

CONSTRUCTING A BALANCED SCORECARD

Weierman Department Store is located in the downtown area of a medium-sized city in the American Midwest. While the store had been profitable for many years, it is facing increasing competition from large national chains that have set up stores in the city's suburbs. Recently the downtown area has been undergoing revitalization, and the owners of Weierman Department Store are somewhat optimistic that profitability can be restored.

In an attempt to accelerate the return to profitability, the management of Weierman Department Store is in the process of designing a balanced scorecard for the company. Management believes the company should focus on two key problems. First, customers are taking longer and longer to pay the bills they incur on the department store's charge card and they have far more bad debts than are normal for the industry. If this problem were solved, the company would have far more cash to make much needed renovations. Investigation has revealed that much of the problem with late payments and unpaid bills is apparently due to disputed bills that are the result of incorrect charges on the customer bills. These incorrect charges usually occur because salesclerks enter data incorrectly on the charge account slip. Second, the company has been incurring large losses on unsold seasonal apparel. Such items are ordinarily resold at a loss to discount stores that specialize in such distress items.

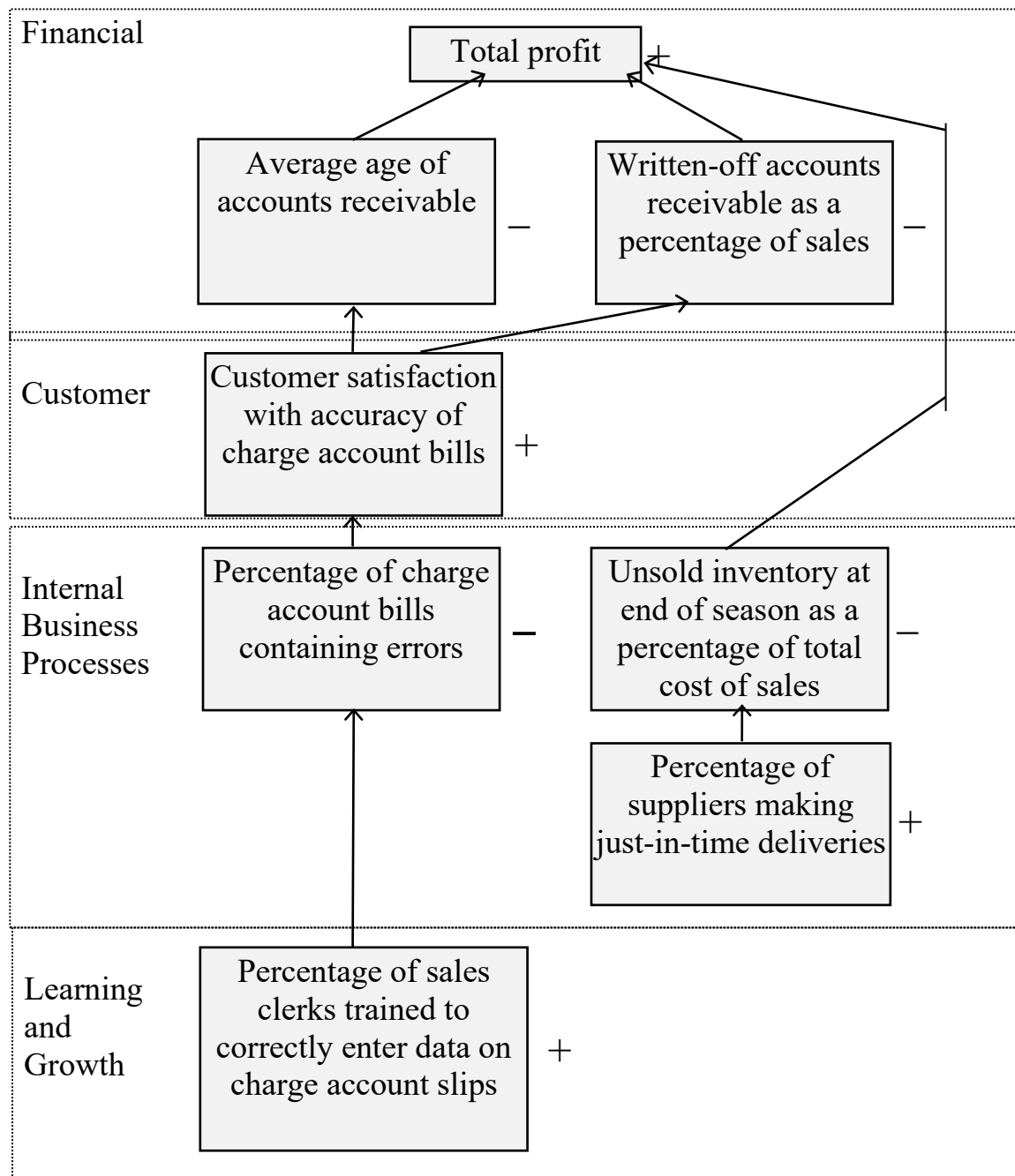
The meeting in which the balanced scorecard approach was discussed was disorganized and ineffectively led—possibly because no one other than one of the vice presidents had read anything about how to put a balanced scorecard together. Nevertheless, a number of potential performance measures were suggested by various managers. These potential performance measures are listed below:

Performance measures suggested by various managers:

- Total sales revenue.
- Percentage of salesclerks trained to correctly enter data on charge account slips.
- Customer satisfaction with accuracy of charge account bills from monthly customer survey.
- Sales per employee.
- Travel expenses for buyers for trips to fashion shows.
- Average age of accounts receivables.
- Courtesy shown by junior staff members to senior staff members based on surveys of senior staff.
- Unsold inventory at the end of the season as a percentage of total cost sales.
- Sales per square foot of floor space.
- Percentage of suppliers making just-in-time deliveries.
- Quality of food in the staff cafeteria based on staff surveys.
- Written-off accounts receivables (bad debts) as a percentage of sales.
- Percentage of charge account bills containing errors.
- Percentage of employees who have attended the city's cultural diversity workshop.
- Total profit.
- Profit per employee.

Requirement #1:

- As someone with more knowledge of the balanced scorecard than almost anyone else in the company, you have been asked to build an integrated balanced scorecard.
- In your scorecard, use only performance measures suggested by the managers above.
- You do not have to use all of the performance measures suggested by the managers, but you should build a balanced scorecard that reveals a strategy for dealing with the problems with accounts receivable and with unsold merchandise.
- Do not be particularly concerned with whether a specific performance measure falls within the learning and growth, internal business process, customer, or financial perspective.
- However, clearly show the causal links between the performance measures with arrows and whether the performance measures should show increases or decreases.



Requirement #2:

- Assume that the company adopts your balanced scorecard. After operating for a year, there are improvements in some performance measures but not in others. What should management do next?
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- The results can be exploited for information about the company's strategy.
- Each link in the balanced scorecard should be regarded as a hypothesis of the form "If ..., then ...".
- For example, the balanced scorecard on the previous page contains the hypothesis "If customers express greater satisfaction with the accuracy of their charge account bills, then there will be improvement in the average age of accounts receivable."
- If customers in fact do express greater satisfaction with the accuracy of their charge account bills, but there is not an improvement in the average age of accounts receivable, this would have to be considered evidence that is inconsistent with the hypothesis.
- Management should try to figure out why there has been no improvement in the average age of receivables. The answer may suggest a shift in strategy.
- In general, the most important results are those in which there has been an improvement in something that is supposed to lead to an improvement in something else, but none has occurred.
- This evidence contradicts a hypothesis underlying the company's strategy and provides invaluable feedback that can lead to modification of the strategy.

Requirement #3:

a. Suppose that customers express greater satisfaction with the accuracy of their charge account bills but the performance measures for the average age of receivables and for bad debts do not improve. Explain why this might happen.

- This evidence is inconsistent with two of the hypotheses underlying the balanced scorecard.
- The first of these hypotheses is “If customers express greater satisfaction with the accuracy of their charge account bills, then there will be improvement in the average age of accounts receivable.”
- The second of these hypotheses is “If customers express greater satisfaction with the accuracy of their charge account bills, then there will be improvement in bad debts.”
- There are a number of possible explanations. Two possibilities are that the company’s collection efforts are ineffective and that the company’s credit reviews are not working properly.
- In other words, the problem may not be incorrect charge account bills at all. The problem may be that the procedures for collecting overdue accounts are not working properly.
- Or, the problem may be that the procedures for reviewing credit card applications let through too many poor credit risks.
- If so, this would suggest that efforts should be shifted from reducing charge account billing errors to improving the internal business processes dealing with collections and credit screening. And in that case, the balanced scorecard should be modified.

- b. Suppose that the performance measures for the average age of accounts receivable, bad debts, and unsold inventory improve, but total profits do not. Explain why this might happen. Assume in your answer that the explanation lies within the company.**
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- This evidence is inconsistent with three hypotheses.
- The first of these is “If the average age of receivables declines, then profits will increase.”
- The second hypothesis is “If the written-off accounts receivables decrease as a percentage of sales, then profits will increase.”
- The third hypothesis is “If unsold inventory at the end of the season as a percentage of cost of sales declines, then profits will increase.”
- Again, there are a number of possible explanations for the lack of results consistent with the hypotheses. Managers may have decreased the average age of receivables by simply writing off old accounts earlier than was done previously. This would actually decrease reported profits in the short term. Bad debts as a percentage of sales could be decreased by drastically cutting back on extensions of credit to customers—perhaps even canceling some charge accounts. (There would be no bad debts at all if there were no credit sales.) This would have the effect of reducing bad debts, but might irritate otherwise loyal credit customers and reduce sales and profits.
- The reduction in unsold inventories at the end of the season as a percentage of cost of sales could have occurred for a number of reasons that are not necessarily good for profits. For example, managers may have been too cautious about ordering goods to restock low inventories—creating stock outs and lost sales. Or, managers may have cut prices drastically on excess inventories in order to eliminate them before the end of the season. This may have reduced the willingness of customers to pay the store’s normal prices. Or, managers may have gotten rid of excess inventories by selling them to discounters before the end of the season.