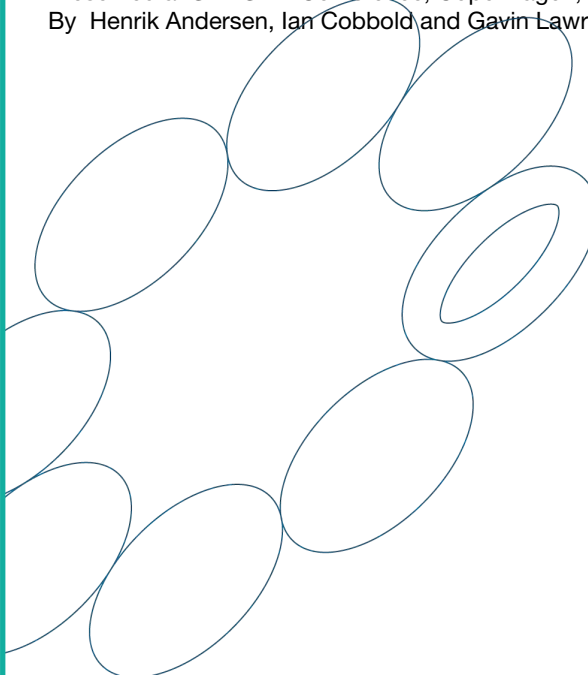


Balanced Scorecard implementation in SMEs: reflection in literature and practice

2GC Conference Paper

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Abstract

Recent research has indicated that the degree of strategic planning in organisations is likely to have a direct impact on business performance and business evaluation. However, these findings leave small and medium-sized businesses (SMEs) in particular, with the challenge of matching the requirement for an improved strategic planning processes with the competitive advantage associated with being a “simple” and highly responsive organisation.

In response to that challenge this paper discusses the potential benefits to SMEs in adopting the Balanced Scorecard methodology and the underlying management processes most relevant to SMEs. It also makes observations about how use and value may differ between Balanced Scorecard application in large and smaller enterprises.

Introduction

Recent research has shown that clear links between an organisation’s approach to strategic planning and its business performance exist in small as well as in large organisations (Lyles et. al 1993; Jennings & Beaver 1997; Juul Andersen 2000; Ernst & Young 2000).

“The root cause of either small business failure or poor performance is almost invariably a lack of management attention to strategic issues”

*Peter Jennings, The Business School, Loughborough University, UK and
Graham Beaver, Nottingham Business School Nottingham Trent University England*

Improved strategic management processes may also facilitate the development of the more complex management structures that are needed as small firms grow (Miller 1959, Atkins & Lowe 1997).

A popular tool used to support strategic management activity in large firms is the Balanced Scorecard. To date, reported activity to deploy management systems that are based around use of Balanced Scorecards has focused on large, multi-national, multi-divisional firms (e.g. Mobil, Cigna, AT&T, Motorola).

This paper discusses from a practitioner point of view the potential merits and feasibility of deploying Balanced Scorecard in SMEs as well as the way in which use and value may differ between its application in large and smaller enterprises.

Neither comprehensive literature nor empirical research exist on the topic of Balanced Scorecard in SMEs. Therefore, the arguments presented in this paper are based on a combination of general literature research on Balanced Scorecard, SMEs, strategic management and corporate planning combined with the authors’ broad practical experience of facilitating Balanced Scorecard design and implementation projects in large and some smaller organisations including using it in our own small company.

The Balanced Scorecard in Large Enterprises

The Harvard Business Review, in its 75th Anniversary issue, cites the Balanced Scorecard as being one of the 15 most important management concepts to have been introduced via articles in the magazine. Since its introduction in 1992, the Balanced Scorecard has featured in a wealth of academic and practitioner papers, and has been the subject of several best selling books. But writing on the Balanced Scorecard focuses on its application in large

organisations, drawing on case examples like e.g. Mobil and CIGNA (Kaplan & Norton 1996, 2000), ABB, Skandia, SKF and Halifax (Olve et al 1999) – all multi billion dollar companies.

