CHAPTER 1

Introduction to the Balanced Scorecard

Roadmap for Chapter One Before you can begin developing a Balanced Scorecard for your organization you must have a solid foundation of Scorecard knowledge and understanding from which to build. This chapter will provide that base.

We'll begin by considering just why measurement is so important to the modern public and nonprofit organization. We'll then look at three factors that have led to the rising prominence of the Balanced Scorecard since its inception over a decade ago. You'll learn that accounting and business scandals in the for-profit world have led to a demand for greater accountability and disclosure from all organizations. Next we'll examine financial measurements and their significant limitations. The final factor escalating the growth of the Balanced Scorecard is the inability of most organizations to effectively execute their strategies, so we'll also review a number of barriers to strategy implementation.

The Balanced Scorecard has emerged as a proven tool in meeting the many challenges faced by the modern organization. The remainder of the chapter introduces you to this dynamic tool. Specifically, we'll examine the origins of the Scorecard, define it, look at the system from three different points of view, and consider just why the word "balance" is so important to the Balanced Scorecard.

WHY MEASUREMENT IS SO IMPORTANT

Recently I read about an historical incident that I'd like to share with you. In the dense fog of a dark night in October 1707, Great Britain lost nearly an entire fleet of ships. There was no pitched battle at sea; the admiral, Clowdisley Shovell, simply miscalculated his position in the Atlantic and his flagship smashed into the rocks of the Scilly Isles, a tail of islands off the southwest coast of England. The rest of the fleet, following blindly behind, went aground as well, piling onto the rocks, one after another. Four warships and 2,000 lives were lost.

For such a proud nation of seafarers, this tragic loss was distinctly embarrassing. But to be fair to the memory of Clowdisley Shovell, it was not altogether surprising. Though the concept of latitude and longitude had been around since the first century B.C., still in 1700 no one had devised an accurate way to measure longitude, meaning that nobody ever knew for sure how far east or west they had traveled. Professional seamen like Clowdisley Shovell had to estimate their progress either by guessing their average speed or by dropping a log over the side of the boat and timing how long it took to float from bow to stern. Forced to rely on such crude measurements, the admiral can be forgiven his massive misjudgment. *What caused the disaster was not the admiral's ignorance, but his inability to measure something that he already knew to be critically important—in this case longitude.*[1]

We've come a long way since Clowdisley Shovell patrolled the seas for his native Great Britain. If sailing is your passion, today's instrumentation ensures that any failure of navigation may be pinned squarely on your shoulders. But for those of you who spend your days leading public and nonprofit organizations, and not cruising the high seas, how far have you come in meeting the measurement challenge? Can you measure all those things you know to be critically important? Today's constituents and donors are better informed than at any time in history. That knowledge leads to a demand of accountability on your part to show results from the financial and human resources with which you've been entrusted. To do that you must demonstrate tangible results, and those results are best captured in performance measures.

Over 150 years ago the Irish mathematician and physicist Lord Kelvin reminded us: *"When you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind...."* The goal of this book is to help you do just that: to measure all those things that you know to be important, those areas that truly define your success and allow you to clearly demonstrate the difference you're making in the lives of everyone you touch. Welcome to your Balanced Scorecard journey.

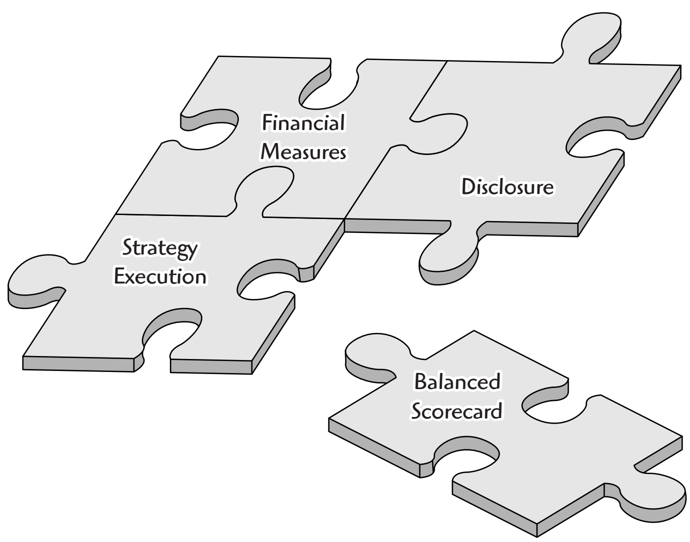
WHY THE BALANCED SCORECARD—AND WHY NOW?

Before we explore the Balanced Scorecard in detail, let's look at some of the factors that have given rise to this new framework for tracking organizational performance. Simply put, performance measurement and management have never been hotter. Three factors have fueled the need for improved performance reporting: the recent spate of corporate accounting scandals, a longstanding reliance on financial measures of performance as the one true way to gauge success, and the inability of many organizations to successfully execute their strategies. We'll look at each of these and discover how they've contributed to the need for a Balanced Scorecard system. We'll then return to an overview of the Balanced Scorecard and learn how this deceptively simple tool is revolutionizing the management of performance (see Exhibit 1.1).

Doing Business in the Post-Enron Era

As I write this in late 2002, it's difficult to pick up a newspaper, turn on a radio or television, or open up a news magazine without almost immediately hearing or seeing a reference to yet another corporate scandal. Everywhere you turn there is news that another organization has run afoul of the law in its almost maniacal pursuit of pleasing shareholders. Leading this infamous pack is of course Enron. Once the seventh largest company in the United States, Enron has become the butt of endless jokes; but more importantly, it's also become the defendant in countless lawsuits launched by those who have collectively lost billions since the company's demise. Of course Enron's $63.4 billion bankruptcy was later dwarfed by that of fellow-wrongdoer WorldCom. WorldCom sought Chapter 11 protection in a $107 billion disaster. The list goes on and on: Tyco, Xerox, Global Crossing, Adelphia, and dozens of others. Even those organizations once considered paragons of corporate virtue have been tainted by the sting of scandal. Johnson & Johnson, for example, an organization renowned for

Exhibit 1.1 The Balanced Scorecard Solves Business Issues



ethical business practices, was cited for irregularities at a manufacturing facility in Puerto Rico.[2] Not surprisingly, these activities have not gone unnoticed by you and me. Trust in organizations has never been lower. In one recent poll, 57 percent of respondents said they don't trust corporate executives to give them honest information.[3] Clearly, something has to change.

