Balanced Scorecard & Incentive Compensation System
Factors Influencing the Linkage

Bachelor’s thesis within Business Administration

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Dedicated to Our Parents
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Abstract

Purpose The purpose of this research thesis is to first find out the number of companies within Sweden, Norway and Finland which has linked their Incentive compensation system with the Balanced Scorecard. The paper also aims to analyze the influence of various factors on the efficient design and implementation of this linkage.

Background The employee motivation and performance have a significant impact on the organizational success and strongly depend on the rewarding system used within an organization. The alignment of the rewarding system with the Balanced Scorecard measures allows better achievement of the organizational strategies and thus leads to enhanced financial performance. The linkage of the organizational Scorecard and incentive compensation plan is considered as the final stage of the Balanced Scorecard implementation and once it is designed effectively, the organizational strategies and goals become actionable.

Method To fulfill the purpose of this thesis, collection of empirical data was done through qualitative research - conducted sample survey and semi structured interviews. For this study, we have included four interviews which were conducted on two financial organizations located in Jonkoping, Sweden, following convenience sampling.

Conclusion The outcome of the study is the investigation of various factors which affect the design and implementation of Incentive compensation system based on the Balanced Scorecard within an organization. An effective management of these factors yields a significant improvement in the employee motivational level and also in the overall achievement of organizational strategy based on the Balanced Scorecard measurements.
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1 Introduction

In this section we will present the broader concept of our study by introducing the research area of interest, and presenting a brief background based on previous empirical findings. Thereafter the alignment of Balanced Scorecard with Incentive system is briefly discussed followed by defining the purpose and delimitations of the paper.

1.1 Background

In current times, firms all around the world are encountering immense challenges due to intensive competition, changing customer demands and volatile innovations in the product and/or services market (Cascio, 1995). To survive, companies have now to be more responsive to the market and customer needs and changes, provide a larger variety of customer specific products and/or services, and possess more flexible processes. To ensure the proactive response to these challenges, management needs dynamic, integrated and perceptible performance information system for assisting immediate decision-making and supporting a flexible and responsive management style (Nudurupati, Bititci, Kumar, and Chan, 2010).

During the late 1980-90’s, conventional financial measures, such as budgeting, had been continuously criticized by a number of academics and experts in the field of management (Dixon, Nanni, and Vollman, 1990; Goldratt & Cox, 1986; Hayes & Abernathy, 1980; Johnson & Kaplan, 1987; Kaplan & Norton, 1992; Keegan, Eiler, & Jones, 1989; Neely, Mills, Gregory, & Platts, 1995; Skinner, 1974) for being internally focused and historical based. The financial performance measures, as an integral part of accounting systems, were designed with the focus on consistency and hardness necessary for instant comparison and evaluation of company’s past performance. They were not developed to communicate information for guiding the decision-making process of people inside the organization (Atkinson, Waterhouse, and Well, 1997). Those financial measures supported short-termism, lacked strategic focus and failed to provide data on quality. In addition, responsiveness was the problem meaning that information on customers demand and the competitor’s performances were absent. Furthermore, the traditional financial measures were mainly historically driven and, therefore, failed to provide forecast measures for possible future developments (Neely, 1999; Nudurupati et al, 2010).

Hence, to facilitate the better attainment of organizational strategies, the system of performance measurement must have been designed which would supervise and evaluate these processes to achieve a set of different objectives. According to Neely et al. (1995) and Waggoner, Neely, & Kennerley (1999), performance measurement “serves the purposes of monitoring performance, identifying the areas that need attention, enhancing motivation, improving communications and strengthening accountability”. The design of the performance measurement system, then, is primarily a cognitive process, which transforms the views of
customer and other stakeholders’ demands into business goals and suitable performance measures (Bourne, Mills, Wilcox, Neely and Platts, 2000)

In the course of running the business organizations set goals and adopt various strategies to achieve them. This calls for performance measurement system to ensure that such goals and objectives are formulated and achieved effectively (Neely et al., 1995). Performance spans across all levels of the organization from individual to departmental, and serves to evaluate and control the organizational performance against set targets and measures. It is argued that performance measures should be derived from strategy (Neely et al., 1995; Anthony and Govindarajan, 2001), monitor a “balanced” picture of the organization (Keegan et al., 1989; Kaplan and Norton, 1992), be multi-dimensional and reflect all areas of performance (Epstein and Manzoni, 2004), promote congruence of goals and actions (Bititci, Carrie. and MeDevitt, 1997; Epstein and Manzoni, 2004), and examine past and future performance (Fitzgerald and Moon, 1996; Olve, Petri, Roy & Roy, 2003).

Among the other frameworks and models, which significantly contributed to the development of performance measurement systems, there is the concept of Balanced Scorecard introduced by professors Robert Kaplan and David Norton in 1992.

The Balanced Scorecard is the performance measurement system which incorporates financial and non-financial measurements from four different perspectives – financial, customer, internal business processes, and learning and growth (Kaplan and Norton, 1992). The Balanced Scorecard translates the organizational strategy into a linked set of measures which shape the long-term strategic objectives and the ways for attaining and obtaining feedback on those objectives (Kaplan and Norton, 1996b). These objectives are believed to be essential for generating the long-term shareholder value. By investigating various performance indicators, other than those of financial, managers can better monitor progress towards an organization's strategic goals and render them into the actionable objectives (Kaplan and Norton, 1992). Each business unit in the organization develops its own scorecard which is integrated with the scorecards of other units to achieve the strategic objectives. These perspectives, through which the business strategies are planned, implemented and monitored, are interlinked with each other and outlined in a strategy map via a cause and effect relationship (Kaplan & Norton, 1999; 2000).

The Balanced Scorecard has been adopted by an extensive number of companies all over the world. According to the survey conducted by Rigby and Bilodeau (2009), of more than 9900 companies in North America, Europe, Asia, Africa, the Middle East and Latin America, the usage rate of Balanced Scorecard was 53 per cent or the 6th most used management system. Considering this high usage rate and the large number of publications made on the Balanced Scorecard over the past decade, the question such as “Why is the Balanced Scorecard so popular?” appears.

The Balanced Scorecard is the revolutionary innovative tool which takes a balanced view of an organization by combining financial and non-financial perspectives and providing an
organization with a measurable way to execute their business strategies (Niven, 2006; Kaplan and Norton, 1996b; Kaplan, 2009). Though recognizing the importance of financial measures as the ultimate indicator of strategy success, the Balanced Scorecard also emphasizes the critical roles played by measures from customer, internal process, and learning & growth perspectives. By considering all these aspects related to this performance measurement system, we decided to select the Balanced Scorecard and study how it works with organizational incentive compensation systems.

![Balanced Scorecard](image)

Since the early 1930’s, incentive compensation systems have been widely used in profit and non-profit organizations of all sizes (Hilton, Maher & Selto, 2003). In order to ensure that the organizational strategy will be achieved, it is essential to motivate people to perform in the specific direction. In fact, there is a strong correlation between the organizational performance and incentives selected for endorsing people to perform (Gordon and Kaswin, 2010). Incentive rewards relate to the employee performance and are contingent on the employee performance for the period. Organizations introduce performance based incentives to employees at different hierarchal levels to achieve individual as well as organizational objectives (Gordon and Kaswin, 2010). An effective incentive plan should clearly define the desired goals and objectives aligned with the organizational strategy. Then, these performance goals should be linked with individual, business unit and company level objectives (Gordon and Kaswin, 2010).
1.2 Problem Discussion

The diversity of performance measures improves incentive compensation plans by solving the problem of goal congruence and making these measures valuable which leads to greater effort intensity (Feltham & Xie, 1994; Datar, Cohen Kulp and Lambert, 2001). Consequently, the selection of the right performance measurement system becomes significant.

The Balanced Scorecard and incentive compensation can be regarded as the perfect match since the Scorecard incorporates the vital metrics extracted from the organizational strategy which sets a path for future growth and profitability, while the compensation aspect keeps everyone committed and motivated to achieve these Scorecard objectives (Olve et al., 2003; Niven, 2005; 2006; 2008). If the organization wants its employees to embrace the principles represented in the Balanced Scorecard, then it must ensure that the rewarding system is in compliance with those dogmas. The fact that some incentive compensations are based on financial and non-financial indicators of performance conveys the consistency of principles embodied in the Balanced Scorecard – nonfinancial measures are the driving forces of future financial success – and that the strategy should be pursued (Kaplan and Norton, 1996a; Olve et al., 2003; Niven, 2006, 2008).

Kaplan and Norton (1996b) regarded the linkage of incentive compensation with the Balanced Scorecard as the final step of the Scorecard implementation at an organization. Once this alignment is designed, the Balanced Scorecard can be considered as fully implemented and the goals and objectives become achievable (Kaplan and Norton, 1996b; Olve et al., 2003; Niven, 2005; 2006).

Ittner, Larcker and Meyer (2003) studied the impact of allocating different weightings to various performance measures in a subjective Balanced Scorecard based incentive system. Further, Gurd and Shead (2004) investigated the effectiveness and acceptability of using performance pay plans based on Balanced Scorecard measures. They argued that such systems do not improve motivation and performance among the employees; rather they end up with unfavorable results. Later, Niven (2005; 2006; 2008) suggested what kind of design and planning attributes should be considered while developing the effective linkage of Balanced Scorecard and incentive compensation system.
1.3 Purpose

The previous sections in this paper suggest that there is still little knowledge when it comes to establishing the linkage of the Balanced Scorecard and the incentive compensation at organizations. Professor Kaplan in an interview with De Waal (2003) stated the fact that the issue of how incentive systems can be better aligned with Balanced Scorecard measures to create the optimal compensation plan requires further studies.

With respect to the previous discussion, the purpose of this thesis is to find out the number of companies around Sweden, Norway and Finland which link their Balanced Scorecard with the organizational incentive compensation plan to reward their employees’ performance. Furthermore, we will analyze the factors which influence the efficient design and implementation of incentive compensation system based on Balanced Scorecard within an organization. These factors gain more importance because they have substantial impact on employee motivation and performance, while proper application of these factors results in effective alignment of organizational resources and strategy.

The following research questions will then become the focus and purpose of our study:

- What proportion of Balanced Scorecard using companies has linked their incentive compensation system with the Balanced Scorecard in Sweden, Norway and Finland?

- What are the influencing factors that need to be considered while designing and implementing this linkage?

1.4 Delimitations

The paper does not aim at discussing the acceptability or efficacy of using the Balanced Scorecard in linkage with the organizational performance pay systems; rather we want to evaluate the factors/issues impacting this linkage.

Note: In this paper, incentive compensation is used for the variable pay or incentives given to employees and excludes the basic pay from it, which is not affected by performance. Furthermore, the terms incentive compensation and reward compensation are used interchangeably in the thesis as used in the original literature sources.
1.5 Thesis Disposition

The disposition of this thesis is as follows:

**Frame of Reference:** In this chapter there will be a description of the theoretical framework concerning the issues behind linkage of the Balanced Scorecard and Incentive compensation system which form the ground for our empirical findings and analysis. When establishing this theoretical background, we will rely on earlier research and findings. The section will end with the diagram summarizing the factors influencing the linkage.

**Methodology:** In this chapter the study’s course of action will be described. We will motivate for the choice of method and present arguments to why certain actions and not others were taken. Specifically, we will argue for the chosen qualitative method and qualitative semi-structured interviews. We will also discuss the selection of respondents to our interviews, followed by how the data collected were analyzed. The chapter will end with a discussion regarding the reliability and validity of the study.

**Empirical Findings:** In this chapter a summarized description of the conducted qualitative interviews will be presented to facilitate the understanding of analysis. The description will enclose how the case companies establish the linkage between the Balanced Scorecard and Incentive compensation systems and will be structured according to the concepts and factors described in the frame of references. The central questions asked within each of these concepts and factors will be presented to demonstrate the basis of the empirical data.

**Analysis:** In this chapter the analysis of the empirical material will be displayed through the application of the important theories and concepts discussed earlier in the frame of references.

**Conclusion and Discussion:** In this chapter the conclusion of the study will be delivered by providing the answers to the research purpose. This section will end with a final discussion about our thesis, its limitations and some proposals for further studies.
2 Frame of Reference

In this section we will describe the important concepts and theories behind linkage of the Balanced Scorecard and Incentive compensation system which form the ground for our empirical findings and analysis. When establishing this theoretical background, we will rely on earlier research and findings.