One explanation for this predominantly large company focus may be found in the challenges of communication, coordination, and control in large organisations. The task specialisation and levels of organisational hierarchy that is required to support the scale of the organisation make all forms of change more difficult in large organisations (Miller 1959, Sprott 1973; Simon 1976; Atkins & Lowe 1997).

Application of the Balanced Scorecard in SMEs

In our view, the fact that no comprehensive literature on Balanced Scorecard used by SMEs exists today should not be taken as an indication that Balanced Scorecard implementation is only appropriate for large organisations. Core to this view is our experience of benefiting from having implemented the Balanced Scorecard in our own organisation and the proposition that many basic strategic management issues are relevant in both small and large organisations. Examples of these include:

- The need for a clear sense of direction: where is the organisation headed?
- Managers must have a profound understanding of the business model: is the organisation doing all the things it needs to be doing?
- An ability to focus and prioritise: how to strike the balance between long-term development and short-term operational pressures?
- Agility: flexibility driven by learning: how to incorporate new knowledge in the strategic and operational planning processes?

Common to each of these issues is the need for the identification, pursuit and achievement of strategic goals. Recently it has become common for these to collectively drive towards fulfilling stakeholder expectations in general, and for publicly quoted firms in particular to deliver Shareholder Value.

“Pick up most well respected finance texts and you will find the maximisation of returns to shareholders being quoted as being the key business objective”

R. Mills, Professor of Accounting and Finance, Henley Management College

Using the Balanced Scorecard as part of a “Strategic Management Framework”

The Balanced Scorecard was originally proposed as an approach to performance measurement that combined traditional financial measures with non-financial measures to provide managers with richer and more relevant information about organisational performance, particularly with regard to key strategic goals (Kaplan & Norton 1992). By encouraging managers to focus on a limited number of measures drawn from four ‘perspective’, the original Balanced Scorecard aimed to encourage clarity and utility.

Over time Balanced Scorecard has developed to form the centre-piece of a strategic communication and performance measurement framework that helps management teams articulate, communicate and monitor the implementation of strategy using a system inter-linked with the long-term destination of the organisation.

More recent insights suggest that a successful Balanced Scorecard implementation will require adjustments to be made to other management processes used by the enterprise. Only in so doing will the Balanced Scorecard be able to become a central part of a “strategic management

framework” (Kaplan & Norton 1996a; Epstein and Manzoni 1997)

“To be successful the Balanced Scorecard must be viewed as the tip of the improvement iceberg.”

A.M. Schneiderman, Consultant on process management

It is, in our experience, this evolution of Balanced Scorecard methodology that has increased its relevancy for small companies. The reason being that in SMEs a greater proportion of the value of Balanced Scorecard comes from its use to formalise the description of strategic destination and associated strategic objectives and priorities in a way that builds consensus; and the impetus it gives to the development and application of more effective strategic and general management processes – both areas that are normally only weakly addressed in SMEs (Jennings and Beaver 1997).

Characteristics of Small and Medium Sized Enterprises

Much work has been done to identify ways in which management practice in small and medium-sized enterprises (SMEs) differ from larger ones. Two linked areas of comparison have been differences in organisational structure, and differences in management processes. SMEs (particularly small ones) have been characterised as being typically “simple structures” or “simple systems” in which the leader (often the entrepreneur or owner-manager) directs the work of a small number of operators with the help of few or no other managers. At around 100 staff, this type of approach begins to become inefficient, and by the time the enterprise has about 500 employees some sort of hierarchical structure has been introduced – most commonly introducing a layer of managers each tasked with management of a functional area of activity. As the organisation grows, further structure changes occur driven by the increasing problems of communication and co-ordination. It has been observed that the points of transition between organisational forms present or represent particularly risky periods for the enterprise, during which enterprise failure is not uncommon (Mintzberg 1981). Coordination in small organisations mainly happens through direct instruction and supervision, minimising the need for formal management (i.e. planning and control) processes. Many see this as a key strength of the smaller enterprise, since by avoiding extensive standardisation and coordination, and the associated need for support staff and line-management; small firms maintain their flexibility, responsiveness and low cost structure (Miller 1959, Mintzberg 1981).

