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Reducing conflict in balanced scorecard evaluations

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[a] *Department of Accounting, Washington State University, P.O. Box 644729, Pullman, WA 99164-4729, USA*
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Abstract

Recent studies [Ittner, C., & Larcker, D. (2003). Coming up short on nonfinancial performance measurement. *Harvard Business Review*(November) 88–95; Ittner, C., Larcker, D., & Randall, T. (2003b). Performance implications of strategic performance measurement in financial services firms. *Accounting*, *Organizations and Society*, *28*, 715–741] provide evidence of companies' tendency to overlook the validity of the causal links between driver and outcome measures of the balanced scorecard (BSC), and to ignore the underlying strategically-linked causal business models. It is posited that this propensity leads to conflict between top management and divisional managers because of the failure of the former to evaluate and consider strategy effectiveness in performance evaluation. The present study hypothesizes that individuals in the top-manager role do not take into account strategy effectiveness unless they are explicitly required to do so. In contrast, individuals in the store-manager role automatically consider the quality of strategy without being prompted to do so. A study using 63 evening MBA students provides support for the hypotheses. The results have implications for the study of evaluation biases in BSC as well as in other performance measurement systems, and for devising means to mitigate them.
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Introduction

Performance evaluation is an essential function in any organization. Consequently, it is important to understand how performance measurement systems influence such appraisals. In a seminal study on the role of accounting data in performance evaluation, Hopwood (1972) highlighted problems with traditional accounting measures of performance. In particular, he noted the lack of comprehensiveness of the measures, the imprecision with which accounting systems measure performance, the limited focus on outcome measures, and the over-emphasis on short-term performance (pp. 157–158). Hopwood (1972) hypothesized and found that depending on the evaluation style, reliance on these accounting performance measures can result in dysfunctional consequences including disagreement and conflict between supervisors

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(raters) and subordinates (ratees). Subsequent studies (e.g., Hartmann, 2000; Otley & Pollanen, 2000) have similarly provided evidence suggesting that, depending on various contextual factors, negative consequences (e.g., job-related tension and distrust in supervisor) may result from the reliance on conventional accounting measures when evaluating performance.

In contrast to traditional performance measurement systems, the balanced scorecard (BSC) introduced by Kaplan and Norton (1992) is expected to address many of the concerns raised by Hopwood (1972). The BSC is a multi-dimensional performance measurement system that includes financial, outcome and short-term as well as non-financial, driver and long-term measures. A key feature of the BSC is its emphasis on linking the performance measures with business unit strategy (Otley, 1999, pp. 374–375). Because of its comprehensive and strategy-linked measures, the BSC can be expected to reduce the likelihood of previously observed disagreement and conflict between raters and ratees by promoting a more holistic approach to performance evaluation. For example, when evaluating poor performance, the inclusion of strategy-linked outcome and driver measures in the BSC may direct raters to attend to strategy quality as an explanation, which they are unlikely to consider when using a system strictly based on outcome measures. Consequently, raters using the BSC may ascribe inferior performance less to ratees and more to strategy-related causes. This would presumably lead to more favorable performance appraisal of ratees and reduce the likelihood of disagreement and conflict between raters and ratees.

Recent studies (Ittner & Larcker, 2003; Ittner, Larcker, & Randall, 2003b), however, suggest that the causal links between driver and outcome measures are often overlooked. For example, Ittner et al.'s (2003b, p. 725) study of financial services firms found that of those claiming to use a balanced scorecard, 76.9% place little or no reliance on their strategically linked causal business models. In another field study of manufacturing and service companies, Ittner and Larcker (2003, p. 90) note more specifically that among those that create causal models, only 21% go on to validate the causal links between driver and outcome measures. They also observe "businesses often fail to establish such links partly out of laziness or thoughtlessness" (p. 89). Thus, the evidence from these studies indicates that although information about strategy effectiveness is available in the BSC, it is not used as much as would have been expected presumably because of cognitive limitations.

The present study posits that the above-noted tendency to overlook the validity of the causal links between driver and outcome measures of the BSC is a potential source of conflict between top management and divisional managers. Specifically, it is proposed that discrepancies in performance ratings between raters and ratees may result from top management's failure to consider the quality of its chosen strategy when evaluating divisional managers' performance. Based on research (Feldman, 1994; Ilgen, Barnes-Farrell, & McKellin, 1993; Landy & Farr, 1980) that views performance appraisal primarily from a cognitive process perspective, the present study further posits that top management's failure to consider strategy effectiveness is due to its selective attention bias. Thus, it is hypothesized that increasing top management's awareness of the impact of strategy effectiveness on performance, may reduce conflict resulting from differences in evaluation between top management and divisional managers.

The purpose of this research is to test the foregoing propositions. To establish the existence of a bias, the present research first assesses the extent to which, when using the BSC, divisional performance evaluation differs between individuals who adopt the perspective of top management (the rater) and those who assume the role of divisional managers (the ratees). The study then examines the effectiveness of a mechanism for reducing top management's bias, and thus, the disagreement in performance appraisal between the two perspectives. The specific procedure involves increasing the rater's awareness of the quality of top management's strategy in influencing divisional performance. This is achieved by requiring an explicit assessment of the role of strategy quality in determining divisional performance prior to performance evaluation.

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