2.1 Linking BALANCED SCORECARD & Incentive Compensation

2.1.1 Why should Balanced Scorecard be linked with Incentive Compensation

The literature on the Balanced Scorecard states that linkage with compensation plans brings cultural change, improved financial performance and increased employees’ understanding of strategic objectives, resulting in improved organizational performance. Though creating this linkage is a complex process, it is essential for successful and efficient implementation of the Balanced Scorecard. There is an increasing trend in firms to shift from traditional financial based performance measurement and incentive compensation system to integrating financial and non-financial measures. Use of Balanced Scorecard for this purpose is an example of this trend. As stated above, Kaplan and Norton (1996a) suggest that the Balanced Scorecard should be aligned with the organizational incentive or reward management system at the final stage of its implementation. Neely, Gregory and Platt (2005) also support the claim for consistency and alignment of the performance measurement system with reward and incentive structure in organization. As suggested earlier, traditional compensations systems focus on short-term goals and objectives making it impossible to achieve long-term strategic objectives. Linking the rewards and incentives to Balanced Scorecard would allow better alignment of organization towards its strategies. This would also result in coherence of individual’s personal goals and objectives with the overall goals and objectives of the organization.

Although there is less empirical evidence on the relationship between the organizational performance and compensation system, an increasing number of companies are using Balanced Scorecard measures as the basis of their compensation management system (Ittner, Larcker and Meyer, 1997; Franco-Santos, Bourne & Huntington, 2004). Kaplan and Norton (1996a) argue that linking Balanced Scorecard to compensation system is not the matter of choice but the matter of deciding when and how to adopt Balanced Scorecard measures and objectives as a basis for compensation management of employees at all levels of the organization.

The significant number of large US, European and Australian organizations has linked their strategic performance measurement systems with executive compensations (Frigo and Krumwiede, 1999; Ittner et al., 1997; Gates, 1999). Later, Franco-Santos et al. (2004) focused their research on the proportion, purpose, method and impact of linking incentive systems with performance measurement system at companies. The survey findings indicate that
companies using the Balanced Scorecard based their incentive compensation system on achieving the Scorecard targets and measures as compared to others which used budgetary targets and personal management targets. (Franco-Santos et al., 2004).

Survey of more than 1000 organizations by Debusk and Crabtree (2006) revealed that about 23 per cent used the Balanced Scorecard. Out of these, 60 per cent were providing various financial incentives to their employees depending upon their hierarchy within the organization and the achievement of the targets in congruence with the Balanced Scorecard measures. They also emphasize the fact that linking the Balanced Scorecard measures and incentive compensation requires a challenging task of determining and assigning relative weights to various Balanced Scorecard measures.

### 2.1.2 Improved Performance through Balanced Scorecard-Incentive System Linkage

Debusk and Crabtree (2006) claim that the correlation exists between an improved performance and the linkage of the Balanced Scorecard measures with incentive compensation. Their survey showed that 66 per cent of organizations reporting improved performance used the Balanced Scorecard measures for designing their compensation systems. Banker, Potter & Srinivasan (2000) characterized this relation of non-financial measures and improved performance to be either direct or indirect.

Banker et al. (2000) studied the implementation of the new incentive system in a hotel chain where customer satisfaction measures were included in the incentive program. They observed a relationship between financial performance and non-financial measures (customer satisfaction in this case). They concluded that implementation of financial and non-financial measures in the incentive compensation plans improved financial as well as non-financial performance within an organization. Similarly, Griffith and Neely (2009), in a quasi-experiment, studied the impact of performance incentives on performance in various branches of a company. The results revealed that branches where Balanced Scorecard measures were linked to the incentives performed relatively better than those branches where it was absent.

Niven (2005) research also showed some evidence to Kaplan and Norton’s claim that linking compensation system to performance measurement improves focus and understanding of strategic objectives at individual level and to some extent enhances the performance and extrinsic motivation of individuals. However, this raises the question of appropriate size of such rewards. Since there is relatively low influence on motivation, small incentive packages could suffice rather than using larger incentive packages for alignment purpose (Franco-Santos et al., 2004).

### 2.2 Agency and Expectancy Theories

The agency and expectancy theories discuss the motivational facets of incentive compensation systems. Despite the differences in the focal point of these two theories, both
are relevant and significant to designing incentive plans in the Balanced Scorecard environment. These theories have an important role in establishing a linkage between incentive compensation and balanced scorecard as they give insight as to how this linkage will be perceived by the employee and thus what aspects need to be incorporated in the incentive system.

The expectancy theory states that incentive plans should offer desirable and attainable rewards for employees to act in the desired manner. Expectations of rewards vary from person to person depending upon his/her priorities and state of mind. For some individuals, extrinsic rewards such as bonus, extra pay, prizes and promotions act as motivators; while for others, intrinsic rewards like personal satisfaction, sense of contribution and recognition are more preferable. In order to improve the employees’ motivation, organizations should incorporate both of these rewards in their incentives systems (Hilton et al., 2003).

The agency theory for incentive plans is based on the principal-agent relationship between an employer and an employee where the employee (agent) contracts to work for the employer (principal) in consideration for an incentive. One organization has many principal-agent relationships depending upon the hierarchal levels, e.g. board of directors (principal) and top managers (agents), top managers (principal) and department managers (agents) etc. According to the agency theory, incentive plans (a) improve organizational performance, (b) motivate employees, (c) align employee’s and employer’s goals and (d) assign decision making authority (Hilton, et al., 2003). The linkage of Balanced Scorecard with the incentive compensation plan turns it into a principal-agent contract between the employer and employees. According to this contract to receive the incentive compensation the employee (agent) is liable for the execution of the targets and goal mentioned in the contract by the employer/management (principal) (Olve et al., 2003).

Jensen (2001) criticizes the role of Balanced Scorecard as an incentive system and argues that it fails to solve the agency problem within organization. In particular, he argues that it only provides information about an organizational strategy and objectives, but no guidance on how to deal with trade-offs between those objectives. Thus, managers/employees are skeptical as to the importance of the tasks and might focus their efforts on less imperative tasks.

2.3 Planning and Designing the Linkage

The design, development and implementation of the Balanced Scorecard differ among companies depending upon the purpose, organizational culture, managerial processes and strategic objectives. In the similar manner, linking the Balanced Scorecard with incentive compensation would be much more distinctive depending upon the pay preferences, union contracts and job classes, etc. (Niven, 2008).

Incentive compensation plan constitutes of two main elements: the performance measures and the compensation method used. Usage of performance measures includes the choice of financial or non-financial measures for performance evaluation. Due to the ease of
understanding and familiarity at all management levels, most corporate incentive plans include traditional financial measures for performance measurement purposes. Financial measures tend to focus on the historical performance of the organization while giving little or no view of the future. Financial measures provide lagging information of the past performance while non-financial measures are leading indicators which drive the performance in the long run (Kaplan & Norton, 1996, 2001; Ittner & Larcker, 1998; Epstein et al., 2000; Banker, Potter & Srinivasan, 2000; Shields & White, 2004). Niven (2008) criticized the use of financial measures for gauging performance equal to “driving the car using rear-view mirror”, whereby you can get the view of your past track, but cannot see the future ahead. Also, the traditional financial indicators lack the ability to assess intangible assets making them less attractive for performance measurement (Rappaport, 1999; Ittner et al., 2003).

The design and feature of incentive compensation system, besides aligning organizational strategic and individual objectives, affects employee motivation. Certain aspects need to be considered for appropriate and effective linkage of compensation system and Balanced Scorecard measures including the use of appropriate measures, availability of data for the measures used, reliability of the data, an unexpected behavior of employees to achieve the goals, and inconsistency of actions taken for achieving short-term and long term targets. Niven (2006) also highlights some issues that need consideration while planning to establish the linkage. These include purpose of the linkage, communicating the plan to all employees, participants involved in the process and continual review of the system. Considerations related to design elements include the timing of the linkage, involvement of employees in the compensation planning, the number and perspectives of performance measures included, short or long-term measure focus, performance thresholds for incentives and the source of funding for the new compensation plan.

2.4 Factors Influencing the Linkage

The linkage between the Balanced Scorecard and the incentive compensation system is influenced by various factors. Some of these factors are important in the process of developing the linkage while others are more important in the implementation phase of the system. Therefore, the incentive system should be constantly reviewed and updated according to the requirements and circumstances along the way. These factors are discussed in the following part of the frame of reference:

2.4.1 Basis for Measurement - Objective or Subjective Incentive Plans

Two methods or systems are used for performance evaluation and allocation of weights for various measures to determine the incentive. They are classified as objective compensation system (based on pre-determined formula) and subjective compensation system (based on subjective evaluation by the supervising manager).
Objective or Formula Based Compensation Systems

The first method uses pre-determined weights of measures from all perspectives of the Balanced Scorecard in a given formula which is usually designed in the beginning of the period. For example, company can give 25 per cent of the incentive compensation based on operating profit, 20 per cent on annual revenue growth, 15 per cent on customer satisfaction and retention, etc.

The main difficulties associated with formula based incentive system are the problem of determining appropriate weights for each measure, game-playing and rewarding for unbalanced performance (Ittner et al., 2003). These kind of formula-based systems fail to incorporate all measures because managers try to restrict the number of measures to the minimum to avoid complexities. Thus, the employees tend to focus more on those measures which will affect his/her compensation and ignore other measures though they have significance for the overall organizational objective (Shields & White, 2004; Debusk and Crabtree, 2006). Robbins (2008) highlights this phenomenon in the words “you get what you reward” (p. 60), meaning that employees show that behavior for what they are rewarded in the organizations which might be totally different from what the organization actually wants to boost. As a result, employees can manipulate the results to achieve short term benefits and ignore the goals and objectives in the long term.

Subjective Compensation Method

The second method calls for subjective evaluation by supervising manager who determines weights for various measures at the end of the period. The subjectivity includes the flexibility of weighting various quantitative performance measures, using qualitative performance evaluation and adjustment of rewards based on the overall organizational performance (Ittner et al., 2003). Based on the Balanced Scorecard results reported for the period ended, the supervising manage can design the compensation plan using subjective assessment of overall performance. Subjective incentive plans reduce the possibility of employees’ gaming behavior and manipulating the results for their own benefit. However, employees usually demonstrate dissatisfaction for this system by claiming that managers put too much emphasis on financial measures, thereby focusing on short term results only. Furthermore, such kind of system is not clearly understandable by the employees and loses its credibility among them, resulting in complaints of favoritism and biasness.

Comparison of Objective and Subjective Compensation Plans

Research by Ittner et al. (1997) indicated that replacement of formula-based Performance Incentive Plan (PIP) system with the subjective Balanced Scorecard compensation system did not generate any significant improvements. Despite both systems using financial and non-financial indicators for performance and compensation evaluation, the subjective system increased complexities compared to the formula-based system rather than decreasing. There are, however, limitations for generalizing these research findings owing to the field study
based on the initial years of the implementation of Balanced Scorecard measures as incentive compensation system in a single company.

Findings of Ittner et al. (1997) are contradictory to Kaplan and Norton (1996a) views who consider subjective compensation plans to be superior and efficient as compared to objective formula based plans. Kaplan and Norton (1996a) consider subjective compensation system to be “easier and more defensible to administer . . . and also less susceptible to game playing” (p. 220). On the contrary, the formula-based compensation plans pose many difficulties. Firstly, the evaluator needs to determine the weights for each performance measure, which might make it complicated for employees to understand the comparative importance of those measures. Secondly, this allows for gaming behavior (Ittner et al., 2003; Shields & White, 2004) by employees and unbalanced performance to achieve strategic objectives.

Scholars researching on expectancy theory contradict Kaplan and Norton (1996a) by pointing possible drawbacks of subjective performance evaluation and compensation plans. Commenting on the expectancy theories, Newson (1990) argued that an increase in motivation is dependent upon the criteria, credibility and consistency of the performance evaluation plan. Thus, performance evaluation plans can enhance motivation only when the employees can see the relationship between their efforts to outcomes and outcomes to rewards, which is not visible in subjective plans. Prendergast and Topel (1993) differ from Norton and Kaplan (1996) by considering objective measures to be superior due to the problems of breaking promise, lack of verification, favoritism, biasness (Kaplan, Peterson & Samuels, 2006) and unfairness and complaints of discrimination. Subjectivity in incentive systems decrease the motivational level of employees since key performance measures in performance evaluation process are believed to be ignored, consistent variation in the criteria and issues of favoritism and biasness (Prendergast and Topel 1993; Ittner et al., 2003).