In response to the much-publicized shenanigans taking place in boardrooms around the country, the public is demanding greater disclosure of information. The rationale is that the more we know about a company's financial situation, the better equipped we are to discern the true state of its operations. On July 30, 2002, President George W. Bush took a great stride forward in this direction by signing into law the Sarbanes-Oxley Act. All companies required to file periodic reports with the Securities and Exchange Commissions (SEC) are affected by the Act. Proponents suggest it represents the most far-reaching U.S. legislation dealing with securities in many years.

While the act contains many provisions, two are particularly relevant to this chapter. First, Section 906, which is effective immediately, requires certification by the company's chief executive officer (CEO) and chief financial officer (CFO) that reports fully comply with the requirements of securities laws and that the information in the report fairly presents, in all material respects, the financial condition and results of operations of the company. Basically, company executives are making a pledge that what is in their financial reports is accurate and true. The act also requires plain English disclosure on a "rapid and current basis" of information regarding material changes in the financial condition or operations of a public company as the SEC determines is necessary or useful to investors and in the public interest.

Reforms such as the Sarbanes-Oxley Act represent tremendous advances in the pursuit of increased disclosure, but they miss a fundamental point: We need more than just financial information and disclosure to judge the health of an enterprise. To make an informed decision about any organization's true state of affairs, we require information that covers a broader perspective. This is the case whether we're talking about a Fortune 100 company, a local nonprofit health services organization, or state governments. We need to uncover the real value-creating and destroying mechanisms that are ultimately reflected in financial results. Even Wall Street is beginning to carry a torch for broader reporting. The accounting firm PricewaterhouseCoopers asked institutional investors and stock analysts what measures were most important to them. As you would expect, earnings and costs were consistently cited. But so too were nonfinancial indicators such as market share, new product development, and statements of strategic goals.[4] They could be on to something. Hewitt Associates found evidence that companies highly aligned with traditional metrics (financial) tend to be the worst performers in shareholder returns.[5]

All of the developments just described have prompted leaders and those who work in, and follow, organizations to further embrace concepts that place a premium on providing a balanced view of performance. Calls for use of the Balanced Scorecard are ringing out from observers around the globe. In

Canada, for example, the Society of Certified Management Accountants (CMA) has developed a new management accounting guideline entitled, "The Balanced Scorecard for a Board of Directors." The document serves to address corporate governance and management issues that have arisen in the wake of the Enron collapse.[6] France now mandates what it calls "sustainability reporting" for all publicly traded companies. The government has outlined indicators—in the areas of workplace, community, and environment—that companies must legally report on in annual reports.[7] Here in the United States, the American Institute of Certified Public Accountants (AICPA) has noted its support of the Balanced Scorecard in annual reporting to satisfy enhanced reporting requirements. Harvard University professor Jay W. Lorsch very nicely sums up the value of the Balanced Scorecard in this capacity: *"If directors were getting a Balanced Scorecard, they would be much more likely to be informed about their companies on an ongoing basis. The Scorecard's emphasis on strategy (linking it to all activities, day-to-day and long-term) could help directors stay focused."*[8]

Limitations of Financial Measurements

As the preceding discussion has clearly demonstrated, we require balanced performance information to fully assess an organization's success. Despite this realization, recent estimates suggest that 60 percent of metrics used for decision-making, resource allocation, and performance management are still financial in nature.[9] It seems that for all we've learned, we remain stuck in the quagmire of financial measurement. Perhaps tradition is serving as a guide unwilling to yield to the present realities. You see, traditionally, the measurement of all organizations has been financial. Bookkeeping records used to facilitate financial transactions can be traced back thousands of years. At the turn of the twentieth century, financial measurement innovations were critical to the success of the early industrial giants like General Motors. The financial measures created at that time were the perfect complement to the machinelike nature of the corporate entities and management philosophy of the day. Competition was ruled by scope and economies of scale, with financial measures providing the yardsticks of success.

Over the last hundred years, we've come a long way in how we measure financial success, and the work of financial professionals is to be commended. Innovations such as Activity-Based Costing (ABC) and Economic Value Added (EVA) have helped many organizations make more informed decisions. However, as we begin the twenty-first century, many are questioning our almost exclusive reliance on financial measures of performance. Here are some of the criticisms levied against the over-abundant use of financial measures:

- *Not consistent with today's business realities.* Tangible assets no longer serve as the primary driver of enterprise value. Today it's employee knowledge (the assets that ride up and down the elevators), customer relationships, and cultures of innovation and change that create the bulk of value provided by any organization. In other words, intangible assets. If you buy a share of Microsoft's stock, are you buying buildings and machines? No, you're buying a promise of value to be delivered by innovative people striving to continually discover new pathways of computing. Traditional financial measures were designed to compare previous periods based on internal standards of performance. These metrics are of little assistance in providing early indications of customer, quality, or employee problems or opportunities. For more on the rising prominence of human capital, see Exhibit 1.2.