Designing a Balanced Scorecard based Strategic Management System in an SME

Balanced Scorecard design in an SME will include similar process steps to those required in large organisations. The key difference is the duration of the process - it is quicker in small organisations as there are fewer people and generally less complex organisational structures¹. We certainly experienced this when designing our own Scorecard applying an approach similar to what we have used to facilitate design projects in many large organisations.

We see Balanced Scorecard design as the initial effort to produce the physical documentation: Destination statement, strategic objectives, measures and strategic initiatives² normally

¹ With efficient internal or external process facilitation, a small organisation can usually complete the initial design over a period of 4 – 6 weeks, compared with 12 – 14 weeks in large organisations. Most of the work is then completed “live” during two one-day workshops. Additional design activities by each participant normally do not require more than ½ to 1-½ workdays. (2GC Active Management 2000)

² These elements are described below

forming the basis for subsequent implementation and use of the Balanced Scorecard methodology. The design process can therefore be said to form a structured or formalised approach to strategic planning – the importance of which to SMEs was considered earlier.

Best practice in large organisations suggests that Balanced Scorecard design activity should be a collective effort drawing upon the combined operational and strategic insights of key employees involved with running the business. Failure to use a collective approach may weaken the value of the strategy itself (Simon 1957, Mintzberg 1990) and its implementation due to lack of support from those accountable for executing it (Thomson's "dominant coalition": Thomson 1967).

Small organisations in particular were characterised earlier as being likely to have limited planning and control systems (Mintzberg 1981; Atkins & Lowe 1997). Even so, there is always potential to add value by including more staff in the decision making process, as Mintzberg and Simons note. As an enterprise grows into a medium sized enterprise, the complexity of the internal operational environment increases (Miller 1959; Atkins & Lowe 1997). As a consequence, achieving "insight into value creation" (Campbell & Alexander 1997) becomes more complicated – one person can no longer fully capture the activities of the enterprise and determine better strategies for success.

"Most of the insights important for strategy formulation reside in the heads of the operating managers.... excluding them from strategy development means excluding their insights as well."

*Marcus Alexander & Andrew Campbell – Directors
Ashridge Strategic Management Centre*

In both small and medium firms, the wider sense of ownership of a strategy by the organisation is understood to be as important as effective strategy formation. Whether an organisation is large or small, success ultimately depends on persuading employees to align their behaviours with the enterprise's strategic goals.

"One may say that on the whole people do not like being ordered about.... it is not so much being led that people resent, as being controlled by some external power whose intentions are not coincident with theirs"

W J H Sprott, Social Psychologist

Describing Strategic Destination

In order to make rational decisions about organisational activity and not least set targets for those activities, an enterprise should develop a clear idea about what the organisation is trying to achieve (Senge 1990, Kotter 1996). Accordingly, the most effective Balanced Scorecard design processes use the creation of a strategic destination statement describing, ideally in some detail, what the organisation is likely to look like at an agreed future date (Olive et al. 1999; Shulver et al. 2000). In many cases this exercise builds on existing plans and documents – but it is rare in practice to find a pre-existing document that fully serves this purpose within an enterprise.

Strategic objectives

Once the strategic destination has been established the next step is for the same group to agree on the most important strategic activities and outcomes (strategic objectives) required for the destination to be achieved. Best practice calls for this process step to focus on the actions directly within the scope of the team building the Balanced Scorecard – increasing the likelihood that the objectives agreed will (or can) be pursued once the design process is complete. By representing the selected objectives on a "strategic linkage model" (see Figure 1), the design team is encouraged to apply "systems thinking" (Senge 1990; Senge et al. 1999) to identify cause-and-effect relationships between the selected objectives – this is a useful test to

ensure the objectives chosen are mutually supportive.