2.4.2 Basis of Incentives - Individual or Group performance

The second major factor that can influence the effectiveness of a Balanced Scorecard based incentive system is to decide whether to provide incentives on group or individual basis. The consistency of the design features of the incentive plan with the corporate culture should be kept in mind when designing and implementing new incentive plans (McKenzie and Shillings, 1998). If the organizational culture promotes team-based behavior and encourage collectivistic behavior, then incentives should also be offered on group performance. Particularly, group rewards are more effective at lower levels where it is difficult to precisely evaluate and measure contribution of each individual towards achievement of the goal. However, in certain circumstances, individual incentive plans are the best option to improve performance. It is usually so when recognition of individual performance enhances motivation and boosts the future performance among employees. Therefore, it is the manager’s role to decide which behavior to promote and keep balance between the two at various levels in an organization.
There are common misconceptions that pay and incentives which are based on individual merit increases motivation and improve performance. Pfeffer (1998) argues that in fact individual merit pay decreases motivation and, consequently, individual and organizational performance levels are also lowered. Therefore, to increase collaboration and team spirit, organizations should adopt group-based compensation systems. In many cases, incentive plans can be used as a tool to bring change in the organizational culture and behavior by introducing appropriate incentive systems which promote desired behavior among the employees and discourage the opposite (McKenzie and Shillings, 1998) e.g. promote team/group environment in the organization by rewarding group performance. However, the decision to base the incentive compensation system on individual or group performance depends upon the objective of the organization to instill individual or group behavior within the organization. Zehnder (2001) argues that organizations should retain their best performing employees not by compensating them for individual performances, but rather reward companywide according to their seniority. This, however, might create a sense of rejection and discontent among the employees when they consider themselves to be the reason for such high performance, yet they receive less compensation for their work.

2.4.3 Determining Time Perspective - Current or Future Performance

Another important factor in incentive systems is the time horizon for rewarding performance, i.e. rewarding for current or future performance. In case of rewards linked to current performance, incentives are given at the end of period usually a year, while rewards for future performance relate to long-term goals of the organization, where employee is promised to be rewarded for improved performance after few years. Such rewards help to retain employees in the organization for longer period of time and also allocate their focus to achieve long-term objectives along with short-term goals. However, if the rewards for future performance are promised too far in future, they then might not be able to achieve the desired motivation and rather result in counter-productiveness (Hilton et al., 2003). Organizations can use combination of current and future rewards for employees at various hierarchies. For example, top management and executives could be offered both current and future rewards, whereas middle and lower level managers only get short-term current rewards.

2.4.4 Types of Incentive Rewards Used

The rewards and compensations can be broadly categorized into extrinsic and intrinsic (Franco-Santos et al., 2004). Thereby, extrinsic rewards are further broken down into various monetary and non-monetary rewards. Monetary rewards include basic pay, incentives and fringe benefits. However, as benefits are used as indirect compensation, which vary depending on the status of the employee in the organization, this paper only discussed direct incentive compensation.
Deciding upon what kind of rewards and incentives would be offered to the employees is a significant part of designing the incentive plan based on balanced scorecard performance. Behavioral psychologists (like Herzberg (1987)) emphasize that both extrinsic and intrinsic motivation factors are vital for encouraging the individual at the workplace. Extrinsic motivation arises when individuals strive to achieve specified goals and tasks to acquire promised incentive compensation (Kaplan and Norton, 1996a). Ittner and Larcker (1997; 2003), on the other hand, argue for the lack of empirical verification for this claim. They relate extrinsic motivation is related to achieving corporate and business level goals, while intrinsic motivation is related to individual goals and objectives. A well balanced compensation system should consider extrinsic and intrinsic motivation of the individual while deciding the incentives. The Balanced Scorecard contributes towards intrinsic motivation by aligning individual goals and objectives with organizational goals and objectives (Kaplan and Norton, 1996b; Niven, 2006; 2008). Hence, individuals ultimately adopt organizational goals and strive to achieve them even in the absence of any explicit rewards.

The trend of using non-monetary rewards for incentive compensation has been largely increasing with 70 per cent of companies today using non-monetary rewards (Niven, 2006; Niven, 2008). Regardless of the role of money as the major motivator, often intangible rewards make individuals focus more on achieving desired rewards. For instance, employee groups offered non-monetary rewards (merchandises) at Goodyear showed approximately 50 per cent better results as compared to the group offered cash rewards for tire sales (Niven, 2006; 2008).
The impact of monetary rewards is not always positive on performance and motivation and often it rather depicts negative or indefinite impact (Weghe and Bruggemen, 2004). The reason for such counter-productive behavior is explained by Bonner and Sprinkle (2002) as employee’s reward expectations, self-interest, personal goals and objectives, self-efficacy etc. Nonetheless, out of all these, reward expectations and personal goals tend to have most influence on their performance. Bonner and Sprinkle (2002) classified such factors to have direct relationship with incentives-effort-performance relation. The practicality of non-monetary incentives increases for companies where cash incentives are prohibited by employee unions as mentioned by Kaplan and Norton (2001) in the example of Texaco Refinery and Marketing, Inc. where awarded Texaco points to employees based on their plant wide, individual and group performance.

2.4.5 Using Standardized or Customized Incentive Plans

The notion of “One size fits all” is often discouraged in management matters. The same goes for incentive compensation plans where one standardized incentive plan is not sufficient for employees at different levels of the organization. Doubleday, Pilv and Lamptey (2009) give their perspective regarding shortfalls in effective measurement and rewarding performance by identifying seven deadly problems of performance measurements. One major problem mentioned by them is that the management opts to reward all employees based on similar performance measures. Such strategy can be effective in small organizations to promote team work and collaboration, but it fails to deliver results in larger organizations. Such diversified organizations require customized and differentiated reward systems for each business unit, department and group depending upon their strategic goals and performance targets. This problem can be addressed by striking a balance between customization and the need for encouraging collaboration and teamwork within the organization.

2.4.6 Measures and Perspectives used for Performance Evaluation

McKenzie and Shilling (1998) state that Human Resources practitioners use traditional financial measures along with various non-financial measures and approaches, such as Balanced Scorecard, for performance evaluation and designing incentive plans. Often management considers incentive compensation as alternative to effective performance management, thereby reducing focus on interaction, communication and on-going management of employees. The performance measures used for incentive compensation should be controllable and attainable by the employee (Weghe and Bruggemen, 2004) because uncontrollable and unattainable performance goals result in disapproval of incentive systems. It means that when selecting measures, managers should emphasize on the key measures that are related to the employee performance and are in employee’s control (McKenzie and Shillings, 1998; Hansell, Luther, Plaschke and Schatt, 2009). If too many measures are introduced in the incentive plan then focus deviates from key success drivers and goals are not achieved. McKenzie and Shilling (1998) identify a major pitfall of all-or-nothing incentive plans where employees are rewarded for achieving pre-defined targets completely and no incentive is given in case of underperformance. They suggest that such
plans should be avoided as they result in loss of focus and interest when employees perceive targets to be unattainable. Furthermore they can also tempt employees to manipulate results to cope for the variance when target is nearly achieved.

2.4.7 Communication & Feedback to Employees

Communicating the incentive plan to the employees is often overlooked by the management and much negligence is shown in this regard (McKenzie and Shillings, 1998). To get most of the desired objectives, the incentive plan should be properly communicated and employees should understand the system. Representatives from the concerned employee group should be involved in the designing and the presentation of the incentive system to ensure buy-in of the decision. In order to make the incentive plan simple to communicate and administer managers try to keep it simple and avoid complex measurements from the system. This results in a trade-off between accuracy and complexity (Doubleday et al., 2009) because complex measures are more efficient in measuring actual performance and ensure achievement of desired goals by providing a holistic view.

The communication process does not end after design and implementation, rather it is an ongoing process and the employees should be provided periodic feedback on their performance (McKenzie and Shillings, 1998). For example, if formula based plans are used then the employee should be able to access the performance information and plan ahead to achieve the targets. Likewise, in case of subjective evaluation, the supervising manager should provide information to employees on periodic basis to recognize the expected criteria and manage their performance in future.
Summary of the Theoretical Framework

The above mentioned factors influence the process of designing and implementing the linkage between the Balanced Scorecard and Incentive compensation system to varying extent. Adequate management of these factors can result in efficient implementation of the compensation system and achievement of the desired results. These factors are presented below in the form of a diagram:

![Diagram](image-url)

Figure 3 Factors influencing BSC-Incentive system linkage (Authors)
3 Methodology

In this section we will present the methods and strategies chosen to collect data to answer our research purpose/question. We clarify how and why we have decided to deploy a qualitative method, qualitative interviews, and surveys. We will also explain the process of interviewee selection and survey implementation. Finally, we will show how the collected data was analyzed/interpreted and discuss the issues of reliability and validity.

Methodology enables us to collect knowledge about the social world as argued by Strauss and Corbin (1998) and the variety of this includes biography, case study, grounded theory, historical research and ethnography (Denzin and Lincoln, 2000). The methodology we have used is partially based on the grounded theory performed through qualitative methods of data collection. We aimed to expand upon the research phenomenon and identify its key elements; however, we did not intend for generating new theory from our findings. Our research design and data collection are based on our research purpose which is derived from the empirical findings mentioned in our frame of references. The empirical findings and research purpose are connected in a logical sequence to validate our research design as asserted by Yin (1994).

3.1 Research Approach

Inductive or Deductive

The objective of the researcher is to observe and faithfully record the investigated material without prejudice and draw conclusions through induction or deduction, a combination of both. Induction approach is based on empirical evidence and, thus, theory is the implication of research, whereas deduction approach is based on logical reasoning – developing hypotheses from the existing literature as well as presenting how information can be gathered to test these hypotheses and concepts (Ghauri and Gronhaug, 2010). Considering the nature of the research topic and since the data deduced from interviews was compared and analyzed in accordance with our theoretical framework data, we believed that the abductive approach (the combination of inductive and deductive) would be most suitable.

The process for us began with the investigation of various concepts and theories incorporated in our frame of references which then grounded the basis for our in-depth semi-structured interviews to see the correlation between the two perspectives. Afterwards, we analyzed/interpreted our empirical findings to draw conclusions on the influences of different factors on the linkage of Balanced Scorecard and incentive compensation plans.
3.2 Research Strategy

3.2.1 Qualitative Research

Qualitative research is often exploratory, unstructured and instinctive with the focus to better understand the nature of the problem since little knowledge is available; it aims at developing concepts, insights from the data analysis (Sekaran, 2003; Ghauri and Gronhaug, 2010).

The major reason for selecting the qualitative research strategy was our desire to uncover and understand an interesting phenomenon for us and about which little data were available. Moreover, we did not aim at obtaining the “standardized” answer rather we wanted to explore the subject by acquiring individuals’ opinions and experiences. For that purpose, we believed that the qualitative research was the most appropriate choice. It goes in line with Ghauri and Gronhaug (2010) who suggest that qualitative research is the most accurate for understanding “the behavior, events, organizational functioning, social environments, interaction and relationship” (p.104).

3.3 Data Collection

3.3.1 Primary and Secondary Data

The material for our research was mainly gathered through the primary data sources, i.e. sample survey and interviews. Primary data refer to information collected directly for the particular research purpose and it is especially useful when secondary data are not available and/or considered irrelevant for addressing the research question (Sekaran, 2003; Ghauri and Gronhaug, 2010). Since there was not enough information in the secondary sources to answer our specific research questions, also because we wanted to investigate organizational and individual behavior and opinions, the interviews and sample surveys were beneficial. The disadvantages/problems we experienced when collecting our primary data were the time frame, difficulties of finding case companies willing to collaborate and answer our research questions.