- *Driving by rear view mirror.* This is perhaps the classic criticism of financial metrics. You may be highly efficient in your operations one month, quarter, or even year. But does that signal ongoing financial efficiency? As you know, anything can, and does, happen. Financial results on their own are not indicative of future performance.
- *Tendency to reinforce functional silos.* Working in mission-based organizations, you know the importance of collaboration in achieving your goals. Whether it's improving literacy, decreasing HIV rates, or increasing public safety, you depend on a number of teams working seamlessly together to accomplish your tasks. Financial statements don't capture this cross-functional dependency. Typically, financial reports are compiled by functional area. They are then "rolled-up" in ever-higher levels of detail and ultimately reflected in an organizational financial report. This does little to help you in meeting your noble causes.
- *Sacrifice of long-term thinking.* If you face a funding cut, what are the first things to go in your pursuit to right the ship? Many organizations reach for the easiest levers in times of crisis: employee training and development, or maybe even employees themselves! The short-term impact is positive, but what about the long-term? Ultimately, organizations that pursue this tactic may be sacrificing their most valuable sources of long-term advantage.
- *Financial measures are not relevant to many levels of the organization.* Financial reports by their very nature are abstractions. Abstraction in this context is defined as moving to another level and leaving certain characteristics out. When we roll up financial statements throughout the organization, that is exactly what we are doing: compiling information at a higher and higher level until it is almost unrecognizable and useless in the decision-making process of most managers and employees. Employees at all levels of the organization need performance data they can act on. This information must be imbued with relevance for their day-to-day activities.

Exhibit 1.2 Rising Prominence of Human Capital

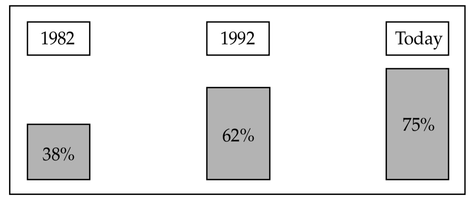
Writing in the Economist, Peter Drucker noted, "*They (knowledge workers) now account for a full third of the American workforce, outnumbering factory workers two to one. In another twenty years or so, they are likely to make up close to two-fifths of the workforces of all rich countries.*"***[i]*** Our organizational world is clearly in a time of change as we make the transition from an economy based on physical assets to one almost fully dependent on intellectual assets.

While this switch is evident to anyone working in today's business world, it is also borne out by research findings of the Brookings Institute. Take a look at the chart to the right which illustrates the transition in value from tangible to intangible assets. Since this research was completed the pace of change has continued unabated. Speaking on National Public Radio's Morning Edition, Ms. Margaret Blair of the Brookings Institute suggests that tangible assets have continued to tumble in value: "*If you just look at the physical assets of the companies, the things that you can measure with ordinary accounting techniques. These things now account for less than one-fourth of the value of the corporate sector. Another way of putting this is that something like 75% of the sources of value inside corporations is not being measured or reported on their books.*"***[ii]***

While Ms. Blair used the term "corporations" in the above quote, public and nonprofit organizations are certainly not immune to these changes. The challenges represented by this switch are well known in Washington. David M. Walker, Comptroller General of the United States said in a February, 2001 testimony to the U.S. senate that "*human capital management is a pervasive challenge in the federal government. At many agencies human capital shortfalls have contributed to serious problems and risks.*"***[iii]***

This transition in value creation from physical to intangible assets has major implications for measurement systems. Financial measurements were perfectly appropriate for a world dominated by physical assets. However, the new economy with its premium on intangible assets demands more from our performance measurement systems. Today's system must have the capabilities to identify, describe, monitor, and provide feedback on the intangible elements driving organizational success. The Balanced Scorecard focuses on identifying and translating all of an organization's value-creating mechanisms, including intangibles, into objectives, measures, targets, and initiatives. As such, organizations are turning to the Scorecard in ever-increasing numbers as a powerful framework in both measuring and managing intangible assets.

[i] Peter F. Drucker, The New Society, " *The Economist,* September 15, 2001.
[ii] Interview on National Public Radios Morning Edition October 27, 2000.
[iii] Testimony by David M. Walker, Comptroller General of the United States before the Subcommittee on Oversight of Government, Management, Restructuring, and the District of Columbia Committee on Governmental Affairs, U.S. Senate.



Thus far in the chapter, I've taken a hard line on financial measures of performance. We just reviewed their many limitations; and a little earlier I suggested that a single-minded focus on financial success might have been among the causes for the epidemic of scandals currently plaguing the corporate world. With all that in mind, the question is: Do financial metrics deserve a place on your Balanced Scorecard? Absolutely. Despite their many shortcomings, financial yardsticks are an entirely necessary evil. This is especially the case in the public and nonprofit sectors. In an era of limited, often decreasing, funding, you must consistently tread the delicate balance between effectiveness and efficiency. Results must be achieved, but in a fiscally responsible manner.

Your stakeholders will be looking to you to achieve your missions, thus nonfinancial measures of performance become critical in your efforts. However, pursuing your goals with no regard to the financial ramifications of your decisions will ultimately damage everyone: You'll be the victim of decreased funding as it becomes clear that you're unable to prudently manage your resources. Your funders will be discredited and, potentially, unwilling to support you in the future. But most important, your target audiences will not receive the services they need as a result of your inability to reach them in both an effective and efficient way.

Strategy: Execution Is Everything!