The importance of clearly articulated objectives is highlighted by Lingle & Schiemann (1996), who warns against what they call “fuzzy objectives” as a frequent cause for lack of implementation and expected results.

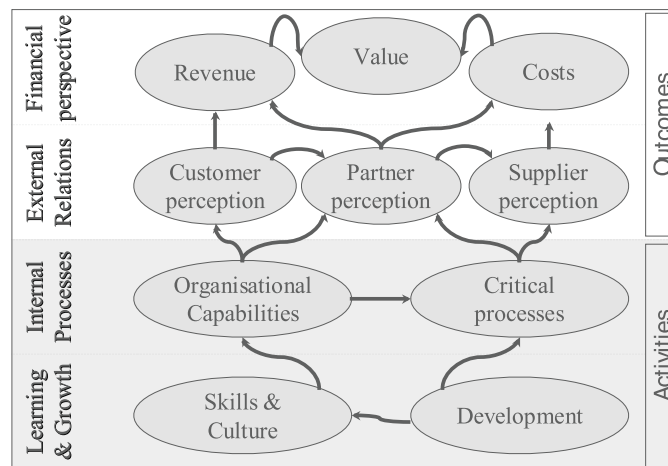


Figure 1: Simplified example of strategic linkage model

Perspectives

In Figure 1 the chosen strategic objectives are spread across four zones or ‘perspectives’. This is a typical feature of Balanced Scorecard designs.

The lower two perspectives contain objectives relating to the most important activities in terms of business processes, cycle time, productivity etc. (Internal Processes) and what needs to happen for these processes to be sustained and further developed in terms of people, product and process development (Learning & Growth).

The two top perspectives house objectives relating to the desired outcomes of the activities undertaken i.e. how we wish customers, partners and other external relations to perceive us (External Relations) and how this will ultimately translate into financial results and economic value (Financial).

Linking objectives together in this way helps with the articulation of ‘causality’ between objectives – a key element of linking strategy to relevant performance measures according to Robert Simons (1995) and also Epstein & Manzoni (1997).

Developing a ‘strategic linkage model’ as described above can thus help an SME to:

- test the validity of a business model by developing a thorough understanding of the model and its strategic/operational requirements
- identify the most important strategic objectives in the form of a coherent strategy spanning the whole spectre of the business and that way create the necessary focus for things to get done

Measures

Balanced Scorecard designs in large enterprises normally include an elaborate process for identifying and describing measures selected to inform management about the organisation’s progress towards achievement of its goals (Olve et al. 1999). In SMEs (particularly small enterprises) the utility of formal measure definition is lower. The limited size and complexity of the organisation means that managers are often well aware (at least collectively) of all performance related issues due to the limited size and complexity of the organisation (Miller

1959; Mintzberg 1981). But identification of measures, at least to the extent where targets can be set and followed up, does help to test the validity of the assumptions about cause and effect on which the design team has based its strategy. Without a deliberate approach to testing assumptions aimed at informing the choice of corrective action, the idea of planning risk losing part of its value – an aspect further highlighted below. Because of this, some SMEs, though not all, will find measure definition activities of value.

Deployment

It is a truism, but a Balanced Scorecard needs to be used to realise its full value. Balanced Scorecards fail when, having developed strategic goals and identified relevant performance measures an enterprise doesn't use the information provided to drive changes in the way the organisation works (Schneiderman 1999).

For example, if an organisation is strongly budget orientated in its planning approach, the budgeting cycle will have to change and take its starting point at the Balanced Scorecard. If not, the long-term strategic requirements highlighted during the Scorecard design process are not likely to be integrated in the short-term financial planning of the budget. As noted by Jennings & Graham (1997), the balancing of long-term development with short-term requirements for survival is a particularly important issue for small companies and start-ups – failing to get the budget process aligned with the strategic goals of the enterprise can make achieving this balance harder.