In addition to primary data, we also used the variety of secondary data, including the library sources (books, articles) and the information contained in companies’ web-pages. The advantages of these were that we noticeably saved our time and money, and also acquired reliable information. In fact, Ghauri and Gronhaug (2010) argue that the reliability and high standards with which the international organizations, national governments, as well as world renowned researchers collect and compile their findings in various secondary sources are high. We think that the interpretation and understanding of our primary data were only strengthened as the secondary data were extremely helpful in comparing the different sources and findings. By going through the secondary sources data, we were able to better understand the topic and gain a clear idea of what we wanted to further investigate. In addition, the secondary data became the principal base of our theoretical framework – the starting point -
and we believed it was critical to have an unambiguous research problem formulated in the theoretical background.

### 3.3.2 Method of Information Collecting

As mentioned above, to collect our primary data, we conducted an electronic survey and four in-depth semi-structured interviews with our case companies. The process of survey and interviews implementation will be described in the following sections.

### 3.4 Survey Sampling

The purpose with electronic surveys was to learn the number of companies which linked the Balanced Scorecard with their incentive compensation schemes. Survey research, as described by Given (2009), is the set of methods for collecting data in a systematic way from a range of individuals, organizations, or other units of interest. As we conducted the electronic survey, we did not experience any geographical problems. Also, no financial costs were incurred for us and respondents. The actual data derived from our survey research will be presented in the empirical findings section.

As it was difficult to identify the companies which used the Balanced Scorecard, the sample for survey was selected from the list of organizations mentioned on the webpage of “Balanced Scorecard Collaborative Group” (part of the Palladium Group, founded by Kaplan and Norton). The sample consisted of companies from various industries including industrial manufacturing, pharmaceutical, non-profit (public companies), telecom, IT, energy and health sectors in Sweden, Norway and Finland.

When e-mailing, we tried to contact the most relevant person/people (for e.g. from the accounting and controlling departments) and if that was not possible, we e-mailed to the general contact addresses. Initially, the response rate was very low, so follow-up emails were sent as a reminder for respondents to answer the questions.

The survey questions were not extensive, with both of the questions consisting of just “Yes” or “No” options for respondents. Given (2009) argues that closed questions are beneficial for both parties (researchers and respondents) as this kind of question is easy and fast for respondents to answer, whilst for researchers it is easy to code and analyze. If the first question had a purpose to learn whether an organization used the Balanced Scorecard, the second one was to provide us with the information on whether these organizations linked their incentive compensation systems to Balanced Scorecard. Although the first question seemed unnecessary to ask as these companies were listed on the “Balanced Scorecard Collaborative Group”, we asked it because some of the companies from this list might have stopped using the system.
The emails were sent to the sample of 59 companies, out of which 3 companies replied that they did not use the Balanced Scorecard anymore. Thus, our sample was reduced to 56 companies. We received 26 responses which equals to 46 per cent of response rate. The lack of interest to such a study, accountants/controllers busy job schedule or company’s information restriction policy for external parties can be an attempt to explain this relatively low response rate.

3.5 Interviews

The variety of in-depth interviews which can be employed includes face-to-face interviews, group interviews, telephone interviews, computer-assisted interviews (Ghauri and Gronhaug, 2010).

Our main focus was on the semi-structured face-to-face interviews. In our view, this method was very suitable and we managed to explore and understand our respondents’ ideas on our research topic. The reason for conducting semi-structured face-to-face interviews was that they enabled us to adapt questions, make clarifications, repeat and/or rephrase questions when it was necessary. At times when our respondents were not able to understand the questions due to the technical terms used, the lack of knowledge in the field, and language barriers, we tried to deliver the questions in a more perceptible manner. During the interviews, we also tried to detect non-verbal communication cues of the respondents such as discomfort, stress, and body-language. This, of course, would have been impossible to do if telephone interviewing had been employed instead. Though telephone interviews would have cut our costs, we did not employ this method for a number of other reasons as well. First, the two case companies (Bank A and Bank B) were located in the close proximity to university. Thus, there were no transportation/geographical costs incurred and we could reach them easily. Second, there is a greater risk of non-response associated with the telephone interviews or respondent could without any reasoning or explanations hang up the phone and terminate the interview (Sekaran, 2003).

3.5.1 The Structure of the Interviews

The structure of the interview is not predetermined by prepared questions, as it is in the questionnaire, and can be divided into structured, unstructured or semi-structured (Maylor and Blackmon, 2005).

The series of semi-structured personal interviews enabled us, as suggested by (Sekaran, 2003), to combine advantages of both unstructured and structured interview outlines. Semi-structured interviews are designed differently from both unstructured and structured interviews. The difference between the unstructured and semi-structured is that that the topics and issues to be covered, sample sizes, people to be interviewed and questions to be asked in the semi-structured have been determined beforehand (Sekaran, 2003). We prepared a list of predetermined questions to be asked, which allowed us to remain flexible about the direction of the interview though follow-up and clarifying questions.
We interviewed two managers from one of the case companies in one day and time, while the other two managers from the second company were interviewed separately. The questions were developed from the careful analysis of the theoretical framework and the preliminary research made on the organizations (company background, internal management system, and the hierarchical structure). To allow our respondents to become familiar with what we would ask and prepare themselves for the interviews, we e-mailed the interview questions to them beforehand. The nature and type of questions we asked slightly varied in content depending on interviewee’s position in the organization.

3.5.2 Selection of Interviewees and Case Companies

As our interviewees at both case companies have requested full confidentiality, their names will be kept anonymously in this paper. Only their respective positions within the organizations will be disclosed. In fact, we do not consider revealing the information about names to be critical, since doing otherwise would lower the credibility and validity of the data collected from these interviews.

During the process of contacting organizations willing to participate in this research, we experienced a number of problems. Some organizations refused the involvement in the project by referring to time constraints and busy schedules. Others in spite of showing interest at the preliminary stage became unresponsive later on for the reasons we are not aware of. To get the case companies we continuously bothered the organizations (which showed the interest in the research) by e-mailing, calling them on the phone, and visiting them at their offices. As a result, two financial companies located in the city of Jonkoping, Sweden expressed their interest in our research and agreed to help us. Straightly afterwards, we set the appointments for interviews with the suitable company representatives to proceed with collecting our empirical data.

There are mainly three reasons why we decided to make our research based on these two financial companies, Bank A and Bank B. First of all, the banking industry follows strict management control system and emphasizes on various financial and non-financial measures. These two banks were large enough to use an extensive list of the Balanced Scorecard measures which enabled us to obtain more information on how the linkage with the incentive system was designed and what factors influenced that. Secondly, these banks had a relatively more complex hierarchy of positions and the established system compensation plans then compared to other companies. Thirdly, among the other companies, these two companies were most enthusiastic about this project and thus more willing to collaborate with us.

Two branch managers (one responsible for Corporate Customers, the other for Private Customers) and one regional manager at Bank A, and manager of private banking at Bank B were selected for the interviews to fulfill the purpose of this study. The reason we interviewed these people was that they were actively involved in the design and implementation of the incentive compensation plans based on the Balanced Scorecard. Since we wanted to acquire a holistic view and learn opinions of people at different positions –
those who designed and evaluated the performance measurement and incentive systems and those who were under evaluation – we are satisfied with our selection of interviewees.

3.5.3 Interview Procedure

We realized that in order to get reliable information from the respondents, we needed to be able to establish rapport and trust with them through the projection of our knowledge, skills, confidence, articulation and enthusiasm. We tried to clearly signal the purpose of our interviews, assured complete confidentiality about the sources, and also the fact that we did not intend to take sides harm the staff. To let our respondents feel comfortable and relaxed about the interview and us, we tried to be pleasant, open, and sincere. In addition, to enable a better communication, we informed our respondents about the interview selection process – how and why they were chosen – and motivated them to give honest responses by explaining the importance of those contributions to our research and the organization.

To obtain unbiased and reliable responses, we employed some other interview questioning techniques. These included such strategies as funneling, i.e. we began from broad to narrow questions as the interview proceeded; unbiased questions our questions were asked with specific wording, tone, voice and appropriate suggestions; clarification (sometimes we would rephrase the information given by the respondents to ensure that we got it right). Also, we helped the respondent to think through issues, meaning that questions were asked in a clear and direct manner so that the respondent was able to articulate their perceptions. During the interview, one of us was taking notes and other one was asking the questions and listening. We believe that it was a good idea to make notes during the interview as relying on memory reproduces imprecise and biased information (Sekaran, 2003). We deliberately avoided recording because in that case the respondents’ anonymity would not be preserved completely and we could get biased responses.

3.5.4 The Transcription process

Immediately after the four interviews, we went through our notes and wrote a complete, descriptive report of the interview - the important points and notes regarding the new information obtained. In the beginning, instead of printing interviews as a whole we summarized the important and central parts of the interview and, where necessary, making complementing notes for future investigation and clarification. The written material was then subject to our interpretation.

Since the qualitative method requires an interpretive approach, we were careful to the respondents’ actual and true experiences, and not limited to what they explicitly expressed. Therefore, we also discussed the responses, body language, non-verbal cues and the social interaction between us and our interviewees after each interview to extract valuable input for our analysis. We also sent out our descriptive report to the respondents for any additional comments and to ensure that we did not miss any important points and that we perceived the given information correctly.
3.6 Data Analysis

Interpretation of data is essential for it to become information and it is the process whereby order, structure and meaning of the data are implemented (Ghauri and Gronhaug, 2010). After the research material was collected, we began analyzing it. As the qualitative studies incline that research can be beleaguered by the amount of data, the key for our analysis was to dissect, reduce, sort and reconstitute data.

The process called Meaning Condensation was employed in our data analysis which involved a reduction of large interview texts into concise formulations so that our gathered data become easier to work with. Then, we referred to our theoretical framework to organize and direct our data analysis. Since the purpose of the thesis was to study the linkage of the Balanced Scorecard and the Incentive System, and the abductive approach was selected, we did the following. Departing from our theories we compared them with our data from interviews and tried to conceptualize and our findings. This helped us guide our analysis and interpretation, and still allowed us to identify some aspects that had not been found in previous research.

3.7 Reliability and Validity

The reliability of a measure represents the elimination of any biases such as interviewer or respondent biases and, therefore, assures consistency of measurement across time and the different items in the instrument (Sekaran, 2003). To reduce the interview biases and obtain reliable information, we let our respondents speak freely and openly and without any influencing comments. To ensure the highest degree of reliability and validity, we conducted a number of interviews with both the higher-positioned and lower-level managers and within the companies.

Validity deals with the extent to which the fundamental truth of the situation has been detained and not been misled by particular influences (Maylor and Blackmon, 2005). By ensuring the validity, we also refer to the extent to which we obtained access to the research participants’ knowledge and experience. The high level of validity of our findings lies within the transcription process explained earlier in the method section. We gathered the empirical data in a way which allowed one of us focusing on taking notes and interpreting nonverbal communication and the other one on the interview itself. Transcription and discussion of the collected data took place as soon as possible before and after the transcription was held. As stated earlier, we intentionally avoided the use of recording device since it could jeopardize to some extent the respondents’ willingness to stay anonymous. As a result, we could have got biased information.

Validity and reliability are also important aspects of the survey research we conducted. To ensure the validity of our survey sampling, as suggested by Given (2009), we designed the questions in a way that the answers would precisely measure and reflect what we wanted to know (the number of companies linking the Balanced Scorecard and the incentive
compensation system) and would not be distorted by any factors. The reliability of the survey sampling was ensured through the investigation of the question wording and whether they asked for the data in the most appropriate manner.
4 Empirical Findings

In this section we will present a summarized description of the conducted qualitative interviews to facilitate the understanding of analysis. The description will enclose how the case companies establish the linkage between the Balanced Scorecard and Incentive compensation systems and will be structured according to the concepts and factors described in the frame of reference.

