

IMPLEMENTATION OF BALANCED SCORECARD AND FINANCIAL PERFORMANCE OF SMEs

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ABSTRACT

The balanced scorecard (BSC) is widely propagated as one of the strategic policy instruments for achieving the desired level of performance. This study is aimed to examine the effect of BSC implementation on the financial performance of SMEs. For the said purpose, this study used four facets of BSC i.e., financial perspective, customer perspective, internal processes and learning growth perspective are used as independent variables. This study emphasized on resource-based view and balanced score card theory. Questionnaires containing closed ended questions were sent to chief financial officers and chief operating officers of SMEs located in Lahore district. Only three hundred and eighty (380) respondents returned duly filled questionnaires. Out of which 72 are from service sector and the remaining 308 were from industrial sector. The findings of the study revealed that implementation of balanced scorecard has significant positive impact on the financial performance of SMEs. All four facets of BSC are found positively related with the financial performance. The study is helpful for SMEs in getting better performance by implementing BSC. However, the successful implementation of BSC requires commitment and allocation of adequate resources. There is a need to explore the challenges and barriers confronted to SMEs in the successful implementation BSC.

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Keywords:

BSC, Customers Perspective, Financial Perspective, Internal Perspective, Learning & Growth Perspectives and Small Medium Enterprises Performance

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1. INTRODUCTION

For the industrial, economic, and social development of a nation small and medium enterprises (SMEs) are considered very important (Mujahid & Noman, 2018). SMEs are considered a major source for generating new jobs and increase in earnings levels. By increasing the job and income level this sector contributes to the living standard and economic development of the country. SMEs are very crucial for economic growth, advancement in technology, cottage industry development as well as economic and social rehabilitation of the economy of Pakistan (Manzoor et al., 2021). According to Zada et al. (2021) like other developed nations, the economy of Pakistan is also directly influenced by the SME sector of the country. Small and medium-sized enterprises were developed in Asian region economies in the 1990s and work as a booster to enhance the living standard of millions of people and reduce the poverty. In last a few decades SMEs play the role of a significant contributor

to the development and growth in Asia (Yoshino & Taghizadeh-Hesary, 2018). It is inferred that the SME sector is very important and necessary for the economic development, growth, and social prosperity of industrial nations around the globe. The SME sector in Pakistan is contributing 30 to 40 percent of the gross domestic product (GDP) of the country. For the recovery of the nation from present economic crises, SMEs are considered a vital part of economic resources (Amir et al., 2020).

Kaplan and Norton (1992) developed the balanced scorecard to measure the performance of an organization through accurate balanced performance indicators. To measure the long-term performance of enterprises, use of balanced scorecard is now very common (Kumar et al., 2022). Use of balanced scorecard improve the performance of internal system (Sainaghi et al., 2013). Organizational abilities just like (learning and growth) architecture, technology, internal process, and other resources are considered crucial elements for growth. Balanced scorecard must be used by organizations to track their financial data and intellectual assets to measure their weaknesses and success. This also helps to save time and resources for management to make decisions (Muhsyaf & Aoki, 2018).

A framework based on a balanced scorecard helps the organizations to measure the health of the organization at different levels, such as people, procedures, and resources (Rahayu et al., 2022). A balanced scorecard provides great benefits to its users. Balanced scorecard concept has been used by many organizations in Europe and United States. According to Balanced scorecard has been used by the 40% of all Fortune Global 500 United State companies and its usage has grown by 44% percent (Rigby, 2001).

The most popular management idea and concept is a balanced scorecard. This is the most popular and basic used concept by the managers of all companies around the globe (Tanaka, 2020). Now the major contribution to research about balanced scorecard is its implementation (Ferber-Pineyrua et al., 2021). Many present research studies concentrate to measure the usage of the balanced scorecard in organizations. SMEs are recognized for their contributions to the economic development of the world (Chong et al., 2019). SMEs are considered keystone for industrial development in developing and developed economies. Production and labor cost is less in small and medium enterprises, due to this lower cost SMEs can produce the products and services at low cost as compared to the big firms. Moreover, small, and medium enterprises owners work consistently which also increases the productivity of the labor (Cariola et al., 2020).

