Chapter One
Introduction

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1.1 Performance Management

Performance Management is nothing but managing the performance. In other words, PM is ‘managing translation of plans into results i.e. execution’ It is like an umbrella which includes methodologies, processes, tools, controls, systems etc. Sometimes it is confused with Human Resource or Personnel Management which is not true as such. It is actually a complete planning and control system. In other words PM is nothing but a total system which covers areas like Financial Planning, Budgeting, Strategy Formulation, Resource planning, Capacity Planning, Costing. This also includes like Customer Relationship Management, Supply Chain Management, and Human Resource Management etc.

In the end organizations need top down guidance and bottom up execution or from top desk to desk-top. Most importantly PM has to convert data available to decision-making may be in form of Economic Value Added, Standard Costing, Budgeting, Value Chain Analysis, Activity Based Costing Management, Competitive Benchmarking etc.

A simple definition of performance management is "the translation of plans into results – execution." It is the process of managing an organization's strategy. For commercial companies, strategy can be reduced to three major choices:\n
1. What products or service lines should we offer or not?  
2. What markets and types of customers should we serve or not?  
3. How are we going to win?

Although PM provides insights to improve all three choices, its power is in achieving number three – winning by adjusting and executing strategies. PM does this by
helping managers to sense earlier and respond more quickly and effectively to
uncertain changes.

Think of PM as an umbrella concept that integrates the business improvement
methodologies you are already familiar with (or likely have heard the terms) with
technology. In short, the methodologies no longer need to be applied in isolation –
they can be orchestrated.

PM is sometimes confused as a human resources and personnel system. It is much
more encompassing. PM describes the methodologies, metrics, processes, software
tools, and systems that and manage the performance of an organization. PM is
overarching from the C-level executives cascading down through the organization and
its processes. From the top desk to the desk top. To sum up its benefit, it enhances
broad cross-functional involvement in decision making by providing tremendously
greater visibility with accurate, reliable, and relevant information – all aimed at
executing an organization's strategy.

To minimize anyone's confusion, there is no single PM methodology because PM
spans the complete management planning and control cycle. Think of it as a broad
dependable union of solutions including three major purposes: collecting data,
transforming and modeling the data into information, and web-reporting it to users
and decision makers. Many of PM's component methodologies have existed for
decades or have become recently popular, such as the balanced scorecard. Some of
PM's components, such as activity-based cost management, are partially or crudely
implemented in many organizations, and PM refines them so that they work in better
harmony with PM's other components. Early adopters have deployed parts of PM, but
few have deployed its full vision.

The term "knowledge management" is frequently mentioned in business articles. It
sounds like something an organization needs, but the term is somewhat vague and
does not offer any direction for improving decisions. In contrast, the main thrust of
PM is to make better decisions that will be evidenced, and ultimately measured, by
outputs and outcomes.
Need of Management for Success

Executive management's greatest challenge is in communicating its strategy. If asked to describe their organization's strategy, most employees and managers cannot adequately articulate it. Employees can effectively implement a strategy only when they clearly understand the strategy and how they contribute to its achievement. An integrated suite of methodologies and tools – the PM solutions suite – provides the mechanism to bridge the business intelligence gap between the CEO's vision and employees' actions.

Many organizations, however, jump from improvement program to program hoping that each new one may provide that big yet elusive competitive edge. However, most managers would acknowledge that pulling one lever for improvement rarely results in a substantial change – particularly a long-term sustained change. The key for improving is integrating and balancing multiple improvement methodologies.

PM tightly integrates the business improvement and analytic methodologies executives are already familiar with. These include strategy mapping, balanced scorecards, costing (including activity based cost management), budgeting, and forecasting, and resource capacity requirements. These methodologies fuel other core solutions such as customer relationship management (CRM), supply chain management (SCM), risk management, and human capital management (HCM) systems, as well as Six Sigma. It is quite a stew, but they all blend together. In the end, organizations need top-down guidance with bottom-up execution. PM does this by converting plans into results. PM integrates operational and financial information into a single decision-support and planning framework. And based on a common database platform, it provides "one version of the truth" rather than disparate inconsistent data that annoys both employees and customers. Simply put, PM helps an organization to understand how it works as a whole.
The Roles of Strategy Maps and the Balanced Scorecard in Performance Management

Leadership's role is to determine strategic direction and motivate people to go in that direction. However, senior executives are challenged and usually frustrated with cascading their strategy down through their organization. Executives and management consultants have hailed the balanced scorecard as the new religion to resolve this frustration. It serves to communicate executive strategy to employees and also to help navigate direction by shaping the alignment of people with strategy. The balanced scorecard bridges the substantial gap between the raw data spewed out from business systems, such as enterprise resource planning systems (ERP) and the organization's strategy. In addition, it provides immediate and visual feedback through graphical meters displaying differences between actual performance and the targets set by management.

Despite much publicity about the balanced scorecard, the strategy map that precedes the development of the scorecard is considered to be much more important. Strategy maps enable leadership to motivate people by serving as a guide with signposts and guardrails. Strategy maps explain high-level causes and effects with if-then logic, helping executives choose the best strategic objectives and the supporting projects and action items that will help the company attain them.