4.1 Survey Results

As stated earlier, we conducted the survey to find out the number of companies which has tied the Balanced Scorecard with their incentive compensation plans. The findings from this survey are summarized in the following table:

Table 1 Survey Data

<table>
<thead>
<tr>
<th>Sector</th>
<th>Sample Total</th>
<th>No. of Responses</th>
<th>Percentage Response Rate</th>
<th>Companies linking BSC &amp; Incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial manufacturing</td>
<td>10</td>
<td>3</td>
<td>11.53</td>
<td>1</td>
</tr>
<tr>
<td>Non-Profit Organizations</td>
<td>16</td>
<td>12</td>
<td>46.15</td>
<td>1</td>
</tr>
<tr>
<td>Services Providers</td>
<td>15</td>
<td>3</td>
<td>11.53</td>
<td>3</td>
</tr>
<tr>
<td>IT &amp; Telecom</td>
<td>5</td>
<td>2</td>
<td>7.69</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>3</td>
<td>2</td>
<td>7.69</td>
<td>2</td>
</tr>
<tr>
<td>Pharmaceutical &amp; Health</td>
<td>7</td>
<td>4</td>
<td>15.38</td>
<td>-</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
<td>26</td>
<td>46.42 %</td>
<td>7</td>
</tr>
</tbody>
</table>

4.2 Case Companies

The choice of industry and case companies has the key role in the research process. Globalization and increased competitiveness in the banking industry has led the focus of banks towards devising strategies to compete and survive more profitably in the long run. The changing market structures, modes and extent of bank services and organizational environment in the banks has altered the role of bank managers (Hempel and Simonson, 1999). A large number of banks around the globe especially in the Nordic region (Balanced Scorecard Collaborative, 2011) are adopting tools such as Balanced Scorecard to monitor and follow up the performance of their branches. For our research, we selected the two major banks in Sweden which used Balanced Scorecard as their performance measurement system.
As the same management system is employed in all the branches within the region, we decided to focus on the branches located on Jönköping city.

**Bank A**

**Company Description**

Bank A, with a network of 1400 branches, is among the top ten largest banks in Europe and of the two largest in the Nordic and Baltic region. According to the data given in the bank’s corporate website, through this network of branches, Bank A provides financial services to its 11 million (10 million private and 1 million corporate) customers in the areas of retail banking, corporate and institutional banking, asset management and life insurance (Company Website, Bank A).

In 2001, to increase shareholder value creation focus, effective strategy implementation and developing the common Bank A culture, Bank A’s executive team designed the “Planning and Performance Management Model (PPMM)” (Statement by Lars G. Nordström, CEO; Johnson, 2005). PPMM consisted of three main components:

- Balanced Scorecard as the basis to translate organizational strategy into targets and goals;
- Rolling Financial Forecasts (RFFs) to give updated overview of financial forecast in future; and
- Service Level Agreements (SLAs) which emphasized reduce of costs and increase of internal service quality.

Thereafter, the strategy execution process was periodically reviewed on monthly (tactical performance), quarterly (Balanced Scorecard and RFFs) and annual (strategy and targets) basis for different components (Johnson, 2005). The system helped to clarify the strategic targets and a corporate culture valuing teamwork. As a result of implementing PPMM at Bank A’s, its total shareholder return increased up to 47.9 per cent and the operating profit increased by 17 per cent. Such a breakthrough improvement brought Bank A to 3rd place among its 20 competitor banks and the market cap went up from the 15th to 8th place in 2004.
Interviewees

We interviewed the branch managers from two different branches of Bank A in Jönköping. (Interviewee A2) works as the branch manager for corporate customers and (Interviewee A3) is the branch manager for private customers at another branch. Both of the managers report to the Regional Manager (Interviewee A1) who is responsible for the management of all the branches in the Jönköping region. Interviewee A2 has worked at Bank A for the last four years and deals with the corporate customers. She has supervises at the corporate section team of the bank. Interviewee A3 has worked at Bank A for the last 27 years and is currently the manager of his branch which serves only private customers. He has been at this position for quite a few years and before worked at different positions and locations at Bank A.
Bank B
Company Description

The Bank B is operating in Sweden, Estonia, Latvia and Lithuania serving around 9 million private and more than half a million corporate customers of small and medium size. The company operates through its 330 branches within Sweden and 220 branches in other countries (Bank B, 2011). The Bank B claims that it strives to build closer relationships with its customers and provide them with their “need and wishes – not our products”.

The Bank B has deployed a management control system which is a modified form of the Balanced Scorecard with one extra perspective (apart from 4 perspectives incorporated in the Balanced Scorecard) since 1994. The system has undergone many improvements and an increasing number of measures were added annually. Although the scorecard attempts to balance between all the perspectives, the customer perspective is given a higher priority or weightage as the revenue and profitability directly depends upon the customer satisfaction (Jonsson and Moa, 2008). The higher management at the head office reviews and changes the scorecard periodically whenever necessary. Most of the changes involve variations in the targets and performance measures. The scorecard is cascaded for each business unit and branch office level to better suit the requirements of that level. The scorecard is reviewed monthly by the branch manager and the overall branch and individual employee’s progress are discussed by managers.

Interviewees

We interviewed the two managers at the local Bank B branch. Interviewee B1 is the manager for private banking and also the vice-head of the branch along with the other colleague who is responsible for corporate banking. They are both headed by the Branch Head who is also the Regional Manager of all the branches in Jönköping region. She is of the view that running the branch is similar to running a company with defined targets and to earn higher profits while being competitive and sustainable in the future. Her role involves supervising the employees in private customer department and their personnel planning. Along with her team, she works towards achieving the predetermined targets and goals assigned from the head office in terms of certain percentage of revenue increase.

The second interviewee (Interviewee B2) works as a loan advisor for private customers. He is under the supervision of Interviewee B1 and reports to her. He is responsible for advising private customers about various loan plans and other related services and has been working at the bank for the last three years.
Table 2 Information of Interviewees

<table>
<thead>
<tr>
<th>Company</th>
<th>Interviewee</th>
<th>Position</th>
<th>Interview Date</th>
<th>Place</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank A</td>
<td>Interviewee A2</td>
<td>Corporate Banking Manager</td>
<td>26 April 2011</td>
<td>At the Bank</td>
</tr>
<tr>
<td></td>
<td>Interviewee A3</td>
<td>Branch Manager</td>
<td>26 April 2011</td>
<td>At the Bank</td>
</tr>
<tr>
<td>Bank B</td>
<td>Interviewee B1</td>
<td>Private Banking Manager</td>
<td>21 April 2011</td>
<td>At the Bank</td>
</tr>
<tr>
<td></td>
<td>Interviewee B2</td>
<td></td>
<td>23 April 2011</td>
<td>At the Bank</td>
</tr>
</tbody>
</table>

4.3 Summary of Empirical Findings

Below we will summarize our empirical data obtained from the interviews of the managers and employees at the two banks. The data will be arranged according to the order of the factors influencing the linkage of incentive compensation with the Balanced Scorecard presented in the frame of reference.

4.3.1 Balanced Scorecard and Incentive Compensation Linkage

Bank A

The aim of Bank A’s remuneration policy is “to attract, develop and retain highly motivated, competent and performance-oriented employees and thereby the People strategy” (Annual Report, 2010). Therefore, they strive to confirm that the compensation system promotes effective risk management and is consistent with Bank A’s long term interests and values such as Great customer experiences. It is all about people and One Bank team. Remuneration at Bank A consists of various components which vary according to the employee position in the organization. The remuneration components along with the eligible employees are as follows:

- Fixed salary (all employees),
- Profit sharing (all employees),
- Variable Salary Part – VSP (selected managers and specialists),
- Bonus scheme (selected employee groups),
- One Time Payment – OTP (selected employees in case of extraordinary performance),
- Long Term Incentive Programme – LTIP (top level managers and key employees),
- Pension and Insurance (all employees), and
- Other benefits. (Annual Report, 2010)

Among the above remuneration components bonus scheme, VSP and OTP are dependent on individual and group performance with predefined criteria for performance measurement.
consisting of financial and non-financial measures taken from the Balanced Scorecard along with Bank A Group criteria. However, there is a limitation that employees cannot benefit from any other plan if they get compensated under some plan, unless it is an extraordinary situation. During the interview with the managers they told us about the compensation system offered to them:

“Bank A offers performance based Variable Salary Plan (VSP) along with monthly salary to its employees at higher management levels. We as the branch managers are at the lowest level for incentive compensation at Bank A. Employees below our level are not offered any kind of incentives besides basic pay and benefits” (Interviewee A2).

As suggested above, the incentives at the Bank A are only offered for higher management. The branch manager is the lowest level within the organizational hierarchy to be eligible for VSP. Both managers considered absence of incentives for their subordinates to be a drawback. The Interviewee A2 suggested that the incentive plans could become much better and effective by bringing all employees on board and offering them some sort of incentives for improving performance. “This would result in better performance and working together to achieve the organizational targets would help to focus on short as well as long run” (Interviewee A2).

Complementing the point made by Interviewee A2, Interviewee A3 added:

“The annual 2 per cent increase in the salary for other bank employees is not sufficient motivator to encourage them to improve their performance. We lack the carrots (rewards) to motivate our employees to achieve the targets assigned to them. The availability of certain rewards based on performance would help to motivate them to perform better and work towards the organizational goals and objectives. Therefore, the incentive compensation policy, in my opinion, should be introduced for the whole organization.” (Interviewee A3)

The Bank A introduces new incentive compensation plans annually based on various Key Performance Indicators (KPIs) based on the Balanced Scorecard measures. On the achievement of those measures, incentives consisting of 1-3 months extra pay is allocated to managers. Bank A states that the aim of VSP is to attract, motivate and retain well performing managers by rewarding their performance.

“VSP must be transparent and have predefined success criteria with clear weightings. A VSP must include success criteria based on Bank A Group KPIs decided annually by CEO. In the event of weak or negative overall Bank A Group results, VSP outcomes will be adjusted downwards at the discretion of the CEO.

A VSP agreement does not exceed a maximum outcome of 25 per cent of annual fixed salary, except for very few managers and key employees within specific areas, where the amount can be a maximum of 50 per cent of annual fixed salary. Head of Customer Areas and corresponding units may in extraordinary cases approve a VSP agreement exceeding 50 per cent of annual fixed salary.” (Annual Report, 2010)
While explaining the compensation system Interviewee A3 told us that the VSP consists of different measures from all perspectives with different weightage assigned to each measure. “These measures are delivered or assigned to us at the start of each year based on which the incentive compensation amount would be determined. These measures are normally based on the market share of the bank and the performance of the bank in different KPIs.”

These KPIs include various measures selected from the Balanced Scorecard with varying weightings for each category, including common group measures such as Income, Return on Equity, Customer Satisfaction Index (CSI), living the Bank A values, Sales KPIs, Financial KPIs, Leadership and Personal measures. This linkage was developed to strengthen the alignment of Balanced Scorecard and organizational resources by tying the goals and incentives of senior and lower level manager. Resistance of employees to cascading the scorecards was also overcome by linking the incentive compensation system to the Balanced Scorecard measures (Johnson, 2005).

Both of the managers were of the view that the measures used for incentive compensation should also be followed up and monitored during the year rather than just being reviewed at the end of year. In this regard, Interviewee A3 suggested:

*The performance is measured once a year based on those measures and they are not considered in daily routine for the rest of the year. During the year, we do not work with those measures and they are not followed up on monthly or quarterly basis. Achieving the activity goals can improve performance and deliver results in some cases, but is not the basis to assess performance in all cases (Interviewee A3).*

When asked to comment on the effectiveness of linking the incentive plans with the Balanced Scorecard measures, the managers admitted that profitability and sustainability in the long run should be the main focus rather than earning the incentives. Putting too much focus on short term profitability and performance creates problems in the long term, which is more evident in the case of a financial institution. The focus therefore should also be given to other long term measures to sustain competitiveness and profitability in the long run. In this regard Interviewee A2 said:

“There are chances to improve when you expect a reward and everyone would try their best to achieve the goals. However, for us, the branch managers, getting rewards and incentives is not the ultimate goal or driving force for better performance. Rather, the aim for us is to run the branch in a good manner and more profitably. It is the main motivating factor to improve performance and stress performance improvement for all employees.” (Interviewee A2).

Edie (the senior vice-president and the head of group planning) also considers that the current linkage of incentives and Balanced Scorecard lacks in many aspects. He believes that there is a need to further improve the linkage of the incentive compensation system and Balanced Scorecard to effectively implement the organizational performance measurement system (Johnson, 2005).
The Bank B asserts that the organizational remuneration system should be clear, consistent and based on the employee performance to recruit and retain best performing employees (Bank B, 2011). It should be consistent in its design and also with the values of the bank to create maximum value for all the stakeholders. The Bank B introduced the performance based remuneration system about 10 years ago which since then has been continuously updated and improved. During the year of 2010, the board changed the structure of this system and introduced restricted shares as part of the variable remuneration. They considered that this would help to focus more on the bank’s strategy in the long run by increasing the employee stake in the bank. Earlier, during the economic crises period, the bank revoked all variable remuneration plans for 2009 to cover the loss suffered by the bank. Later in 2010, following the rules of EU, the bank introduced a new incentive model which included shares as incentives along with traditional monetary compensations.