A balanced scorecard helps to create the balance between financial and non-financial resources to achieve better strategy implantations in SMEs. Balanced scorecards now have been used in service and industrial sector alike. Most of the earlier studies on balanced scorecard were focused on large scale manufacturing companies (Asiaei & Bontis, 2019). For the purpose of datamining the present level of knowledge about performance metrics and their application in small and medium-sized businesses (SMEs) in developing countries, a balanced scorecard-based method has been employed effectively.

This research is motivated by the lack of available empirical data on the post-implementation impacts of BSC on the performance of SMEs, especially those based in developing countries. The Balanced Scorecard (BSC) is a performance evaluation method that does not only assists small and medium-sized businesses (SMEs) in evaluating their performance but also guides them to establish strategy in a more efficient manner. There is not yet a significant need for small businesses to use BSC, and most of these businesses would rather focus on selecting certain non-financial metrics. An examination of the relevant published research reveals that a few studies concentrated on the use of BSC in SMEs. Despite the fact that BSC has garnered a lot of interest from companies, yet, SMEs do not make efficient use of their systems. Consequently, the purpose of the research is to assess the influence of putting BSC into practice on the financial performance of SMEs.

Rest of the paper is organized as follows. In section 2 hypotheses are stated and methodology employed to investigate the impact of implementation BSC on financial performance of SMEs is described in section 3. Results and their discussion are reported in section 4. Finally, conclusion and recommendation are described in section 5.

2. LITERATURE REVIEW

The literature review put light on how the balanced scorecard is useful for organizations to achieve their targets and improve their performance. Resource-based views (RBV) focus on how organizations internally work (Asad et al., 2021). RBV is used in the field of strategic planning and this represents the structure of the organization. According to Sameera (2018), RBV suggests the utilization of individualistic and fixed resources by businesses, and it is the competitive edge for the organization. This also acts as external

economics for organizations, as how organizations react towards external competitors and an internally competitive environment and goal achievement (Mackey & Barney, 2019).

Balanced Scorecard Theory (BSC) was developed by Kaplan and Norton in 1992. The achievement of non-financial goals leads to the development of BSC. A company cannot get the information it needs to thrive in the current environment by focusing solely on financial outcomes. According to the notion, both financial and non-financial measures should be used to evaluate a firm's performance. According to BSC theory, this provides benefits to the organizations to perform well over their competitors in the shape of profits that they earn. The theory also leads to the implementation of balanced scorecard which also includes both financial and non-financial aspects of performance that helps to improve the performance of an organization (Kaplan & Haenlein, 2010).

2.1. Hypotheses Development

Existing literature on the performance of management shows that various methods have been developed to measure the performance of firms. But balanced scorecard is most widely used by the management of firms irrespective of their size and sector. It provides information about the organizational strategy to the employees and provides feedback to the management about the achievement of the organizational goals. Therefore, now balanced scorecard is being used as a strategic tool for improving the performance of organizations (Bouamama et al., 2021). According to Striteska and Spickova (2012) balanced scorecard can help managers to make the cause-and-effect argumentation by linking both strategic planning and their outcomes. Following hypotheses are developed to investigate the impact of BSC implementation on financial performance of SMEs.

2.1.1 Financial perspective of balanced scorecard and SMEs performance

In different industries, financial perspective of BSC is used by managers to measure the financial performance of organizations. To quantify the efficiency and effectiveness of the organization performance metrics are used that help to reveal the success and failure (Kennerley & Neely, 2002). Many financial indicators like revenues, expenses and return on investment are contained in balanced scorecard (Malagueño, Lopez-Valeiras & Gomez-Conde, 2018). Companies must act based on financial and non-financial goals included in the balanced scorecard.