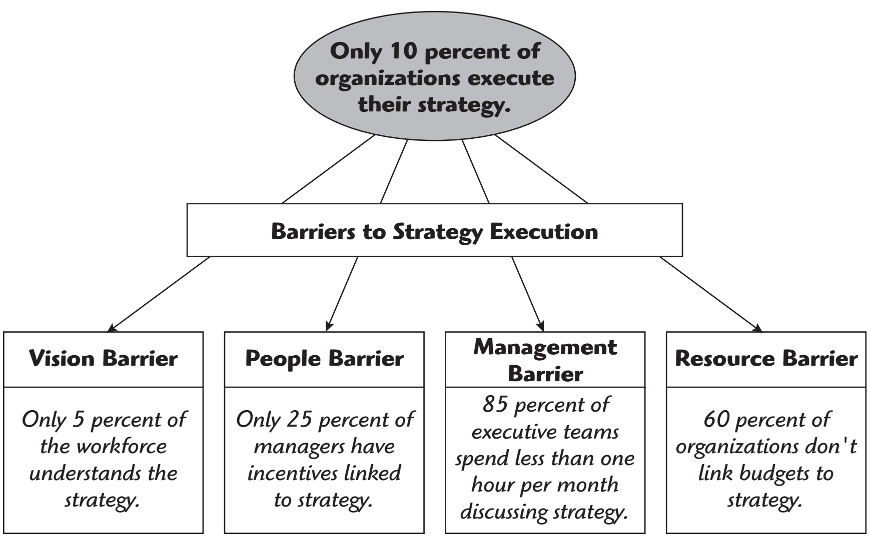
When I was conducting research for my book on private-sector Balanced Scorecard development (*Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results,* John Wiley & Sons, 2002), I knew I'd come across many references to strategy. After all, strategy is probably among the most discussed and debated topics we encounter in the world of organizations. But of course it's not just organizations that wrestle with strategy. The concept has entered the mainstream of our society. Professional sports teams all have a strategy to beat their opponents (and their owners have a strategy to separate us fans from our money!). I have a strategy for writing this book, and I'm sure you all employ strategies in achieving your daily tasks, both at home and at work. The interesting thing about strategy in the business sense of the word is that nobody seems to agree on what it is, specifically. There are as many definitions for the term as there are academics, writers, and consultants to muse on the topic. In fact there is even a book titled *Strategy Safari.*[10] I enjoy conjuring up that image of strategy—I picture myself cutting through the dense forest of research, attempting to find my quarry: the holy grail of strategy.

One point on which strategy gurus do seem to agree is this: The *execution* of a strategy is more important, and more valuable, than the *formulation* of a strategy. It's one thing to sit down and craft what is seemingly a winning strategy, but successfully implementing it is another thing entirely. For those who can execute, the rewards are significant. In the for-profit world, a 35 percent improvement in the quality of strategy implementation, for the average firm, is associated with a 30 percent improvement in shareholder value.[11] While shareholder value is not the end game of your organizations, you too will benefit greatly from an ability to carry out your strategies. Unfortunately, the vast majority of organizations fail miserably when attempting to execute their strategies. In fact, a 1999 *Fortune* magazine story suggested that 70 percent of CEO failures came not as a result of poor strategy, but of poor execution.[12] Why is strategy so difficult for even the best organizations to effectively implement? Research and experience in the area have suggested a number of barriers to strategy execution, and they are displayed in Exhibit 1.3. Let's take a look at these in turn.

The Vision Barrier

Employee empowerment, two-way communication, and information sharing—executives and managers alike frequently espouse the benefits of these concepts. Talk is cheap. The fact of the matter is that the vast majority of organizations have a long way to go when it comes to getting their most important messages—their vision and strategy—out to their most important constituents: their employees.

Exhibit 1.3 Barriers to Implementing Strategy



Adapted from material developed by Robert S. Kaplan and David P. Norton.

The previous section pointed out that many financial measures were developed at the turn of the twentieth century. Transport yourself back in time for a moment and put yourself inside one of those fortresses of industry, complete with towering walls and smokestacks billowing who-knows-what into the atmosphere. Chances are, as an employee there, you'd be told what to do, when to do it, where to do it, and how to do it. Would knowledge of the organization's vision and strategy have been the least bit relevant or helpful in your task? Probably not. But the world today is an entirely different place. Value is created largely from intangible assets like customer knowledge and information-rich networks. Today, to contribute in a meaningful way, you must know where the organization is headed and what the strategy is to get there. Only then can you combine your talents with others from across your agency to create value for your stakeholders and, ultimately, achieve your mission.

People Barrier

Debate has raged for decades as to whether incentive compensation plans really do lead to improved performance. We may never know the answer, but it is probably safe to suggest that an incentive of any kind tends to increase focus—at least temporarily. The danger with incentive plans is the possibility that managers will sacrifice long-term value-creating activities and initiatives in order to reach a short-term financial target and receive a monetary award. Strategy cannot be executed if the focus is continually on the short term. By its very nature, strategy demands a longer-range view of an organization's landscape. Financial incentives can distort or entirely block an organization's strategic view.

Resource Barrier

Sixty percent of organizations don't link budgets to strategy. If that's the case, then what are they linking their budgets to? For many organizations, it's as simple as looking at last year's budget and adding or subtracting a few percentage points as appropriate. This is a particularly damaging blow to the hopes of executing strategy. What is a budget if not a detailed examination of the priorities of the enterprise for the next fiscal year? If the budget is not linked to some form of strategic plan and goals, then what does that say about the organization's priorities? Does it even possess any, or is it simply spinning its wheels and wasting precious resources in the process? We'll return to the important topic of budgets in Chapter Eleven.

Management Barrier

Have you ever heard the phrase “management by walking around?” It suggests an approach of staying close to your employees by speaking to them frequently and informally, ensuring communication is two-way and beneficial to all. By contrast, I believe most of us live in the age of “management by firefighting!” We move from one crisis to the next, never taking the time to pause and reflect on our larger objectives, strategies, and mission. A client of mine uses the analogy of “working in the business”; that is, fighting fires, versus “working on the business,” taking the necessary break to examine things from a wider perspective.

Many would argue there is literally no time to slow down, not even for a minute. Undoubtedly, we live in an era of fast-paced organizations, but virtually all of us attend regular management meetings. In order to have any chance of executing strategy, these meetings must be transformed. No longer should we sit around and examine the “defects” that result when actual results do not meet budget expectations. Instead, these meetings should be used to discuss, learn about, and debate our strategy.