On 1 January 2010, the Financial Supervisory Authority’s new rules on variable remuneration (FFFS 2009:6) entered into force. During the summer, the EU also presented new rules on variable remuneration, which will take effect in Sweden on 1 March 2011. Both sets of rules require, among other things, that a portion of variable remuneration be paid out in shares or other financial instruments...

Based on these new rules, the Board in August 2010 approved a new performance and share based remuneration programme, called Programme 2010. It applies retroactively as of 1 January 2010 pending the approval of the 2011 AGM. With this new programme, which replaces older programmes, we go further than regulations require – e.g. by deferring the share based portion for those who both qualify as risk-takers and those who do not. The goal has been to combine regulatory requirements with our values, which serve as part of the qualitative evaluation criteria. (Bank B, 2011)

The Bank B integrated the incentive compensation plans into its current management control system. Based on these, employees were offered various rewards for achieving various targets and goals in terms of extra salary at the end of the year. The system is designed in a way that every employee can see their performance scorecard on the organizational information system each month. When asked to explain the incentive compensation system at the Bank B, Interviewee B1 replied:

“Bank B uses a performance measurement tool named FOCUS which was initially designed to measure performance of employees in the private banking sector. Later, it was also introduced for corporate banking employees. In this system, the head-office sets targets for all the branches to achieve certain targets and goals within the financial perspective. As soon as the targets are announced, they are then divided among all the branches in the country according to their corresponding sizes (the number of employees and customers) and their growth rate. The target assigned to the Jonkoping branch is distributed among the employees and I monitor the employee performance each quarter. The targets assigned to each employee vary according to their positions and responsibilities in the branch i.e. cashier, customer services, credit counseling, etc.” (Interviewee B1).
As mentioned earlier, the system is designed and implemented from the higher management and followed throughout the whole Sweden and the Baltic region. As a result, managers and employees at the regional branches have no participation in designing the system.

Interviewee B1 mentioned that in the process of annual targets allocation, each employee’s vacation plans are also considered. The specific tasks of one employee are assigned to their colleague(s), so that entire process is not interrupted by one employee’s absence. She compared the whole process of getting and assigning targets to subordinates to “splitting the share of cake allocated to the branch further among the employees.”

4.3.2 Objective or Subjective Incentive Plans

The design of the incentive compensation plan is described by its construction. It can be objective or formula based plan with a pre-determined measures and weightage allocated to each measure. Alternatively, it can be more subjective nature where the managers have to be subjective in evaluating the performance of employees without declaring any pre-determined criteria. When we asked about the basis of performance measurement from our interviewees, we found out that even though the systems were formula based but they involved certain degree of subjectivity.

“Although the incentive plan is formula based but still there are some measures which cannot be explicitly measured but rather involve subjectivity of the supervising manager to assess the performance in that area. I consider that there should be no subjective measures because they are not clearly understood or communicated to us. Such as leadership and coming up to the values is bit vague and cannot be assessed easily. Furthermore, even during the year only financial facts and figures are given more emphasis while other measures are not emphasized much” (Interviewee A2).

Similarly, the Bank B also uses a formula based incentive compensation system; however, there are some measures where the manager has to exercise subjectivity to measure the performance of the employees, as Interviewee B1 said:

“At our bank, formula based rewarding system is used and it presumes a certain level of subjectivity in the evaluation process. For some areas, the rewarding system is strictly objective and clearly defined but in others, where employees have more frequent customer interaction, the level of subjectivity is present.”

4.3.3 Individual or Group Performance Incentives

The incentives can either be offered on the basis of individual or group performance depending upon the level at which they are offered. At the Bank A, the incentives are offered to selected managers only and not to all employees in the branch. Thus, the incentives are based on the manager’s performance only. However, Interviewee A2 admitted she was against of this practice and expressed that the compensation should be both individual and
group based for various departments to inculcate team-based environment at the branch and foster the bank’s values. In particular, she suggested:

“The individual performance based incentives are against Bank A Values of “One Bank A Team”. I think that all employees at the branch work to achieve the target goals and, thus, they should be given a share from the reward. Though all the personnel contributes to the overall organizational goals, only higher positioned employees, like us managers, and not others, obtain rewards for that” (Interviewee A2).

Interviewee A3 added:

“Incentives should be offered at team as well as individual levels. As most work in the corporate sector needs to be done in teams, one individual cannot be held solely responsible for the whole deal. However, when rewarding for group performance, in case the group fails to achieve the assigned targets then no individual should get the rewards. Additionally, group incentive is better for team spirit and can help to strengthen the “One Bank A team” value of the company.” (Interviewee A3).

The bank B rewarded incentives based on individual as well as group performance depending upon the functions and roles performed by that department of the bank. Answering the question about individual or group performance, Interviewee B2 replied:

“The rewards are given on individual and group performance depending on the business section. For some departments, such as customer service, the rewards are given for individual performance, for other divisions, such as loan department, rewards are allocated on a group basis.” (Interviewee B2).

4.3.4 Types of Incentive Rewards

Organizations use various types of incentives to reward the employee performance. This could be monetary based on certain percentage of annual salary, gifts, shares offering etc. At the Bank A, the incentive compensation takes the shape of 1-3 months extra salary depending upon the performance under each KPI. Both managers (Interviewee A2 and Interviewee A3) considered monetary rewards to be more important at the end of the year. However, career development plans and pensions etc. are also important factors during the year.

The incentive compensation system at the Bank B offers monetary as well as non-monetary rewards to the employees in terms of restricted shares and gifts etc. Interviewee B1 told us:

“The bank offers both monetary and non-monetary types of rewards to their employees. However, the monetary rewards contribute to the largest part of the rewarding system and consist of salary increase and profit sharing at the end of the year. Non-financial rewards usually consist of gifts and specially organized leisure activities. These rewards are given for outstanding performance in different organizational campaigns. The non-financial rewards
are not determined under any formal system but are developed at the discretion of the manager (herself) at the branch level.” (Interviewee B1).

4.3.5 Standardized or Customized

At the Bank A, the incentive systems are standardized for all managers irrespective of the branch or business sector they are working in. The only difference between the incentive reward amounts for different hierarchical levels is the maximum amount of annual fixed salary that the manager can obtain. This amount varies from 25 per cent to 50 per cent. In the case of our interviewees at the Bank A, both had 25 per cent of annual fixed salary as reward for achieving all the KPIs under each perspective of the Balanced Scorecard.

Likewise, the incentive system at the Bank B is also standardized for all employees, which allows each employee to involve in the “competition” for the best performance and, thus, enjoy different opportunities for earning the remunerations.

4.3.6 Measures and Perspectives for Performance Evaluation

The Bank A exploits a number of measures under each perspective for performance evaluation. These measures are taken from both financial as well as non-financial perspectives. Although the management attempts not to overfocus on financial perspective, being the financial institution, more concentration is given to the financial objectives. The KPIs for measuring the performance of the managers include Income, Return on Equity, Customer Satisfaction Index (CSI), living the Bank values, Sales KPIs, Financial KPIs, leadership and personal measures etc.; with each given a certain weightage summing up to 25 per cent. For example, 4 per cent of the incentive amount is based on the leadership measure and 6 per cent on income and return and equity and so on. Interviewee A3 told us that during the month follow up KPIs and P&L of the branch are monitored through various reports.

At the Bank B the measures used for performance measurement vary according to the role and tasks a certain employee performs. For example, the employees responsible for loan counseling are required to have 400 meetings with the customers. Similarly, 1500-2000 customers per year for employees in the customer service department; and there is no limit for the cashiers as their work depends upon the number of customers visiting the bank during the day. When explaining the nature of various measures, the interviewee B1 mentioned the use of non-financial measures for performance evaluation. In particular, she said:

“Apart from financial objectives achievement, the employees are also assessed based on other non-financial measures, including politeness with customers, service-minded behavior, etc. These non-financial performance measures are often subjective and hard to assess accurately” (Interviewee B1).

The non-financial measures are also significant when evaluating the employee performance. The Interviewee B1 participates during the employee-client meetings to examine how
employees deal with customers and how the service is delivered. Once a year, the head-office conducts interviews with various customers to measure the customer satisfaction index of the bank’s services and offerings.

4.3.7 Communication and Feedback

An effective and unambiguous communication of the incentive plan is the key to motivate employees and improve the organizational performance. If the incentive rewarding system is vague and not communicated properly, then the employees might not be willing to compete to achieve incentives. During the early years of the Balanced Scorecard implementation, the Bank A communicated the new system and incentive criteria through information on its intranet and through the quarterly internal magazine. This helped to bring everyone on common grounds to understand organizational strategy and discuss it at all levels. When asked about the communication of the incentive system from managers at the Bank A, the Interviewee A2 replied:

“The incentive compensation plan has been changing from year to year and sometimes it is not so clear and not communicated properly. The incentive compensation system should be used consistently for a certain period of time before making variations in the system. However, any variations or new plans should be communicated properly and the employees should know the basis of the system. The system could be made more efficient if the performance measures are followed each quarter instead of only once a year.” (Interviewee A2).

The Interviewee A3 believed that the incentive system should me made simpler to understand follow-up by the managers to see their performance along the way. The manager meets with the supervising manager once a year to discuss the performance and to determine the incentive amount. Apart from that, no feedback is given to the manager.

At the Bank B, communication and feedback is a continuous process done on monthly, semi-annual and annual basis. Similar to the Bank A, the employee can track their performance against set targets through the system on monthly basis. Talking about the communication and feedback process at the bank, the Interviewee B1 said:

“The employee performance is communicated on a monthly basis during the meeting with the manager. The employees who underperform are given guidance to cope with their performance gap of what was targeted and what they actually managed to achieve. In addition, I meet every employee after six months to discuss various job related issues and to inform them about their performance during the past period and what I expect from them in the future.”

During the annual meetings with the employees, their performance during the entire year is discussed and their salary for the coming year is decided. This meeting also includes career development discussions, employee need for training or education and vacation plans etc.
The emphasis is also devoted to the organizational values and culture to evaluate how much the employee attains and coheres with those values. Furthermore, issues such as recommendation for promotion or transfer to other departments or business units are also raised during these meetings. Explaining the feedback process, the Interviewee B1 said:

“Employee performance is followed up on a weekly basis to give them feedback on their performance and guide them to deliver the optimal performance. If the employee continuously performs well and delivers 100 per cent of what has been expected and assigned to him/her, then they get promotion. In the follow up session, issues of employee’s personal goals and objectives achievement are discussed along with salary” (Interviewee B1).

The employees at Bank B are generally satisfied by this incentive system based on performance with Balanced Scorecard measures. In reply to our question about his comments and thoughts about this system, the Interviewee B2 said:

“Overall, majority of the employees is satisfied with the incentive system based on the Balanced Scorecard measures and considers the competition associated with this tool as an additional motivating factor to improve performance. However, there are some employees who dislike the nature of competition at the workplace and thus seem to feel pressured. For those employees, extra assistance and support are organized including coaching and feedback sessions, where they discuss with me on how the working environment can be improved for them.”

The Interviewee B1 considered a manager’s task in effective management of the branch goals and objectives, and creating a vision through which those goals are split and communicated to individuals, while keeping everyone on board. In her view, the manager needs to ensure that employees are focused (given appropriate incentives) and act as a team to serve the customers in the best possible way. The Interviewee B1 was also quite satisfied with the current incentive system:

“The current system is well functioning and provides employees with the same opportunities and possibilities for achieving their prescribed goals. Sometimes, however, problems arise when the employee believes that the target is too high for them to reach. If the employee perceives goals to be unachievable, then he/she discusses them with the manager (Interviewee B1) or higher authorities, and the guidance and assistance for the employee(s) follow up. Furthermore, occasionally the head-office makes changes to the goals without communicating the reason for it. The alteration is usually done by increasing the current targets which, in turn, creates problems for employees as they have to adjust their plans. The best way to introduce such kind of changes would be through efficient communication of the purpose and reasons behind them”.
5 Analysis

In this section we will present the analysis of the empirical material through the application of the important theories and concepts discussed earlier in the frame of references.