Financial performance data is based on factual corporate performance. Three basic projections of the balanced scorecard are related to the shareholder's value, profits, and organizational growth which are called the financial objectives and targets of organizations (Chege & Wang, 2020). In the above discussion in the literature review, the following hypothesis is developed.

H1: There is a positive relationship between financial measures implementation and SMEs performance improvement.

2.1.2 Customer perspective and SME performance

Customer perspective is an important element in how an organization perceived the customers and how the customers perceive the organization (Rehman et al., 2021). Customer satisfaction and willingness is the top priority for organizations in the current era of competition. This is also considered an important factor for the development and progress of the business (Zacca & Alhoqail, 2021).

Quality of the products, timely availability, the satisfaction of customers, and cost are the important four key factors that are considered by the customers of the business. Before acting, organizations must fulfill these goals first (Hernández-Linares et al., 2021). The degree of expansion and growth of the business is directly linked to the customers of the business. In this era of competition, there should be the primary goal of organizations to meet the demands, needs, and expectations of their customers. Businesses must give value to the customers, and this should be the prior focus of business (Dudic et al., 2020).

To retain customers, organizations must emphasize on the reliability, flexibility and cost of services and products (Laury et al., 2020). It will cause an increase in the number of customers, their satisfaction, and profitability of organization. According to Ferber-Pineyrua et al. (2021) organizations that are working on old functional basis are not providing better services and products to their customers as compared to those organizations adopting a balanced scorecard. The above literature helps to develop the following hypothesis.

H2: There is a positive relationship between customer measures implementation and SMEs performance improvement.

2.1.3 Internal business process and SME performance

Improvement in internal business processes also brings efficiency in operations that decreases cost and increases the output of organizations. Delivering of the desired product portfolio to the customers at specific places contribute much to the achievement of financial goals of organizations. The main aim of internal business control is to fulfill the customers' needs from a financial point of view (Wahyudin, Sari, Ardiansari et al., 2021). The balanced scorecard contains some performance indicators from the customer's perspective which cause increase in the financial performance of the organization (Gambelli et al., 2021). In consequence, a balanced scorecard fulfills the customer's perspective as well as also improves the internal processes through innovation which leads to meeting the long-term and short-term goals of the organization.

According to Lonbani et al. (2016) balanced scorecard is used for strategic management and to produce the information for external accountability disclosure. Recently, Abueid et al. (2022) reported positive relationship between the implementation of BSC and improvement in internal processes. The following hypothesis is developed based on above discussion.

H3: There is a positive relationship between internal business process measures implementation and SMEs performance improvement.

2.1.4 Learning and growth perspectives and SME performance

Organizational infrastructure facilitates the learning and growth perspective with the purpose to achieve long-term and short-term through improvements in three basic primary sources i.e. peoples, processes, and systems (Puthusserry et al., 2020). Learning and growth fulfills the aims of improving the IT system and skills of employees. It also reduces the gap between the employees, process, and system that are recognized by the balanced scorecard as important perspectives (Malagueño et al., 2018). The learning and growth approach emphasizes at people, process, and system for continuous improvements in organization. This is achieved with the goal of growth and improvement, which is taken from a learning and growth perspective (Khan, 2022). A learning and growth plan aims for improving the skills of employees, introducing new technologies, and improving organizational processes which also helps to transform the goals and objectives of the organization into concrete action plans (Aftab, Veneziani, Sarwar, & Ishaq, 2022). This concept highlights the procedures and competencies that work as fuel to enhance organizational performance in SMEs and big businesses. This approach also focuses on the skills, practices, and systems of the organization's capabilities of employees to achieve success using an internal process that meets the demands of clients at the final stage (Mikula, Vajdová, Koscak & Jenčová, 2020). Considering the above literature, following hypothesis is developed.

H4: There is a positive relationship between learning and growth measures implementation and SMEs performance improvement.

