A framework for applying Balanced Scorecard to Chinese SMEs

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Abstract  Kaplan and Norton’s concept of the balanced scorecard (BSC) has received wide acceptance by both academics and practitioners. But there was little research on its adaptability to the small and medium-sized enterprises (SMEs) in China. According to our investigation on SMEs in Pearl River Delta from July to September of 2005, a BSC framework was created based on the special characteristics of Chinese SMEs, such as no strategy, poor executive ability and lack of capital. The framework included five perspectives. Besides balanced scorecard’s four typical key perspectives, the paper proposed another important perspective: relationship financing and government support. Finally, the strategy map was used to refine the framework. Thus, the framework not only included the advantage of typical BSC, but also can help SMEs to solve the problem of capital. What is more, the framework can be used to remind the managers to pay attention to research and development (R&D), cash flow, the fast and efficient service and the mentors for guiding employees.

Key words balanced scorecard; small and medium-sized enterprises; strategy map; relationship financing; government support.

1 Introduction

The Balanced Scorecard was formally presented by Kaplan and Norton in 1992, which is not only a performance evaluation method but also a performance management system that combines the performance measures and the organizational strategy. It transforms the organizational visions and strategies into the measures from four perspectives: finance, customers, internal process, learning and growth. Kaplan and Norton advised that long-term organizational excellence can be achieved only by taking a broad, holistic and balanced approach but not by focusing solely on financials. Using the BSC approach, managers are encouraged to take a “balanced view across a range of performance measures”. But the approach was always used in large corporations.

“Applications of this model have been primarily within large corporations and selected public sector institutions, including hospitals and government departments; the BSC has not made any appreciable inroads into the small business domain.” (C. W. Von Berge , 2004)[1]. Birch (1998) and Chow et al. (1997) have the similar point of view.

Chow, Haddad & Williamson’s (1997)[2]“Applying the Balanced Scorecard to Small Companies” is an important research topic worthy of investigation in this area. But it is only a case study, lacking general principle and method.

Birch (1998) [3] proposed some guidelines for how to construct the process for the small and medium-sized enterprise specially. And he also argued that the benefits can be just as significant for small businesses.

William Davig, Norb Elbert, Steve Brown (2004) [4] compared the Quality Control results between SMEs using non-financial measures and SMEs using traditional financial measures. The study showed that BSC users distinguish themselves from others in fraction defective, rework rate and the relationship with suppliers.

But up-till now, Chinese SMEs seldom had made use of BSC and there are few papers had been published on the implementation of the BSC to SMEs in China.

This paper discusses BSC as an applicable tool to Chinese SMEs. Firstly, we identified the special characteristics of Chinese SMEs. Then, we proposed a framework for applying balanced scorecard to Chinese SMEs, which emphasized the functions of the relationship financing and government support. Finally, we get a comparatively refined framework based on “strategic map”.

What must be defined beforehand, in this paper, is that the perspective of relationship financing and government support included the relationships with suppliers, customers, banks, government and other associates. Our study was limited only to the loan from bank, the loan between suppliers and customers, the investments from the suppliers to customers or from the customers to suppliers, and the tax or other
financial support.

2 The characteristics of Chinese SMEs

In China, SMEs are mostly concentrated geographically in the south and east coastal area, especially in Zhejiang Province, Guangdong Province, Jiangsu Province, Shandong Province and so on. They play an important role in the continuous increasing of national economy. And the government is paying more and more attention to them. Thus, the government’s support is necessary to the growth of Chinese SMEs.

One of the outstanding characteristics of Chinese SMEs is their difficulty of financing, because of their limited scale, lack of capital, low credit score, no rounded plan and our national immature credit system. From July to September of 2005, we had been making an investigation on SMEs of Pearl River Delta, and found that many enterprises operated under their capability because of lack of capital resulting from the crazy increasing of the industry material price. Another investigation conducted by Xuehua Zhang (2005) in Zhejiang province also indicated that “the capability of a firm’s financing had very strong relationship with the speed of the firm’s development”.

Another characteristic is that the owners of SMEs always undervalue the R&D and invest less in it. Because they know that many R&D projects are uncertain, subject to both technological risk and commercial risk. In china, what is worse, most investment of SMEs prefer safer but far less rewarding improvements on existing technologies to fundamental researches aimed at creating next-generation technologies and products. Correspondingly, they are in favor of modification and extension of current products. But according to Xuehua Zhang’s research, most SMEs in China have recognized the value of the development of new product.

In addition, most of the SMEs evaluate performance with financial measurements alone and the performance evaluation system seldom has relationship with their strategy. Even some of them have no strategy at all, “because they are always fighting for survival and it is difficult for them to make plans for the future when most of the effort is directed to the fire fighting with the present situation”.

3 The framework for applying balanced scorecard to Chinese SMEs

The relationship financing and governmental support is added to the framework in addition to the four typical perspectives such as finance, customer, internal business process and learning and growth (see Figure 1). With the consideration of the characteristics of SMEs in China, keeping good relationship with bank, supplier and customer, the enterprises can get help when they face the capital problems.
For the four typical perspectives, the application of BSC in SMEs is generally similar with that of in large companies. However, SMEs have to pay much more attention to the aspects such as R&D, cash flow, the fast and efficient service and the mentors for guiding employees than before.

