APRA’s investigation into the Commonwealth Bank’s culture is starting to look at how it compensates employees, and whether that incentivises bad behaviour. In fact, my research has shown that cash bonuses are at least partly responsible for the scandals plaguing the financial services industry.

But there isn’t good evidence either to support the banks’ alternative – balanced scorecards . This is a system organisations use to set and track their goals. Companies first set out a series of strategies to achieve their objectives, then create criteria (linked to individual team members) to track progress and give feedback.

If anything, research suggests that balanced scorecards don’t work. Many of the criteria are subjective and therefore can be gamed. And the few objective metrics that are included in the scorecard often face the same issues as cash bonuses – incentivising employees to increase short-term profits.

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Financial institutions previously gave employees incentives by linking their bonuses to profits and sales. This created an unhealthy fixation on short-term profits and a lack of concern for the longer-term consequences.

Under these schemes, an employee is incentivised to increase short-term profits, even if this may mean selling products that are unsuitable for customers. In the short term this leads to higher profits (and bonuses), but eventually customers figure out they’ve been mistreated. The result is often a loss of reputation and customers, legal costs, customer remediation programs and fines.

To counter this problem, many financial institutions have introduced the balanced scorecard as a method for measuring staff performance and, ultimately, deciding who receives a bonus.

The idea is that by considering a range of performance criteria, not just profits and sales, employees will become less focused on these short-term financial measures. This will, in turn, reduce misconduct.

Implementing balanced scorecards was one of the key recommendations of last year's Sedgwick Report. The Australian Bankers' Association sponsored the report.

But even though the balanced scorecard is considered best practice by many in the industry, there is little research to support its adoption.

The research on balanced scorecards

A recent study by Danish researchers reviewed 117 empirical papers on the balanced scorecard that were published in leading academic journals. They found that much of the research has been done on small and medium-sized firms, and that there were design problems in many of the other papers. Therefore, there is too little evidence to conclude whether the balanced scorecards are successful or not.

When balanced scorecards are implemented in financial institutions, they typically include subjective criteria. For example, one criterion could be that an employee's "behaviour is consistent with organisational values". A manager would be required to apply a rating to this criterion.

But there is a lot of doubt as to how credible and consistent these ratings really are.

There's also nothing to definitely discourage bad behaviour (especially in the short term) when criteria include subjective ratings. Due to the large amount of discretion in applying them, managers may give a high rating to staff who are top performers in sales/profits despite poor

behaviour.

When scorecards include both subjective and objective measures (which often include sales and profits), staff will tend to focus on the objective criteria. In other words, the balance in the balanced scorecard goes out the window.

The last thing to consider is that behaviour is influenced not just by bonuses, but also the possibility of promotion. If staff see that those who produce high profits are promoted, regardless of the short-term incentive structure applied, they will draw their own conclusions about how best to climb the corporate ladder.

That is why the promotion of Matt Comyn to CEO of the Commonwealth Bank sends a dangerous message.

Elizabeth Sheedy has received funding from the Centre for International Finance and Regulation to investigate risk culture and governance in banks. She is a member of the Risk Management Association of Australia.

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