2.1.5 Balanced scorecard implementations and SMEs performance

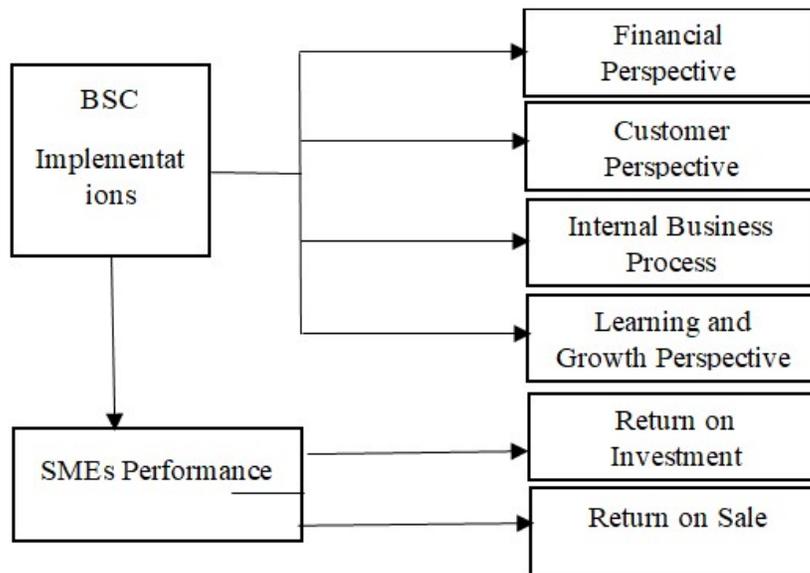
It is argued in the literature that a balanced scorecard may help SMEs to achieve their goals of improving their ongoing activities and implementation of their policies in ongoing routine activities daily basis. Employees are also helped with the usage of a balanced scorecard to achieve their tasks and plans. Organizational management also put focus on BSC usage in organizations to achieve their long-term goals as compared to short-terms. BSC is considered an important tool for SMEs to develop their long-term strategies.

Lass and Gronau (2020) reported that implementation of BSC in SMEs improves their capacity and organizations able to promptly respond to the changes in market demands.

According to Kaplan and Norton (1992) available current performance metrics, to measure internal financial information are outdated and unresponsive to organizational actions. BSC should be developed as a tool for evaluating and singling out the risk that is linked with corporate strategy (Lass & Gronau, 2020). The most popular management idea and concept is a balanced scorecard. This is the most popular and the basic concept used by the managers of all companies around the globe (Tanaka, 2020). Recently, Sharaf-Addin and Fazel (2021) established that the alignment of processes with strategic goals might be helpful for the organizations to run more efficiently. BSC provides information about the organizational strategy to the employees and provides feedback to the management about the achievement of the organizational goals (Bouamama et al., 2021). Literature review guides about the hypothesis's developments such as,

H5: There is a relationship between BSC implementation and SMEs performance

Theoretical Framework



3. METHODOLOGY

For examining the relationship between the implementation of balanced scorecard in SMEs and their financial performance, this study focused on SMEs operating in district Lahore, Pakistan because most of SMEs have their head offices or regional offices in Lahore city. Further, only those SMEs were included in the sample which are mature firms and are using balanced scorecard as a strategic instrument for their performance measurement. The overall, market that deals with SMEs comprised of both production and services. (Burhan et al., 2020). The instruments used in this study for data collection were adopted from previous well-recognized studies (for instance DeBusk & Crabtree, 2006; Kaplan & Norton, 2001; Ducker, 2009).