Performance Management is an Iterative Process

Similar to the popular 'plan-do-check-act (PDCA)' iterative cycle made popular by W. Edwards Deming, the famous quality improvement expert, performance management also has an iterative cycle. As Figure A illustrates, imagine performance management as a wheel with three elements or arcs: focus, communicate, and collaborate. The figure also shows how fact-based managerial accounting data and operational data provide input to the performance management wheel.

1. **Focus** - The process of managing strategy begins with focus. You never have enough money or resources to chase every opportunity or market on the planet. You have to think in terms of that you are continuously limited to
scarce and precious resources and time, so focus is key and strategy yields focus. In this important initial step senior management defines and continuously adjusts its strategy. And next, by mapping cause and effect relationships with its strategy map, it defines strategic objectives and higher impact action steps and projects that will achieve those objectives. Companies can ideally turn big goals into small, manageable projects that can actually be accomplished. The first step in this translation is to create a set of strategic themes that will bridge the gap between the existing state of operations and the desired state. These themes then organize the work of the company. By focusing on critical areas, everyone can identify the true sources of business failure, as well as the best practices that lead to future success.

2. **Communicate** - The process of managing strategy continues with communication. The key is for senior management to articulate its strategy to employees in a way they understand it. Along with articulating strategy comes the all-important feedback to employee teams. "How am I doing on what is important?" The balanced scorecard is the key tool for communicating the strategy. Think of scorecards as the drive gears of the strategy map. Think of a scorecard as having carefully selected and defined indicators and measures, each weighted to reflect their relative level of importance. Think of a scorecard as a set of chain-links of the strategy map's strategic objectives where each chain-link uses "if-then" relationships with leading and lagging measures to drive work efforts to align with organization's mission and vision. If properly implemented, a scorecard enables all employees and managers should be able to quickly answer a powerful question: "How am I doing on what is important?" By integrating, distributing and analysing enterprise-wide information an organization gains the power to act on this information – ahead of its competitors.

3. **Collaborate** - The process of managing strategy ends with collaboration. By aligning various strategies among business units, the organization taps into the collective knowledge of its employees and unleashes each person's potential. From the "top desk" to the "desk top," e-mail discussion threads can be created
for faster consensus and truly make executing strategy everyone's job. Employees do not need to wait for their managers to direct them but rather they can actively make decisions. Collaboration in this sense is all about collective dialog.

Ultimately, executives can move beyond the traditional practice of focusing on backward-looking financial results by using scorecards and strategy maps to focus on their organizations' strategic objectives in the areas of learning, growth, innovation and process. They can focus on non-financial leading indicators, measured during the period, and that ultimately result in the organization's financial performance. By doing so, organizations can achieve their customer-facing objectives and subsequently meet their financial objectives.

Basically role of top management is to get performance done from people by way of motivation and direction towards company's strategies. To achieve this, a normal employee should know what the strategy of a company is and that should be part of his day to day activities. The concept of Balanced Scorecard is developed towards this. Balanced Scorecard is divided in 4 areas of strategies namely Financial, Customer, Internal Business Process and Learning & Growth. Let's see how BSC framework is designed for Performance Management.

### 1.2 Balanced Scorecard

A new approach to strategic management was developed in the early 1990's by Dr. Robert Kaplan (Harvard Business School) and David Norton. They named this system the 'balanced scorecard'. Recognizing some of the weaknesses and vagueness of previous management approaches, the balanced scorecard approach provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective.

The balanced scorecard is a *management system* (not only a measurement system) that enables organizations to clarify their vision and strategy and translate them into
action. It provides feedback around both the internal business processes and external outcomes in order to continuously improve strategic performance and results. When fully deployed, the balanced scorecard transforms strategic planning from an academic exercise into the nerve center of an enterprise.

Kaplan and Norton describe the innovation of the balanced scorecard as follows:

"The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation."

The balanced scorecard suggests that we view the organization from four perspectives, and to develop metrics, collect data and analyze it relative to each of these perspectives:

1. Learning & Growth Perspective
2. Internal Business Process Perspective
3. Customer Perspective
4. Financial Perspective

**Learning & Growth Perspective**

This perspective includes employee training and corporate cultural attitudes related to both individual and corporate self-improvement. In a knowledge-worker organization, *people* -- the only repository of knowledge -- are the main resource. In the current climate of rapid technological change, it is becoming necessary for knowledge workers to be in a continuous learning mode. Government agencies often find themselves unable to hire new technical workers, and at the same time there is a decline in training of existing employees. This is a leading indicator of 'brain drain' that must be reversed. Metrics can be put into place to guide managers in focusing training funds where they can help the most. **In any case, learning and growth constitute the essential foundation for success of any knowledge-worker**
organization.

Internal Business Process Perspective

This perspective refers to internal business processes. Metrics based on this perspective allow the managers to know how well their business is running, and whether its products and services conform to customer requirements (the mission). These metrics have to be carefully designed by those who know these processes in and out. To develop this perspective organization may have to take help of Consultants.