THE BALANCED SCORECARD

Reading the preceding pages could make you feel as though your back is up against the wall when it comes to effectively measuring your performance. Review the considerable hurdles we’ve discussed: First, there are the many scandals erupting around us, forcing all organizations to provide ever-greater disclosure. Second, for the most part, we’ve been limited in our measuring options because of an almost exclusive reliance on financial measures that definitely don’t tell the whole story. And, finally, as important as strategy is, a number of significant barriers make its execution truly elusive.

What is needed is a system that provides real insight into an organization’s operations, balances the historical accuracy of financial numbers with the drivers of future performance, and assists us in implementing strategy. The Balanced Scorecard is the tool that answers all these challenges. In the remainder of the chapter we will begin our exploration of the Balanced Scorecard by discussing its origins, reviewing its conceptual model, and considering what separates it from other systems.

Note

The focus here is on the for-profit Balanced Scorecard model, since the tool was originally conceived with that audience in mind. Chapter Two will detail how the “geography” of the Balanced Scorecard has been successfully adapted to fit both the public and nonprofit sectors.

Origins of the Balanced Scorecard

The Balanced Scorecard was developed by Robert Kaplan, an accounting professor at Harvard University, and David Norton, a consultant from the Boston area. In 1990, Kaplan and Norton led a research study of a dozen companies with the purpose of exploring new methods of performance measurement. The impetus for the study was a growing belief that financial measures of performance were ineffective for the modern business enterprise. Representatives of the study companies, along with Kaplan and Norton, were convinced that a reliance on financial measures of performance was affecting their ability to create value. The group discussed a number of possible alternatives but settled on the idea of a scorecard, featuring performance measures capturing activities from throughout the organization—customer issues, internal business processes, employee activities, and of course shareholder concerns. Kaplan and Norton labeled the new tool the Balanced Scorecard and later summarized the concept in the first of three *Harvard Business Review* articles, "The Balanced Scorecard—Measures That Drive Performance."[13]

Over the next four years, a number of organizations adopted the Balanced Scorecard and achieved immediate results. Kaplan and Norton discovered these organizations were not only using the Scorecard to complement financial measures with the drivers of future performance, but they were also communicating their strategies through the measures they selected for their Balanced Scorecard. As the Scorecard gained prominence with organizations around the globe as a key tool in the implementation of strategy, Kaplan and Norton summarized the concept and the learning to that point in their 1996 book, *The Balanced Scorecard*.[14] Since that time, the Balanced Scorecard has been adopted by nearly half of the Fortune 1000 organizations, and the momentum continues unabated. So widely accepted and effective has the Scorecard become that the *Harvard Business Review* recently hailed it as one of the 75 most influential ideas of the twentieth century.

Once considered the exclusive domain of the for-profit world, the Balanced Scorecard has been translated and effectively implemented in both the nonprofit and public sectors. Success stories are beginning to accumulate and studies suggest the Balanced Scorecard is of great benefit to both these organization types. In one public sector study funded by the Sloan Foundation, 70 percent of respondents agreed that their governmental entity was better off since implementing performance measures.[15]

WHAT IS A BALANCED SCORECARD?

We can describe the Balanced Scorecard as a carefully selected set of quantifiable measures derived from an organization's strategy. The measures selected for the Scorecard represent a tool for leaders to use in communicating to employees and external stakeholders the outcomes and performance drivers by which the organization will achieve its mission and strategic objectives.

A simple definition, however, cannot tell us everything about the Balanced Scorecard. In my work with many organizations, and in conducting Scorecard best-practices research, I see this tool as three elements: measurement system, Strategic Management System, and communication tool (see Exhibit 1.4).

The Balanced Scorecard as a Measurement System

Earlier in the chapter I discussed the limiting features of financial performance measures. To review: They provide an excellent review of what has happened in the past, but they are inadequate in addressing the real value-creating mechanisms in today's organization—the intangible assets such as knowledge and networks of relationships. We might call financial measures *lag indicators*. They are outcomes of actions previously taken. The Balanced Scorecard complements these lag indicators with the drivers of future economic performance, or *lead indicators*. But from where are these performance measures (both lag and lead) derived? The answer is: your strategy. All the measures on the Balanced Scorecard serve as translations of the organization's strategy. Take a look at Exhibit 1.5. What strikes me when I look at this diagram is that vision and strategy are at the center of the Balanced Scorecard system, not financial controls as we see in many organizations.

Exhibit 1.4 What Is the Balanced Scorecard?