Variable and its Items	Source
Financial perspective of BSC	Kaplan and Norton (2001)
Customer perspective of BSC	Kaplan and Norton (2001)
Learning and growth of BSC	DeBusk and Crabtree, (2006)
Internal business process of BSC	Kaplan and Norton (2001)
Financial performance of SMEs	Ducker (2009)

For data collection, questionnaire was shared with 500 respondents (chief operating officers & chief financial officers) through Google form link. 394 respondents submitted the duly filled questionnaires, out of which 14 were found incomplete and were discarded. Finally, 380 responses were considered for analysis, out of which 72 were from service sector SMEs and the remaining 308 were from industrial sector SMEs. The sample size formula of Solvins (1960) was used to calculate the sample size of this study. This study is quantitative in nature and aimed to examine the relationship between the implementation of BSC and financial performance of SMEs. For the said purpose correlation and regression analysis are performed through SPSS and Smart PLS.

4. DATA ANALYSIS AND RESULTS

4.1 Demographic Analysis

Demographic analysis of the study shows two types of SMEs. First are industrial SMEs which are 308 firms (81.1%), second is service SMEs which are 72 firms (18.9%). Another categorical variable is the number of rivals, according to the respondents from SMEs they have the knowledge level about their rivals as (37 firms; 9.7%) rivals fall in the 1-100 category, (97 firms; 25.5%) rivals fall in 101-200 category, (82 firms; 21.5%) rivals falls in 201-300 category, more rivals (165 firms; 43.3%) rivals fall in 301 or more categories.

4.2 Descriptive Statistics

Table 1 Descriptive Statistics

Variables	Mean	Std. Deviation
Financial Perspective	2.808399	4.108724
Customer Perspective	3.608924	2.615613
Internal Perspective	2.661417	2.448863
Learning and Growth Perspective	2.968504	2.437302
SMEs Financial Performance	2.818110	3.241444

The last categorical variable is the division of the SMEs according to their net profit, (47 firms; 12.3%) SMEs fall in below PKR, 1,000,000 profits, (102 firms; 26.8%) SMEs fall between PKR, 1,000,001 – 5,000,000 profits, (60 firms; 17.3%) SMEs falls between 5,000,001 – 10,000,000 range of profits, (90 firms; 23.6%) SMEs falls between 10,000,001 – 15,000,000 range of profits and at last (76 firms; 19.9%) SMEs falls above 15,000,000 profit range. Most of the 102 SMEs earn normal range profits as 1,000,001 – 5,000,000 PKR profits annually. Descriptive statistics are used to measure the means and standardization of the variables. Both the mean values and the "SD values" in this table demonstrate the data's normality. The agreement area must contain all of the response averages since the mean of all variables is greater than 3, which can be inferred.

Table 2 indicated that the values of composite reliability and Cronbach's Alpha are higher than the acceptable limit i.e., 0.70. The AVEs obtained for all constructs ranged from 0.529 to 0.571 suggesting high construct reliability and convergence of measurement models

4.3 Reliability Analysis

Table 2 Reliability Analysis

	Cronbach's Alpha	Composite Reliability	Average Variance Extracted (AVE)
Customer Perspective	0.813	0.867	0.529
Financial Perspective	0.772	0.84	0.571
Internal Business Process	0.788	0.782	0.541
Learning and Growth Perspective	0.822	0.867	0.529
SME's Performance	0.914	0.921	0.545

4.3 Correlational Analysis

The link between the variables was examined in this section. This proved that the factors had a strong relationship. Correlation also looked at the kind and strength of the connection. Statistics on the correlation between variables are shown in Table 3.

Table 3 Pearson Correlational Analysis

Variable	Financial Perspective	Customer Perspective	Internal Perspective	Learning and Growth Perspective	SMEs' Financial Performance
Financial Perspective	1				
Customer Perspective	0.437**				
Internal Perspective	0.389**	0.661**			
Learning and Growth Perspective	0.271**	0.568**	0.496**		
SMEs' Financial Performance	0.102*	0.327**	0.235**	0.570**	1

***Correlation is significant at the 0.01 level (2-tailed)*

**Correlation is significant at the 0.05 level (2-tailed)*

The results of correlation analysis reveal significant connections between BSC four facets and SMEs financial performance at a significance level of 0.05. In this specific inquiry, a correlation analysis was done to see how closely related the research constructs to one another. The Table 3 presents the results of correlation analysis. According to the findings, customer perspective and financial perspective have a positive correlation of 0.437**. Financial perspective and customer perspective have a positive correlation of 0.389** and 0.661** respectively with internal perspective. Financial perspective, customer perspective, and internal perspective all have positive correlations with learning and growth perspectives 0.271**, 0.568** and 0.496** respectively. Further, coefficient of correlation between the independent variables is less than 0.80, so there are less chances of severe multi-collinearity.

