into account external environment of organization (bank) such as politics, economy, etc. Also, sometimes there is a big number of indicators and information which causes big investments of money and employees.

The main disadvantages of BSC model are novelty and comprehensiveness (Hočevar, 2007). This is a result of resistance and fear of employees to changes.

But all I all, there are more advantages then disadvantages regardless of long time needed for BSC model application and financial resources because by this model translation of vision and strategy into concrete activities is encouraged.

IV. process of construction of balanced scorecard in banks

Next table represents a Balanced Scorecard model for a bank (Carpenter, 2010). Usually a bank will have about 15 – 20 key indicators for performance measurement of its strategy.

TABLE II. BALANCED SCORECARD MODEL FOR A BANK

Financial	Customer or Market
Return on equity Return on assets Net interest margin Revenue mix Revenue growth Return on equity growth	Market share (by segment) Customer retention Customer satisfaction Survey Customer acquisition
Process	Learning and Growth
Error rates Investment in technology Number of complaints Cross – sell ratio	Revenues from new products Product development cycle Employee survey Revenue per employee Employee turnover Training hours per employee

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Also, the implementation process of Balanced Scorecard in bank last about four months through four phases which is represented in the table below (Renko, 2000).

TABLE III. the construction process of BALANCED SCORECARD MODEL FOR A BANK

Phase	Week	Tasks
I. Defining main indicators	1-3	1. Selection of appropriate organizational unit (defining of business unit for which the model will be developed) 2. Identifying of organizational unit and it's connection with the entire organization (through interviews with executives)
II. Goals acceptance	4-7	3. First cycle of interviews (manager that leads the project prepares model materials as well as internal documents about the bank, its goals and competition) 4. Synthesis (Discussion about proposals, goals and indicators) 5. Seminars: first cycle (meeting with board, distribution of meeting results)
III. Selection and designing of indicators	8-13	6. Meetings of subgroups (list of goals and indicators for each goal; identifying key connections between indicators of the model) 7. Seminars: second cycle (middle managers discuss about goals and indicators; after comments begins the implementation plan)
IV. Plan of implementation	14-16	8. Developing of implementation plan 9. Seminars: third cycle (identifying of preliminary action program) 10. Finishing implementation plan (model must be integrated in management system)

When implementing Balanced Scorecard in banks it is very important to make certain to appropriately balance all imperatives of the bank.

V. concluding remarks

Balanced Scorecard is such a model by which strategy is translated into concrete activities with the aim of achievement of settled goals. Reporting that is based exclusively on historical, i.e. financial indicators isn't enough because it isn't in direct connection with the bank's long-term goals. The reason is because financial indicators put emphasis on short-term financial indicators while, on the other side, Balanced Scorecard engage all hidden resources in order the ensure bank's leading position on the market.

Application of Balanced Scorecard model helps employees of all levels to better understanding of strategy. By BSC model the visualization of strategy is enabled which helps to its better understanding. This model helps management to consider weaknesses and strengths, areas on which losses are made and profitable ones. Implementation of this model is expensive and requires time and effort but advantages of this model excel its disadvantages.

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