5.1 Balanced Scorecard and Incentive Compensation Linkage

The Balanced Scorecard and incentive compensation linkage, as suggested by the founders of the tool Kaplan and Norton (1996a, 1996b; 2001a; 2001b) and other researchers Niven (2005; 2006; 2008) and Olve et al. (2003), is described an ideal since the Scorecard includes the key measures, particularly derived from the strategy for future growth and profitability, while the reward component keeps everyone committed to achieving the Scorecard objectives. However, the results from our survey indicate that only four companies link their Balanced Scorecard measures with incentive compensation system at all organizational levels. Whilst the other two companies either use it just for the top management level or their sales department, one of the companies is still in the process of designing and introducing the linkage.

The reason why most companies have not yet linked their Balanced Scorecard and incentive compensation could be because they are not confident enough with the implementation of Balanced Scorecard in their organizations or they are in the initial stages of this process. That is why some companies were either in the initial phase of the implementation of the system or were implementing it on pilot basis for some departments and levels to ensure a smooth transition into the new system. When a company has implemented the Scorecard completely at all organizational levels and cascaded it to the individual level, then they move towards linking it with the incentive compensation system (Kaplan & Norton, 1996; 2001b), which would result in improved performance (Debusk and Crabtree, 2006). Furthermore, this would facilitate an enhance understanding of strategic objectives among the employees resulting in superior job productivity and increased motivational levels.

Bank A

At the Bank A, the incentive compensation systems such as VSP and OTP incorporate financial and non-financial rewards for attaining the objectives and measures predefined at the organizational Balanced Scorecard. This compensation system is offered only to employees at top management positions, starting from the branch managers and above. This is a discrepancy in the plan that it does not include employees at levels below the branch manager. This sort of exclusion of the lower level employees can be considered as a drawback of their organizational compensation system. This might result in lack of interest towards the organizational goals and strategies by the lower level employees who are actually executing the strategy in the day to day work. The whole process of Balanced Scorecard implementation can be at stake if the incentives are so poorly designed (Kaplan and Norton, 1996; 2006). We think that there is still room for improvement when it comes to the linkage
of the incentive compensation system and Balanced Scorecard to achieve company strategic goals at Bank A. Since they have been using this linkage for relatively a long period, they should also introduce it for the lower management levels. Therefore, an entire incentive compensation policy has to be redesigned to include the whole organization, as suggested by our interviewees. This notion of offering some sort of incentives to employees at all levels was also asserted by our interviewees who regarded the absence of any “carrot or sticks” i.e. incentives for their subordinates as a negative signal and suggested doing otherwise would result in better performance and help to focus on short as well as long run objectives.

The fact that the compensation plans for managers at the Bank A are based on annually changing Key Performance Indicators (KPIs) based on the Balanced Scorecard perspectives is a good indication. It attracts and retains well performing managers at the company, though their performance is directly correlated with how well their subordinates achieve the targets.

**Bank B**

At the Bank B, the incentive compensation plans are integrated into their management control system and the employees are offered various rewards for achieving the targets and goals from different perspectives. The bank offers variety of incentives to an employee which provides an opportunity to bring everyone on board to achieve the assigned goals of the branch. The only problem is that managers and employees at the regional branches have no participation in designing these systems as the head-office defines targets for all the branches and they only have to achieve those targets and goals. The whole process of assigning goals and designing incentives should be undertaken after consultation with the regional managers at the minimum. It is so because making the Balanced Scorecard measurements accepted and used throughout the organization requires employees understanding of the strategy and the purpose by being involved in the design process (Niven, 2006; 2008). Therefore, in an attempt to facilitate focus and commitment towards the key objectives of the organizational strategy, companies should make the design process available to all employees. This also signals the organization’s confidence in the Scorecard and its ability to affect outcomes by acquiring a win-win proposition for everyone (Kaplan and Norton, 1996a; Niven, 2006; 2008).

The effectiveness of linking the incentive plans with the Balanced Scorecard measures depends on how well the organizational objectives are placed. At both banks, the profitability and sustainability in the long run are among the objectives to gain the key focus when designing this kind of alignments. In fact, over emphasis on short term profitability and performance creates problems in the long term, which becomes more evident with financial organizations.

### 5.2 Objective and Subjective Incentive Plans

Both banks use the objective incentive plans which are communicated to the employees at the beginning of the year along with the targets to which those incentives are related. Based on
the information provided by our interviewees, we are of the view that the problems associated with formula based incentive system, as mentioned by Ittner et al., (2003), such as determining appropriate weights for each measure, game-playing and rewarding for unbalanced performance did not prevail at any of the bank. However, studying the process for a longer period of time (e.g. 3-4 years) might give contrary results for employee behavior in this regard.

Furthermore, the views of the interviewees, at both banks, regarding drawbacks of using subjective incentive plans were in consistence with Prendergast and Topel (1993) and Ittner et al. (2003) that they are less effective due to lack of clarity and communication to the employees. Subjective incentive plans decrease the motivational level of employees, since key performance measures in performance evaluation process are neglected, while the issues of favoritism and biasness, lack of verification, unfairness and complaints of discrimination are present. Performance evaluation plans can improve motivation only when there is consistency in the efforts put and rewards obtained for them. Furthermore, in case of financial institutions the use of subjective incentive plans can result in putting too much emphasis on financial measures, thereby limiting their vision and efforts to short term goals only. Thus, the subjective incentive plans are not considered appropriate rather objective incentive plans should be implemented.

5.3 Individual or Group Performance Incentives

As described in the frame of reference, incentive plans should reflect and strengthen the organizational culture. If, for instance, team-based and collectivistic behavior is regarded important, then incentives should be offered on a group rather than individual performance (McKenzie and Shillings, 1998). The Bank A “One Team” value asserts that the organizational success is attained through group efforts and promoting the team culture in the organization. However, its incentive system is quite contradictory in this respect. The incentives are given only to selected higher-positioned employees, such as the branch managers, thereby, limiting the incentive offering to individual basis only. It is so although all employees at the bank branch put their efforts to achieve those goals under supervision of the branch manager.

We think that using the combination of both types of performance incentives depending on the hierarchical and other variables would be very beneficial for the organizational incentive system at both banks. McKenzie and Shillings (1998) and Zehnder (2001) argue that it is the responsibility of the supervising manager to decide which behavior to promote and balance between group and individual based performance incentives at various organizational levels. If increased collaboration and team spirit are valued, then group based compensation plans need to be designed and implemented. In our study, Bank B used the combination of both individual and group performance based incentives (the lower-positioned employees are usually rewarded on a group based performance, while senior employees are evaluated on individual performance) and this is a sound strategy. This strategy is beneficial because rewarding some employees for their individual performance will increase their motivation
and thus contribution to the overall organizational success might also be higher. On the other hand, Bank A should offer group based incentives to all branch employees to promote and strengthen the team focus to reinforce the “One Team” strategy.

5.4 Current and Future Performance

The concept of the Balanced Scorecard encourages the focus on long-term value creation and therefore emphasizes the measures which focus on future success (Kaplan and Norton, 1996b). During our research, we learnt that the incentive rewarding system of both banks was more concerned to current performance i.e. incentives are allocated at the end of period (quarter, biannual or annual). It seems that if rewards would also be based on future performance, it would help to retain employees in the organization for longer time and enable them to concentrate on achieving long-term objectives rather than just focusing on short-term. The managers at both banks also agreed on this idea and considered that doing so would improve the organizational performance and strengthen the linkage of the Balanced Scorecard with the incentive compensation system.

5.5 Types of Incentive Rewards

Theory greatly emphasizes the role of non-financial rewards for motivating employees. However, practically monetary rewards are more valued than non-monetary rewards by employees in organizations. The managers at the branch considered monetary incentives (certain % of annual pay) as the key motivator for improved performance. They also regarded other non-financial incentives, such as career growth opportunities, recognition, job satisfaction and sense of achievement in life as important to them. The two banks do not fully exercise both types of extrinsic rewards and mainly offer only incentive plans. At Bank B, the Branch Manager offers non-financial rewards for best performing employees at the branch level alongside with the formal incentive system. This strategy goes in line with the argument made by Herzberg (1987), Niven, (2008) and Niven (2003; 2006) that an effective compensation system should consist of financial and non-financial rewards and this will align individual goals and objectives with the organizational goals and objectives.

Although money is often regarded as the major motivator, intangible rewards make individuals focus more on achieving the desired outcomes. In this regard, the fact that non-monetary extrinsic rewards are not very developed at both banks could be considered as a drawback in their incentive compensation systems. Since the two banks use different measures and perspectives of the Balanced Scorecard and they are linked with the organizational incentive plans, non-monetary rewarding should be further improved.

5.6 Standardized or Customized

The standardized rewarding system is designed at the top level and is practiced for all the subordinate managers (branch managers) within the two banks irrespective of the branch or business department they work in. This means that the concept of “One size fits all” which is
usually considered as inappropriate in management system becomes true. This strategy can be efficient in small organizations where endorsement of team efforts and collaboration is needed, but it is not at all effective in larger organizations, which should adopt customized and differentiated reward systems for each of their business departments, depending upon their strategic goals and performance targets.

The managers also regard customized rewarding to be superior and efficient compared to the standardized one. They agreed that if they had a chance to participate in the rewarding system designing, they would propose a balanced implementation of both since it would better address the employees’ and companies’ needs.

5.7 Measures and Perspectives for Performance Evaluation

When selecting measures, it is important to accentuate the key measures related to the employee performance and which are in employee’s control (McKenzie and Shillings, 1998; Hansell et al., 2009). At the Bank A, the number of measures (KPIs) each consisting of a certain weightage (up to 25 per cent of potential reward) from financial and non-financial perspectives for performance evaluation is used. Each of the branch managers has their own assigned measures from various perspectives with different targets depending on the size (no. of customers served and turnover) and growth rate of the branch. However, being the financial organization, the measures from the financial perspective are given heavier weight and, thus, the performance evaluation strongly depends on achieving the financial KPIs.

The situation is a bit different at the Bank B where the measures used for performance measurement vary according to the roles and tasks performed by an employee. These measures include objective as well as subjective measures where the manager assesses various performance aspects of the employee such as customer dealing, politeness with clients, service-minded behavior etc.

A well-designed Balanced Scorecard compensation system should be balanced in terms of different Balanced Scorecard perspectives to ensure that the organizational strategy will be achieved efficiently. Although different weights can be given to different perspectives depending on the type of the business and the current market situation (as it is for our case companies) to focus employee attention on critical drivers of performance, it is important to include all perspectives (Kaplan and Norton, 1996a; Niven, 2006). The incentive plans should be spread across all the organizational Scorecard perspectives to instigate employees to grasp the greater importance of individual performance metrics and ultimately ensure the company success.

5.8 Communication and Feedback

An effective and unambiguous communication of the incentive plan is essential in encouraging employees and improving the organizational performance (McKenzie and Shillings, 1998). As suggested by the interviewees at the Bank A, sometimes communication
of the performance measures and incentive plans is not clearly delivered and this often creates problems. Communication of new incentive system was relatively adequate during the early years of the implementation, but later the communication process weakened. As mentioned earlier, communication of the incentive system is an ongoing process. Thus, it does not stop after the design and implementation phase; rather it needs to be carried on periodic basis to convey the alterations made in the system. In our case, many alterations made in the program are not communicated properly to the managers, so they remain unclear for them. Furthermore, there is a lack of feedback from the supervising manager regarding manager’s performance during the year and how he/she can cover for these shortcomings in achieving the targets. Hence, there is a need for more recurrent meetings where performance track would be discussed and feedback given on how to attain the KPIs at the Bank A.

Communication and feedback takes place on a monthly, semi-annual and annual basis at the Bank B. In this respect, this bank’s system is more efficient compared to its counterpart. Likewise, at the Bank B the employee is able to monitor their performance against assigned targets through the system on monthly basis. In the monthly meetings, the supervising manager is able to see employee’s performance and give feedback and direction on how performance gaps (if any) can be covered. This means that the employees are clearly communicated what is expected from them, why changes occur and how they should perform to achieve their assigned KPIs, and, thus, be rewarded.
6 Conclusion & Final Discussion

In this section we will present the conclusions drawn from the research of the thesis and provide the answers to the research purpose. This section will end with a final discussion about our thesis, its limitations and some proposals for further studies.