Customer Perspective

Recent management philosophy has shown an increasing realization of the importance of customer focus and customer satisfaction in any business. These are leading indicators: if customers are not satisfied, they will eventually find other suppliers that will meet their needs. Poor performance from this perspective is thus a leading indicator of future decline, even though the current financial picture may look good.

Financial Perspective

Kaplan and Norton do not disregard the traditional need for financial data. Timely and accurate funding data will always be a priority, and managers will do whatever necessary to provide it. In fact, often there is more than enough handling and processing of financial data. With the implementation of a corporate database, it is hoped that more of the processing can be centralized and automated. But the point is that the current emphasis on financial leads to the "unbalanced" situation with regard to other perspectives.
What are Strategy Maps?

Strategy maps are nothing but the flow of the balanced scorecard. In other words, strategy maps are built around the structure of these four perspectives. They ensure that the organization’s objectives in each of these perspectives are consistent and internally aligned. That alignment, in turn, means the organization is focused and performing at an optimum level rather than having the actions of one part of the organization impact on the results achieved by another part. Strategy maps clarify all cause-and-effect relationships so that an effective strategy can be developed and then optimized over time. They are the interface between strategy and the Balanced Scorecard.
In the words of Kaplan and Norton “The strategy map, by providing a clear and comprehensive description of an organization’s strategy, gives executives an enhanced ability to execute their strategies. People can’t manage what they can’t measure, and they can’t measure what they can’t describe. The strategy map solves this problem by providing a framework for a simple, one-page representation of the cause-and-effect linkages among the objectives for both the outcomes and the drivers of the strategy. The word statements of objectives in a strategy map are, in turn, converted into a Balanced Scorecard of measures, targets and initiatives. The strategy map and Balanced Scorecard enable everyone in the organization to have a common understanding of the strategy. The strategy map facilitates performance breakthroughs by allowing them to link their management processes to a clearly defined strategy”

To summarize, BSC is a concept of performance management system divided into four perspectives. These perspectives are aligned and drawn out of vision and mission of a company. Further these perspectives have to follow an order which is explained by strategy maps. These maps should explain cause and effect relationship.
1.3 **Profit Maximization**

Profit maximization is the rational behaviour of equilibrium assumption. Any firm which aiming at profit maximization model; will go increasing its output till it reaches maximum profit output. Profit is known nothing but differences between total revenue and total cost. The more the differences between total revenue and total cost will create maximum profit. So, the equilibrium for a firm will be when there is maximum difference between the total cost and total revenue.

**Economist Theory of Firm:**
According to the Economist Theory of Firm, a firm is a transformation unit, which converts input into output and while doing so, tries to create surplus value. This surplus value is nothing but the difference between the value of the product and the value of the factors of production. The firm aiming for profit maximization reaches its equilibrium only when it produces profit maximizing output. The firm maximizes profit by equating marginal revenue with marginal cost.

**Behavioral Theory of Cyert & March:**
According to the theory, in a large multi-product firm the management is not the owner. There are forms of business firm which compromises the group of individuals and not controlled by single entity.

**Marris Growth Maximization Model:**
Robin Marris is the developer of the model. According to this theory, modern firms are managed by both the manager and the shareholders. A manager aims to maximize the rate of growth of the firm and the shareholders will try to maximize the dividend and the increase the share price.

**Sales Maximization Model:**
This is alternative model for profit maximization model. The model has been propounded by W.J. Baumol who was an American Economist. The assumption in
this theory is relation about business behaviour. Baumol thinks managers are more interested in maximizing sales rather than profit.

**Williamson’s Managerial Discretionary Theory:**

According to the theory, in a firm, shareholders and managers are two separate groups. The firm tries to get maximum returns on investment and get maximum profit, whereas managers try to maximize profit in their satisfying function.

At last, Williamson’s managerial discretion theory shows the utility function of a manager. In this theory, the firm will try to get maximum returns or maximum profit where as manager try to maximum utility satisfying function. They are in equilibrium when the utility has maximum amount.

There are lot of definitions available for profit maximization. In this research Profit Maximization is seen from point of view with other companies. Studies and beliefs in the past do not believe in profit maximization. However it is to be noted that the whole idea of Balanced Scorecard is to earn profits and in competitive world it is possible. There are two ways to earn profits; one by way of reducing costs and other by increasing sales.

**Formula,**

**Profit = Sales – Fixed Costs – Variable Costs**

If we see the structure of Balanced Scorecard it is very much in line to achieve the same. Figure 3 below will clarify how Balanced Scorecard is to be used for Profit Maximization. Kaplan and Norton initially experimented with various companies and the strategy they insisted for loss making bank is described here. Stating that; Profit Maximization is the ultimate aim of Balanced Scorecard.
In another example where Balanced Scorecard deals with how to increase profits and reduce costs to get maximum profits. In this situation it is advocating increase in sales. In other word the basic premise on which Balanced Scorecard is based is Profit Maximization.
It is yet another strategy map which is clear indication that there are two ways to reach to profits. One by way of increasing sales and other by reducing costs. The ultimate motive of this tool is to get profit maximization. In this research the need was felt that Profit Maximization should be tested in companies implementing Balanced Scorecard.