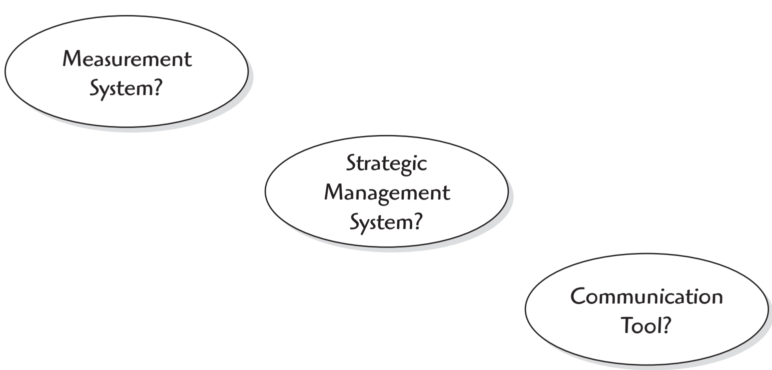
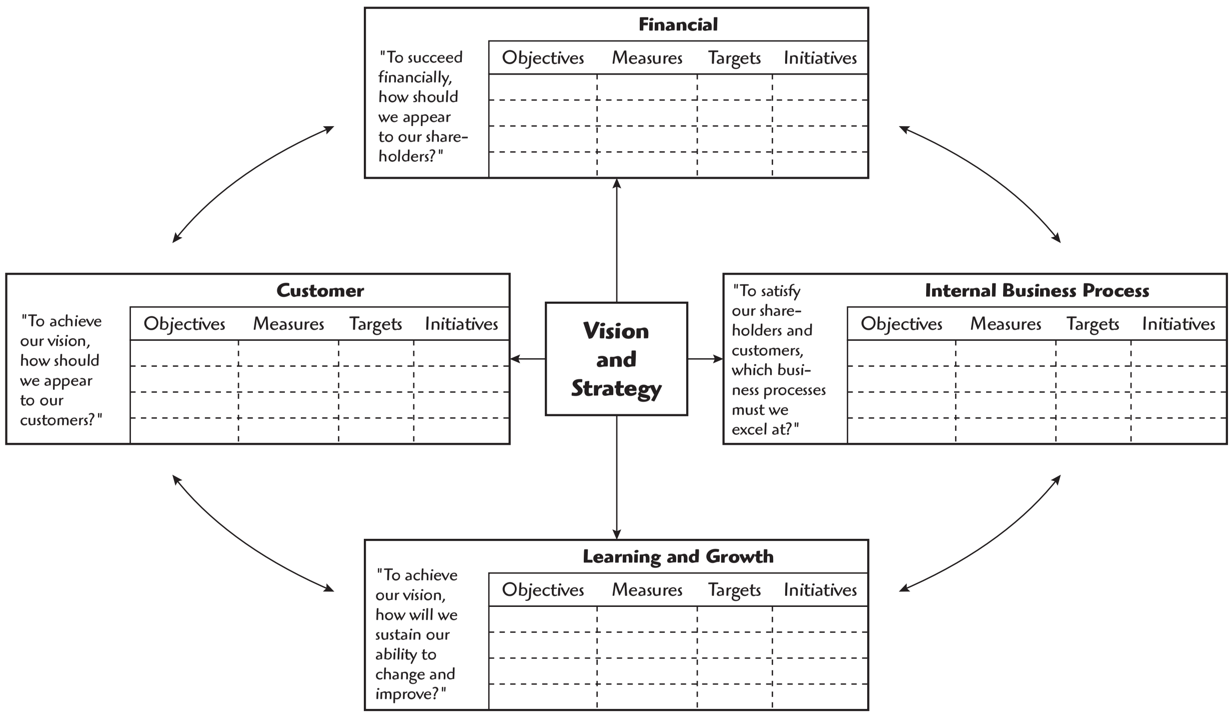


Exhibit 1.5 The Balanced Scorecard



Reprinted by permission from *Harvard Business Review*. Exhibit from "Using the Balanced Scorecard as a Strategic Management System," by Robert S. Kaplan and David P. Norton, January–February 1996, p. 76.

Many organizations script inspiring visions and compelling strategies, but then are often unable to use those beautifully crafted words to align employee actions with the firm's strategic direction. In his book, *The Fifth Discipline*, Peter Senge describes this dilemma when he notes, "*Many leaders have personal visions that never get translated into shared visions that galvanize an organization.*"[16] The Balanced Scorecard allows an organization to translate its vision and strategies by providing a new framework, one that tells the story of the organization's strategy through the objectives and measures chosen. Rather than focusing on financial control devices that provide little in the way of guidance for long-term employee decision-making, the Scorecard uses measurement as a new language to describe the key elements in the achievement of the strategy. The use of measurement is critical to the achievement of strategy. In his book *Making Strategy Work*, Timothy Galpin notes "measurable goals and objectives" as one of the key success factors of making strategy work.[17] While the Scorecard retains financial measures, it complements them with three other distinct perspectives: *Customer, Internal Processes*, and *Learning and Growth*.[18]

Customer Perspective

When choosing measures for the Customer perspective of the Scorecard organizations must answer two critical questions: Who are our target customers? and What is our value proposition in serving them? Sounds simple enough, but both questions present many challenges to organizations. Most organizations will state that they do in fact have a target customer audience, yet their actions reveal an "all things to all customers" strategy. Strategy guru Michael Porter suggests this lack of focus will prevent an organization from differentiating itself from competitors.[19] Choosing an appropriate value proposition poses no less of a challenge to most organizations. Many will choose one of three "disciplines" articulated by Michael Treacy and Fred Wiersema in *The Discipline of Market Leaders*.[20] They are:

- *Operational excellence*. Organizations pursuing an operational excellence discipline focus on low price, convenience, and, often, "no frills." Wal-Mart provides a great representation of an operationally excellent company.
- *Product leadership*. Product leaders push the envelope of their firm's products. Constantly innovating, they strive to offer simply the best product in the market. Nike is an example of a product leader in the field of athletic footwear.
- *Customer Intimacy*. Doing whatever it takes to provide solutions for unique customer's needs help define the customer intimate company. They don't look for one-time transactions, but instead focus on long-term relationship building through their deep knowledge of customer needs. In the retail industry Nordstrom epitomizes the customer-intimate organization.

As organizations have developed, and experimented with, value propositions, many have suggested it is difficult, if not impossible, to focus exclusively on just one. A more practical approach is to choose one discipline in which the organization possesses particularly strong attributes and maintains at least threshold standards of performance in the other disciplines. McDonald's, for example, is a truly operationally excellent organization, but that doesn't stop it from continually introducing new menu items. In Chapters Eight and Nine, we will take a closer look at the Customer perspective and identify the specific steps your organization should take to develop customer measures. Included in the discussion will be ideas you can use to apply the "value proposition" concept to your organization.

Internal Process Perspective

In the Internal Process perspective of the Scorecard, we identify the key processes at which the organization must excel in order to continue adding value for customers. Each of the customer disciplines outlined previously will entail the efficient operation of specific internal processes in order to serve your customers and fulfill your value proposition. Your task in this perspective is to identify those processes and develop the best possible measures with which to track your progress.