The financial performance of SMEs is also positively correlated with the financial perspective at 0.102*, the customer perspective at 0.327**, the internal perspective at 0.235**, and the learning and growth perspective at 0.570**.

4.4 Collinearity Analysis

Table 4 Collinearity Statistics

Independent Variable	Tolerance	VIF
Financial Perspective	0.682194	1.465858
Customer Perspective	0.485283	2.060655
Internal Perspective	0.538210	1.858012
Learning and Growth Perspective	0.489449	2.043112
Acceptable Range	>0, <1	<10

Bagya-Lakshmi et al. (2018) defines multi-collinearity as the phenomenon that occurs when two or more variables arrive at the same value for their correlation coefficient. It is possible to evaluate it by examining the significance of the relationship that exists between the variables. The three approaches used to assess the multi-collinearity of the variables are the variation of inflation factor (VIF), the value of tolerance (VIT), and correlation analysis. When the VIT value is more than 1 and the VIF value is greater than 10, a multicollinearity issue might be present. Results of collinearity analysis reported in Table 4 show that VIF values for all independent variables are less than 10 and VIT values are also lying in acceptable range i.e. more than 0.00 but less than 1. Thus, results revealed that the level of multicollinearity is not severe and does not likely to affect the regression coefficients of BSC perspectives.

4.4 Regression Analysis

Table 5 and figure 1 shows the regression coefficient of financial perspective (FP) is ($\beta=0.383$, $\rho=0.000$), which shows that financial perspective of balance scorecard has positive impact on SMEs financial performance of SMEs at significance level of 0.001. So H1 is accepted. The findings are consistent with the findings of an earlier study conducted by Lonbani et al. (2016). The measures and objectives of the other three BSC perspectives are mostly found having strong connection with financial objectives such as growth, profitability, and shareholder value (Chege & Wang, 2020).

Table 5 Regression Analysis

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	P Values
Customer Perspective ->				
SME's Financial Performance	0.409	0.421	0.022	0.000
Financial Perspective ->				
SME's Financial Performance	0.383	0.373	0.02	0.000
Internal Business Process ->				
SME's Financial Performance	0.388	0.393	0.025	0.000
Learning and Growth Perspective -> SME's				
Financial Performance	0.075	0.07	0.029	0.026

Dependent variable is SMEs financial performance.

The coefficient of customer perspective (CP) is ($\beta=.409$, $\rho=0.000$) which shows that customers perspective of balance scorecard has positive impact on financial performance of SMEs at significance level 0.001. Thus, H2 is accepted at significance level 0.001. It implies that firms performing better in customers' perspective have more satisfied customers which consequently generate more sales and more return on investment. Similar

findings were reported by some prior studies (For example, Malagueo et al., 2018; Musyoka et al., 2022). These studies emphasize that the customers' perspective of the balanced scorecard has a substantial and favorable influence on SMEs' financial performance. For many businesses, especially in today's environment of heightened rivalry, the satisfaction of their customers comes first. It might also be used as a very important key performance indicator for the company's successful operations (Zacca & Alhoqail, 2021). Customers usually emphasize on timely delivery, quality of performance and cost of products and services. Therefore, the firms must link their performance related goals to these perspectives of customers.