Often, implementing changes to management processes requires a management team or manager to “take a leap of faith” in support of their new management system (Schneiderman 1999) and will then require long-term top management commitment to sustain the changes. Herbert Simon, Robert Schrank and Rosabeth Moss Kanter suggests that, breaking these old habits and instilling new behaviours should start with managers changing their own ways.

“If we are to change our institutional arrangements from hierarchy to participation, particularly in our work places, we will need to look to transformation of ourselves as well”

Robert Schrank, Sociologist

Instilling a sense of direction combined with focus and prioritisation

The use of the Balanced Scorecard as the centrepiece of a strategic management system, as described in this paper, naturally promotes goal and task delegation. By jointly constructing and communicating a well-articulated and logical plan, supported by an efficient approach for monitoring its implementation, management and the rest of the organisation is encouraged to focus on critical strategic outcomes in preference to narrow functional or tactical factors. By enabling component parts of an SME organisation to coordinate activities with reference to a clearly articulated corporate strategy, as described above, senior managers can reduce the time spent on detailed operational management control, freeing up management resources that can more valuably be applied to coordinate further developments of the organisation. Introducing a strategic management system based on the Balanced Scorecard may therefore defer the need for the organisation to move to more complex organisational structures (Miller 1959) with potential positive consequences for cost base as well as potentially retaining more innovative flexibility (Mintzberg 1981).

Finally, where an organisation has a clearly defined strategic destination and an equally well-defined strategy for getting there, the risk of ‘scope creep’ is reduced. It is well documented that organisations underestimate the risks of following novel opportunities for potential growth in new and related business areas. For the innovative entrepreneurial organisation in

particular taking them on may seem like an easy way to achieve added growth – “We just work a bit harder”. But pursuing new opportunities carries both additional business risk, and the risk of neglecting established long-term goals (Bhide 1996, Jennings and Beaver 1997). A number of times, we have benefited from using our destination statement and strategic objectives as basis for evaluating the added value and strategic fit of new opportunities.

Understanding the business model

Although the discussion so far has focused on introducing Balanced Scorecard thinking to an established SME, this is not a pre-requisite. Adopting the Balanced Scorecard approach during the planning stages of a business venture has its distinct advantages in terms of its ability to help a management team clearly articulate the goals of the venture, and the activities that will realise the goals. It also will highlight areas with the greatest need for change, and may prove useful in securing the necessary external backing for the business.

Just as the Balanced Scorecard design process helps demonstrate and prove/disprove a business model to the entrepreneur and/or management team themselves, so the ability to communicate a well articulated and logically constructed plan supported by an efficient approach for monitoring its implementation will help any organisation trying to gain or sustain the support of external stakeholders (Bhide 1996) – another area where we feel our Balanced Scorecard has been useful. The importance of demonstrating a sound approach to management, not only while seeking initial funding but also for later investor evaluation of the organisation is emphasised by recent research showing that 35% of investor decisions are influenced by non-financial issues with strategy and quality of corporate strategy being the most important (Ernst & Young 2000).

“The actual root cause of failure [of SMEs] may be seen to lie with the apparently non-rational behaviour and decision-making of the entrepreneur and/or owner-manager who does not obey the ‘rules’ of classical management theory”

*Peter Jennings, The Business School, Loughborough University, UK and
Graham Beaver, Nottingham Business School Nottingham Trent University England*

Increasing flexibility and learning

The concept of using the Balanced Scorecard as a central part of a strategic management system (Kaplan & Norton 1996a, 2000) is based on a “double-loop learning cycle” (Argyris, 1977; 1991), which calls for regular appraisal of strategic performance by asking three questions:

- Have we done what we set out to do?
- Have we achieved the results we thought we would?
- What do we need to do differently in future?