6.1 Conclusion

Throughout our research we have investigated the factors which have an important effect on the efficient design and implementation of incentive compensation system based on Balanced Scorecard within an organization. Based on the analysis of our findings, we define a number of issues which significantly impact the employee motivational level and performance and, therefore, the overall achievement of organizational objectives and goals. Hence, these factors should be carefully examined by decision-makers at an organization when attempting to link the system of compensation with the Balanced Scorecard. This linkage is considered as the final stage of Balanced Scorecard implementation, and once it is designed efficiently, the Scorecard can be regarded fully executed with the organizational strategies and objectives becoming actionable.

Below we will shortly summarize the results of our analysis of these factors and by doing so we will also address the purpose of our study.

- Objective and Subjective Incentive Plans

Despite the problems associated with both types of incentive plans, the analysis suggests that objective incentive system is more preferable. It enables employees to clearly understand the bases and consistencies of performance measures on which they are evaluated. Consequently, the employees do not have feelings that the evaluation is distorted by unfairness or biasness of managers examining the performance. As a result of implementing objective incentive plans motivational level of employees is increased meaning that the organizational objectives are better attained and the overall performance is enhanced.

- Individual and Group Performance Incentive Plans

The analysis of our findings shows that selection between individual and group performance incentive plans should made depending on different variables specific to each organization, including the hierarchy of positions, goals to be achieved, preference of employees and the overall organizational culture. It is the responsibility of the manager to decide which behavior to endorse and balance between group and individual performance incentives at various organizational levels and the various objectives which have to be achieved. Therefore, selection among these two categories of performance incentive plans is an important factor to consider when designing the compensation system.
• **Current and Future Performance**

If the organizational incentive system is linked to current performance only, the critical nature of the Balanced Scorecard can be lost. Apart from current performance which is of course very important, organizations should also emphasize the future performance measures when designing the incentive plans in alliance with the Balanced Scorecard. This will, as suggested in the analysis, keep employees in the organization for longer periods of time as well as direct them on achieving long-term objectives.

• **Financial and Non-financial Rewards**

To ensure that the incentive system is rigorous, satisfies the needs of different employees in the organization, it should consist of both financial and various non-financial rewards. As suggested by our empirical findings, employees are also interested in non-financial rewards such as career growth opportunities and performance recognition by higher management. By exercising the combination of both types of rewards, the incentive system will be more comprehensive and thus better encourage the employees. Enhanced motivational level, in turn, means that the organizational strategies developed from implementing the Balanced Scorecard will be better met.

• **Standardized or Customized Incentive Plans**

One size does not fit all and this is particularly the case when designing the incentive compensation system as the analysis of our empirical findings suggest. Although customized incentive plans require more energy and time to design compared to standardized ones, they are more in line with and better reflect the Balanced Scorecard’s different perspectives. As a result, this leads to better employee and organizational performance. Furthermore, the theory suggests that large organizations are indeed advised to use customized and differentiated rewarding systems for different business departments, also depending upon the strategic goals and performance targets.

• **Measures and Perspectives in the Incentive Plans**

The incentive plans should incorporate all the Balanced Scorecard perspectives used in the organization, since these perspectives reflect the overall company strategy. Also, it is important to stress the critical measures related to the employee performance evaluation so that an employee can see how the evaluation will be made in the end.

• **Communication and Feedback**

The design and implementation of incentive systems based Balanced Scorecard also depends on how well these plans are communicated to employees. Our research shows that the purpose of this communication is to inform and guide people on their actual and expected performance. It is also important that these people get feedback on how well they are
performing against the set targets and objectives assigned to them. By seeing where they stand, they will be able to not only close their performance gaps, but also achieve higher results in the future, thus, improving the organizational performance.

6.2 Limitations

For this study, we employed the qualitative research based on four interviews with bank managers and the sample survey as the only sources of empirical data. This data was gathered from just two financial companies located in Jönköping, Sweden. We did not have access to a larger number of companies which might have limited our insight into how the linkage is established in other industries. Getting more case companies including those from other countries would have made generalization even more credible, however, it would have required considerably more time than was available for this research endeavor.

The four interviewees were all among those who were evaluated on specific performance measures assigned to them from higher-level management and, thus, did not participate in the design of Balanced Scorecard based incentive system. By interviewing the top-managers who actually designed the linkage we might have acquired a more holistic view of the situation. However, due to time constraints and also unavailability of those managers we could not extend the scope of this thesis in that respect.

Last, due to the reasons of confidentiality of company data, we were not allowed to access financial, performance track records, or any other data indicating how the linkage of Balanced Scorecard and incentive compensation plans at both companies resulted in better organizational performance.

6.3 Future Studies

Now when we have come to the end of this thesis, we have acknowledged the need of knowing where to go from here. The limitations of this study are connected with the further studies we would suggest to be made. If more time were given for this study, it would benefit from investigating more companies, including SMEs (our case companies were large) from different industries and countries. It would then be possible to see whether the studied factors would differ or remain the same. Also, we would strongly encourage other researchers to examine the views of supervising managers who design the incentive system based on the Balanced Scorecard to obtain a more holistic picture of this topic.

Furthermore, additional studies on examining how the financial performance (figures from income statements, balanced sheets, etc.) improves when the linkage is designed would be very relevant.
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Interview Questions

1. What is your position/designation at the organization?

2. When the Balanced Scorecard was introduced at your organization?

3. Can you tell us about the Incentive compensation system used in your company?
   a. Who participated in the formulation of this Incentive compensation system and how was it communicated to the employees?
   b. Do you think it is effective? If yes why? If not, what changes would you bring up and why?

4. Is the Incentive compensation system linked to the organizational Balanced Scorecard?

5. How the Balanced Scorecard measures are linked with Incentive compensation system? (Formula based or Subjective)
   a. If formula based system is used - are there any problems or drawbacks?
   b. If subjective system is used - are there any problems or drawbacks?
   c. If subjective system is used – who evaluates the performance and on what basis?
   d. If subjective system is used – whether employees know about the evaluation criteria?

6. Do you clearly understand the method and measures used in the compensation plan?
   a. Was it communicated or explained to you beforehand.
   b. Do you think that the goals are realistic and achievable?

7. What and how the BSC measures/indicators are chosen when designing the rewarding plans?

8. What types of rewards are offered for employees?
   a. Financial or Non-Financial
Appendix

b. Standardized or Customized rewards

9. When determining the BSC measures and goals, are all the four perspectives considered equally or some perspectives are more prioritized? How exactly the BSC perspectives are weighed in the compensation systems?

10. Are the rewards based on group or individual performance?

   a. What benefits and drawbacks do you see in this regard?

11. Does the company offer any kind of rewards based on future performance?

12. Are you satisfied with the current incentive system?

13. Are the performance results communicated to employees on frequent basis (to ensure focus on objectives)?

14. How do you think the BSC and the Incentive compensation system could be better linked at your organization? Comments or feedback?

15. Do you think the fact that Incentive Compensation system is linked to the organizational Balanced Scorecard is a good strategy?
Management Tools and Trends 2009 – Balanced Scorecard

Balanced Scorecard

“Balanced Scorecard: Translates Mission and Vision Statements into quantifiable measures and gauges whether management is achieving desired results. Related Topics: Management by Objectives (MBO), Pay-for-Performance, Strategic Balance Sheet.”

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<th>2008 Satisfaction</th>
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<td>1993:</td>
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- Industries with highest percentage of usage: Chemicals & Metals; Food & Beverage; CPG: Manufacturing
- Industries with highest satisfaction: Healthcare; Services; Pharma & Biotech

☐ Significantly higher rate than other regions/company size  ○ Significantly lower rate

58
Top 10 tools have varied over time

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<td>Strategic Planning* (88%)</td>
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<td>Mergers &amp; Acquisitions (46%)</td>
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*Tool added in 1996  ***Tool added in 2000  **Tool added in 1998

Top 10 most used tools

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<th>Europe</th>
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Note: (t) = tied
## Tool usage varies by market type

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<td>Loyalty Management Tools</td>
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<tr>
<td>Decision Rights Tools</td>
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<td>9%</td>
</tr>
</tbody>
</table>

- Use tool significantly more than those not in market type

## Usage rates vary by region

### N. America

- Benchmarking: 25%
- Strategic Planning: 25%
- Mission and Vision Statements: 70%
- Customer Relationship Management: 69%
- Outsourcing: 61%
- Balanced Scorecard: 49%
- Customer Segmentation: 45%
- Business Process Reengineering: 58%
- Core Competencies: 60%
- Mergers and Acquisitions: 48%
- Strategic Alliances: 51%
- Supply Chain Management: 38%
- Scenario and Contingency Planning: 37%
- Knowledge Management: 45%
- Shared Service Centers: 38%
- Growth Strategy Tools: 61%
- Downsizing: 51%
- Total Quality Management: 30%
- Lean Six Sigma: 33%
- Voice of the Customer Innovation: 28%
- Online Communities: 35%
- Collaborative Innovation: 34%
- Price Optimization Models: 25%
- Loyalty Management Tools: 17%
- Decision Rights Tools: 11%

### Europe

- Benchmarking: 29%
- Strategic Planning: 29%
- Mission and Vision Statements: 63%
- Customer Relationship Management: 68%
- Outsourcing: 61%
- Balanced Scorecard: 54%
- Customer Segmentation: 57%
- Business Process Reengineering: 49%
- Core Competencies: 44%
- Mergers and Acquisitions: 52%
- Strategic Alliances: 45%
- Supply Chain Management: 47%
- Scenario and Contingency Planning: 36%
- Knowledge Management: 43%
- Shared Service Centers: 44%
- Growth Strategy Tools: 49%
- Downsizing: 34%
- Total Quality Management: 33%
- Lean Six Sigma: 34%
- Voice of the Customer Innovation: 24%
- Online Communities: 25%
- Collaborative Innovation: 24%
- Price Optimization Models: 25%
- Loyalty Management Tools: 16%
- Decision Rights Tools: 11%

### Asia

- Benchmarking: 67%
- Strategic Planning: 66%
- Mission and Vision Statements: 61%
- Customer Relationship Management: 70%
- Outsourcing: 62%
- Balanced Scorecard: 54%
- Customer Segmentation: 57%
- Business Process Reengineering: 46%
- Core Competencies: 56%
- Mergers and Acquisitions: 51%
- Strategic Alliances: 45%
- Supply Chain Management: 45%
- Scenario and Contingency Planning: 36%
- Knowledge Management: 43%
- Shared Service Centers: 45%
- Growth Strategy Tools: 44%
- Downsizing: 33%
- Total Quality Management: 37%
- Lean Six Sigma: 31%
- Voice of the Customer Innovation: 28%
- Online Communities: 26%
- Collaborative Innovation: 22%
- Price Optimization Models: 22%
- Loyalty Management Tools: 18%
- Decision Rights Tools: 9%

### L. America

- Benchmarking: 17%
- Strategic Planning: 17%
- Mission and Vision Statements: 17%
- Customer Relationship Management: 17%
- Outsourcing: 17%
- Balanced Scorecard: 17%
- Customer Segmentation: 17%
- Business Process Reengineering: 17%
- Core Competencies: 17%
- Mergers and Acquisitions: 17%
- Strategic Alliances: 17%
- Supply Chain Management: 17%
- Scenario and Contingency Planning: 17%
- Knowledge Management: 17%
- Shared Service Centers: 17%
- Growth Strategy Tools: 17%
- Downsizing: 17%
- Total Quality Management: 17%
- Lean Six Sigma: 17%
- Voice of the Customer Innovation: 17%
- Online Communities: 17%
- Collaborative Innovation: 17%
- Price Optimization Models: 17%
- Loyalty Management Tools: 17%
- Decision Rights Tools: 17%

- Use tool significantly more than those not in region
- Use tool significantly less than those not in region
## Large firms use more management tools

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*Significantly higher usage rate than other sized companies*
*Significantly lower usage rate than other sized companies*