To satisfy customers, you may have to identify entirely new internal processes rather than focusing your efforts on the incremental improvement of existing activities. Service development and delivery, partnering with the community, and reporting are examples of items that may be represented in this perspective. We will examine the development of performance measures for internal processes in greater depth during Chapters Eight and Nine.

Learning and Growth Perspective

If you want to achieve ambitious results for internal processes, customers, and financial stakeholders, where are these gains found? The measures in the Learning and Growth perspective of the Balanced Scorecard are really the enablers of the other three perspectives. In essence, they are the foundation upon which the Balanced Scorecard is built. Once you identify measures and related initiatives in your Customer and Internal Process perspectives, you can be certain of discovering some gaps between your current organizational infrastructure of employee skills, information systems, and organizational climate (e.g., culture) and the level necessary to achieve the results you desire. The measures you design in this perspective will help you close that gap and ensure sustainable performance for the future.

Like the other perspectives of the Scorecard, we would expect a mix of core outcome (lag) measures and performance drivers (lead measures) to represent the Learning and Growth perspective. Employee skills, employee satisfaction, availability of information, and alignment could all have a place in this perspective. Many organizations I've worked with struggle in the development of these measures. Perhaps the reason is that it is normally the last perspective to be developed, hence the teams are intellectually drained from their earlier efforts of developing new strategic measures; or they simply consider this perspective "soft stuff," best left to the human resources group. No matter how valid the rationale, this perspective cannot be overlooked in the development process. Remember, the measures you develop in the Learning and Growth perspective are really the enablers of all other measures on your Scorecard. We will return to this important topic in Chapters Eight and Nine.

Financial Perspective

Financial measures are important components of the Balanced Scorecard, in the for-profit, public, and nonprofit worlds. In the for-profit domain, the measures in this perspective tell us whether our strategy execution—which is detailed through measures chosen in the other perspectives—is leading to improved bottom-line results. In the nonprofit and public sectors, financial measures ensure we're achieving our results in an efficient manner that minimizes cost. We normally encounter classic lagging indicators in the Financial perspective. Typical examples include: revenue, profitability, and budget variances. As with the other three perspectives, we will return to have another look at financial measures in Chapters Eight and Nine.

The Balanced Scorecard as a Strategic Management System

For many organizations, the Balanced Scorecard has evolved from a measurement tool to what Kaplan and Norton have described as a "Strategic Management System."[21] While the original intent of the Scorecard system was to balance historical financial numbers with the drivers of future value for the firm, as more and more organizations experimented with the concept they found it to be a critical tool in aligning short-term actions with their strategy. Used in this way the Scorecard alleviates many of the issues of effective strategy implementation discussed earlier in the chapter. Let's revisit those barriers and examine how the Balanced Scorecard may in fact remove them.

Overcoming the Vision Barrier through the Translation of Strategy

The Balanced Scorecard is ideally created through a shared understanding and translation of the organization's strategy into objectives, measures, targets, and initiatives in each of the four Scorecard perspectives. The translation of vision and strategy forces the executive team to specifically determine what is meant by often vague and nebulous terms contained in vision and strategy statements, for example: "superior service" or "targeted customers." Through the process of developing the Scorecard, an executive group might determine that "superior service" means responding to inquiries within 24 hours. Thereafter, all employees can focus their energies and day-to-day activities on the crystal-clear goal of response times, rather than wondering about, and debating the definition of, "superior service." Using the Balanced Scorecard as a framework for translating the strategy, these organizations create a new language of measurement that serves to guide all employees' actions toward the achievement of the stated direction.

Cascading the Scorecard to Overcome the People Barrier

To successfully implement any strategy, it must be understood and acted upon by every level of the firm. Cascading the Scorecard means driving it down into the organization and giving all employees the opportunity to demonstrate how their day-to-day activities contribute to the company's strategy. All organizational levels distinguish their value-creating activities by developing Scorecards that link to the highest-level organizational objectives.

By cascading, you create a "line of sight" from the employee on the front line back to the director's office. Some organizations have taken cascading all the way down to the individual level, with employees developing personal Balanced Scorecards that define the contribution they will make to their team in helping it achieve overall objectives. In Chapter Ten we will take a closer look at the topic of cascading and discuss how you can develop aligned Scorecards throughout your organization.

Rather than linking incentives and rewards to the achievement of short-term financial targets, managers now have the opportunity to tie their team, department, or agency rewards directly to the areas in which they exert influence. All employees can then focus on the performance drivers of future value and on which decisions and actions are necessary to achieve those outcomes.

Strategic Resource Allocation to Overcome the Resource Barrier

Developing your Balanced Scorecard provides an excellent opportunity to tie resource allocation and strategy together. When you create a Balanced Scorecard, you not only think in terms of objectives, measures, and targets for each of our four perspectives, but just as critically you must consider the initiatives or action plans you will put in place to meet your Scorecard targets. If you create long-term stretch targets for your measures, you can then consider the incremental steps along the path to their achievement.

The human and financial resources necessary to achieve Scorecard targets should form the basis for the development of the annual budgeting process. No longer will departments submit budget requests that simply take last year's amount and add an arbitrary 5 percent. Instead, the necessary costs (and profits) associated with Balanced Scorecard targets are clearly articulated in their submission documents. This enhances executive learning about the strategy, as the group is now forced (unless they have unlimited means) to make tough choices and trade-offs regarding which initiatives to fund and which to defer.