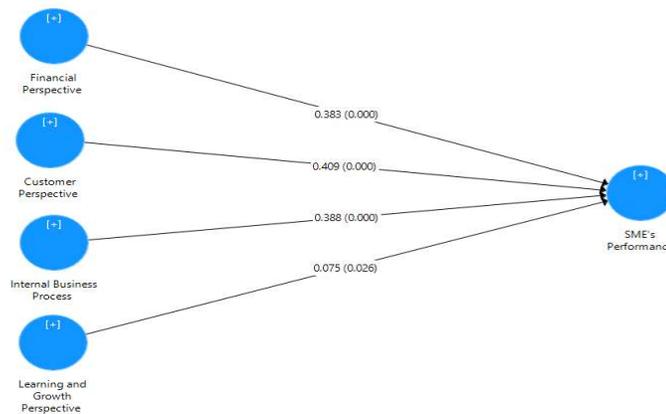


Figure 1: Structural Equation Modeling

Third, facet of BSC, internal process perspective (IPP) has regression coefficient 0.388 at 0.01 significance level. Results support hypothesis H3. It indicates that internal process perspective of balanced scorecard has a positive effect on the financial performance of SMEs at significance level 0.001. Some earlier studies for example, Mikula et al. (2020) and Musyoka et al. (2022), also reported similar results. Since earlier studies have established a significant and positive impact of improvements in internal processes on SMEs' financial performance. by re-engineering the internal processes.

Thus, SMEs can reduce the processing time and wastage of their resources by re-engineering their internal operations. It causes increases in the operational efficiency of firms and resultantly cost of product and services is reduced. Thus, for enhancing the financial performance, SMEs need to establish their strategic goals relating to improvements in their internal processes. Lonbani et al., (2016) also stresses on the improvement in internal business procedures for enhancing the financial performance. To deliver value to clients and to provide better financial returns to owners, SMEs must allocate sufficient resources for enhancing the performance and efficiency of internal processes. A recent study, Dudic et al. (2020) highlighted some KPIs for this perspective which include cycle time, defect rates, and manufacturing efficiency.

Fourth facet of BSC i.e., learning and growth Perspective (LGP) has coefficient 0.075, which shows the positive impact of learning and growth perspective on the financial performance of SMEs at 0.05 significance level. Thus, findings confirm H4 hypothesis. The results are consistent with prior studies. For instance, Malagueo et al. (2018), and Mikula et al. (2020) have noted that internal balance scorecard systems have significant impact on SMEs' financial performance. The learning and growth perspective acknowledges importance of improvements in IT systems, streamlining of organizational processes, and upskilling the people and finally transforming these objectives into specific plans and objectives. It is closely tied to SMEs' financial performance and will help in closing the gaps between the available resources and planned resources. (Malagueo et al., 2018).

5. CONCLUSIONS

The study is conducted to check the impact of implementation of BSC on the financial performance of SMEs. Data was gathered through an online self-administrative questionnaire that was adopted from previous studies on BSC. For the sample of study, SMEs working in manufacturing and service sector and located in the Lahore region are considered. Results of the study show that there is a significant positive effect of BSC

implementation on SMEs' financial performance. The findings of the study are in line with the findings of some previous studies such as Lonbani et al., (2016); Malagueo et al. (2018); Musyoka et al. (2022), and Dudic et al. (2020). Moreover, findings of the study suggest that the implementation BSC is helpful in improving the performance at various levels. It also results in improvement of communication and a better understanding of the organization's goals and plans.

The findings of this study are useful for both academics and policy makers. Findings of the study suggest that administration of SMEs should provide adequate resources for effective implementation of BSC in SMEs. The findings may be helpful in furthering the awareness of SME managers on the feasibility of implementing the BSC as a strategic instrument of performance measurement in their organizations.

The sample size used in this study is relatively small and restricts the generalizability of its findings. The use of structured questionnaire and its online administration has a variety of disadvantages, including a low response rate, a lack of seriousness and dedication to the study, and a lack of specificity. Conversations in focus groups and interviews of individuals can be used to help lessen the consequences of these limitations. The number of participants can be increased because a greater sample size will increase the level of confidence in the findings.

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