**The relationship financing and government support perspective:** The objective is to address the question that “Can we get the support of the banks, customers, suppliers when we are short of capital? Are the stakeholders willing to share the risk with us? And can we get special support from government in our community?” As shown in figure 2, the more of financing relationships an enterprise has, whether with government, bank, suppliers, customers, other associates or a combination of them, the more support that enterprise will receive.

According to our investigate, more and more SMEs solved capital problems by taking advantage of the financing relationship with their suppliers and customers, such as the investment in new projects from suppliers or customers, the reasonable flow of Account Receivable and Accounts payable, and the lower cost of the logistic. In a word, the supply chain has been a “bank” for SMEs.

Especially, the price of industry material has sharply increased in last two years. For survival, many SMEs began to invest in their upstream suppliers or attract the upstream suppliers to invest in their in house facilities.

![Figure 2 The financial supports SMEs get from the financing relationship and government support](image)

**The financial perspective:** The objective is to addresses the question “How the shareholders consider us”[6]. Different financial measures should be used during the different lifecycles of SMEs.

Particularly, it should be pointed out that the operating of financing and industry policy of local government is significantly correlated with the high-speed development of the SMEs. Thus, the measure of cash flow and the Repay ability should be added to the financial perspective.

**Customer perspective:** the objective is to addresses the question that how the firm is evaluated by its customers. From the customer’s view, the enterprises should investigate the market to understand customers’ needs and know how to meet customers’ satisfaction from the aspects of time (delivery
cycle), quality, service and cost. Such as the ratio of on time delivery, customer satisfaction, the ratio of returns, and the amount of canceled contracts are general measures.\[^6\]

In our country, amounts of SMEs are the suppliers of large-sized enterprises in the industry chain. They don’t have enough barging ability. Thus, the measures of customers’ evaluation results, such as market share, customer retention, customer acquisition, customer satisfaction and customer profitability, will directly influence the fulfillment of financial measures and enterprises’ strategy.\[^6\]

**The internal business process perspective**: the objective is to address the question “What we are good at?” In this perspective, managers are allowed to evaluate how well their business is running, and whether the products and services conform to customer requirements (the mission). With firms’ unique missions, these cannot be developed exclusively by outside consultants. Frequently cited BSC measures for the internal business process perspective include the innovation process, operations process, and post sales service.\[^1, 6\]

Finally, we should point out that, “for our national Small and medium-sized enterprises, the better the ability of innovation of product and technique and management is, the easier to exploit the new market and get higher profit ratio”\[^5\]. Some enterprises can not evaluate the right value of the investment of R&D, so they ignored such investment. Chinese government had carried on some policies to encourage the R&D. The SMEs should take some measures to encourage employees’ creativity, and we hope that balanced scorecard can be used to transfer those intangible assets to tangible ones.

**The learning and growth perspective**: the objective is to solve the problem “Are we making progress?” It makes us to pay attention to the basis of leading the firms to future success, which including the intangible assets such as employee, knowledge asset, information capital.

SMEs in our country pay less attention to this aspect and spend little money on it. According to our investigation, some SMEs are unwilling to invest on the employee training because of the high turnover rate of employees. What is worse, most employers are not aware of the benefit of training. Kaplan and Norton (2000) emphasize that learning includes not only training, but also mentoring, ease of communication among workers and technological tools. I think mentoring and communication is more helpful for SMEs to reach the organization objective without paying any money.

**4 Refined framework based on “strategic map”**

The expanded Strategy Map concept, paired with the Balanced Scorecard, offers us a more refined framework (see figure .3).\[^7\]

On the Strategy Map, the objectives in the four perspectives are linked by cause-and-effect relationships. Starting from the top is the hypothesis that financial outcomes can be achieved only if targeted customers are satisfied. The customer-value proposition describes how to generate sales and loyalty from targeted customers. The internal processes create and deliver the customer-value proposition. And intangible assets that support the internal processes provide the foundation for the strategy.\[^7\] The relationship financing and government support propose capital and admittance for all the processes and activities of SMEs. Alignment of each of these five perspectives is the key to value creation and, hence, to a focused and internally consistent strategy.

The detail description of BSC’s four typical key perspectives can be found in literature \[^7\]. The relationship financing and government support perspective is comprised of the relationships with banks, suppliers, customers and government. Metrics based on this perspective allow managers to evaluate whether these stakeholders can share the risk with the firm and whether the government agree to give the SMEs some preferential policy, such as tax deduction and incentive, financial support and so on.
5 Conclusions

Based on the special characteristics of Chinese SMEs, a BSC framework was created in order to help SMEs to execute strategy well, solve the capital problems and get advantages from R&D, the fast and efficient service, growth of employees and so on. However, this framework is flexible and adaptable, so every SMEs should “put forth the effort to identify the measures that appropriate for its own strategy and competitive position” [7].

In addition, according to the characteristics of Chinese SMEs, managers should avoid selecting too many measures, communicate enough and make sure that every measure must be a factor of the chain of cause-and-effect relationship.
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