The answers to these questions and information about changes in the external environment form the basis for wider analysis and discussion leading to decisions about continuing validity of the strategic choices originally described in the Balanced Scorecard. The information provided by the Balanced Scorecard can therefore drive changes in both the objectives and measures used to track them. Such changes are likely to reflect a combination of changing market and organisational conditions as well as increased learning about cause and effect assumptions. Mintzberg 1990 and Simons 1995 each suggest that enterprises that include this type of “interactive component” (which can allow for ongoing adaptation of plans to include “emergent strategies”) in their planning and review processes, are more flexible and adaptable in their responses to external changes than those that do not.

How formal the Balanced Scorecard review process will need to be will vary greatly depending on enterprise complexity and culture. Similarly the effort applied to the collection of Balanced

Scorecard measures varies widely. Setting up formal processes to collect measure data may be seen by small organisations as an unjustifiable administrative burden. But experience from our own company shows that highly informal measurement collection processes work well in small organisations: The greater transparency in these companies tends to make formal and potentially time-consuming information collection exercises redundant. Instead, the output of the design process serves mainly to provide a framework for organising a verbal or even mental thought process “of asking questions and listening to answers...and [resolving questions on] the relevance of basic assumptions about its objectives, strategy, and operations, and their interactions.” (Hatten & Rosenthal 1999) – an often-neglected process in small companies according to e.g. Jennings & Beaver (1997).

Conclusion

Despite the lack of comprehensive literature focused on Balanced Scorecard implementation in SMEs we believe Balanced Scorecard and its associated management processes can prove equally beneficial to SMEs as to large organisations.

However, the potential benefits are likely to differ between the two. In large / complex organisations much of the utility of Balanced Scorecard comes from the communications elements: the two-way provision of concise and relevant summary information about ‘what is going on’ in the organisation. In smaller firms such as our own, a greater proportion of the value of Balanced Scorecard comes from two other elements: the description of strategic destination and associated strategic objectives and priorities in a way that builds consensus; and impetus given to the development and application of more effective strategic management processes.

However, the Balanced Scorecard used at the centre of a strategic management system addresses effectively a number of the fundamental issues relevant to large as well as small businesses:

- **A clear sense of direction**
The Balanced Scorecard framework is an efficient tool for clearly articulating long-term strategic goals in the form of a destination statement that can be translated into short-term activities
- **A profound understanding of the business model**
Identifying strategic objectives within the four business perspectives of the Scorecard and linking them in an expression of cause-and-effect relationships forces managers to apply “systems thinking” and develop a holistic strategy covering all aspects of their business – an equally important exercise for mature organisations as well for start-ups.
- **An ability to focus and prioritise**
Focusing on a clearly defined destination for the future and a clear strategy for how to realise it will help any company reduce the risk of losing sight of what they are trying to achieve
- **Organisational agility**
Using the Balanced Scorecard to regularly check whether the organisation is doing what it set out to do and is achieving the results it expected, creates learning about the validity of the cause-and-effect relationships. It also forms a useful foundation for deciding what needs to get done in the future based on the above learning and any changes in the external environment

In SMEs these Balanced Scorecard benefits can be achieved without the need for developing a complicated and administratively demanding measurement regime by simply using the

Balanced Scorecard and its measures as a mental or verbal frame of reference for addressing general strategic and operational change issues resulting from the pursuit of long-term goals. These are real benefits experienced in our own company.

But successful Balanced Scorecard implementation in any organisation requires sustained management commitment to using it making sure it drives the necessary behavioural changes within the organisation, starting with the managers themselves.

Observing these success criteria, Balanced Scorecard can prove an effective tool for SMEs in meeting the challenge posed by the need to introduce more efficient strategic planning processes while retaining the competitive advantage of having relatively simple structures.

Finally, it should be noted that although this paper has highlighted the existence of important potential and real benefits to SMEs from applying the Balanced Scorecard as a strategic management tool, there is an obvious need for further substantiating these conclusions through empirical research.

About 2GC

2GC is a research led consultancy expert in addressing the strategic control and performance management issues faced by organisations in today's era of rapid change and intense competition. Central to much of 2GC's work is the application of the widely acknowledged 3rd Generation Balanced Scorecard approach to strategic implementation, strategy management and performance measurement.

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