The building of a Balanced Scorecard also affords you a great opportunity to critically examine the current myriad initiatives taking place in your organization. As a consultant, when I begin working with a new client, one of the laments I hear repeatedly from front-line employees is, "Oh no, another new initiative!" Many executives have pet projects and agendas they hope to advance, often with little thought of the strategic significance of such endeavors. Initiatives at every level of the organization and from every area must share one common trait: a linkage to the organization's overall strategic goals. The Balanced Scorecard provides the lens for making this examination. Once you've developed your Scorecard, you should review all the initiatives currently under way in your organization and determine which are truly critical to the fulfillment of your strategy and which are merely consuming valuable and scarce resources. Obviously, the resource savings are beneficial, but more importantly you signal to everyone in the organization the critical factors for success and the steps you are taking to achieve them. Chapter Eleven is devoted to a greater review of this topic and provides guidance on how you can link your budgets to strategy.

Strategic Learning to Overcome the Management Barrier

In rapidly changing environments, we all need more than an analysis of actual versus budget variances to make strategic decisions. Unfortunately, many management teams spend their precious time together discussing variances and looking for ways to correct these "defects." The Balanced Scorecard provides the necessary elements to move away from this paradigm to a new model in which Scorecard results become a starting point for reviewing, questioning, and learning about your strategy.

The Balanced Scorecard translates your vision and strategy into a coherent set of measures in four balanced perspectives. Immediately, you have more information to consider than merely financial data. The results of your Scorecard performance measures, when viewed as a coherent whole, represent the articulation of your strategy to that point and form the basis for questioning whether your results are leading you any closer to the achievement of that strategy.

As you will see in the next section, any strategy you pursue represents a hypothesis, or your best guess, of how to achieve success. To prove meaningful, the measures on your Scorecard must link together to tell the story of, or describe, that strategy. If, for example, you believe an investment in employee training will lead to improved quality, you need to test that hypothesis through the measures appearing on your Scorecard. If, say, employee training increases to meet your target, but quality has actually deteriorated, then perhaps that is not a valid assumption; instead, maybe you should be focusing on, for example, improving employee access to key information. It may take considerable time to gather sufficient data to test such correlations, but simply having managers begin to question the assumptions underlying the strategy is a major improvement over making decisions based purely on financial numbers.

The Balanced Scorecard as a Communication Tool

In the preceding sections I discussed the use of the Balanced Scorecard as both a pure measurement system, and its evolution into a Strategic Management System. In particular, I delved into the power of the Scorecard in translating the strategy and telling its story to all employees—what you might call *communicating*. So why am I devoting an entire section (albeit a short one) to outline why I consider the Balanced Scorecard to be a communication tool? Simply because I believe it to be the most basic and powerful attribute of the entire system. A well-constructed Scorecard eloquently describes your strategy and makes the vague and imprecise world of visions and strategies come alive through the clear and objective performance measures you've chosen.

Much has been written in recent years about knowledge management strategies within organizations, and many schools of thought on the topic exist. One common trait of all such systems may be the desire to make the implicit knowledge held within the minds of your work force explicit and open for discussion and learning. We live in the era of the knowledge worker, the employee who—unlike his or her organizational predecessors who relied on the physical assets of the company—now owns the means of production: knowledge. There may be no greater challenge facing your organization today than codifying and acting on that knowledge. In fact, Peter Drucker, widely considered the father of modern management, has called managing knowledge worker productivity one of the great management challenges of the twenty-first century.[22] Sharing Scorecard results throughout the organization gives employees the opportunity to discuss the assumptions underlying the strategy, learn from any unexpected results, and dialog on future modifications as necessary. Simply understanding the firm's strategies can unlock many hidden organizational capacities, as employees, perhaps for the first time, know where the organization is headed and how they can contribute during the journey. One organization I worked with conducted employee surveys before and after the development of the Balanced Scorecard. Prior to implementation less than 50 percent said they were aware of, and understood, the strategy. One year following a full Balanced Scorecard implementation, that number had risen to 87 percent! If you believe in openly disseminating information to your employees, practicing what some would call "open-book management" then I can think of no better tool than the Balanced Scorecard to serve as your "book."

BALANCE IN THE BALANCED SCORECARD

As you develop the Balanced Scorecard in your organization, you may encounter some resistance to the term itself. Some may feel the Balanced Scorecard represents the latest management fad sweeping executive suites around the nation, hence the mere mention of such a buzzword would preclude employees from accepting the tool regardless of its efficacy. This may represent a legitimate concern, depending on the fate of previous change initiatives within your organization. But whereas others may prefer to use other monikers for the tool—such as Performance Management System, Scoreboard, or any number of others—I believe it is important to consistently use the term Balanced Scorecard when describing this tool, because the concept of *balance* is central to this system, specifically relating to three areas:

- *Balance between financial and nonfinancial indicators of success.* The Balanced Scorecard was originally conceived to overcome the deficiencies of a reliance on financial measures of performance by balancing them with the drivers of future performance. This remains a principle tenet of the system.
- *Balance between internal and external constituents of the organization.* Financial stakeholders (funders, legislators, etc.) and customers represent the external constituents represented in the Balanced Scorecard, while employees and internal processes represent internal constituents. The Balanced Scorecard recognizes the importance of balancing the occasionally contradictory needs of all these groups in effectively implementing strategy.
- *Balance between lag and lead indicators of performance.* Lag indicators generally represent past performance. Typical examples might include customer satisfaction or revenue. While these measures are usually quite objective and accessible, they normally lack any predictive power. Lead indicators, in contrast, are the performance drivers that lead to the achievement of the lag indicators. They often include the measurement of processes and activities. Response time might represent a leading indicator for the lagging measure of customer satisfaction. While these measures are normally thought to be predictive in nature, the correlations may prove subjective and the data difficult to gather. A Scorecard should include a mix of lead and lag indicators. Lag indicators without leading measures don't communicate how you are going to achieve

your targets. Conversely, leading indicators without lag measures may demonstrate short-term improvements but don't identify whether these improvements have led to improved results for customers, ultimately allowing you to achieve your mission.

SUMMARY

Many leaders feel they know what is most critical to the success of their organizations. However, it is only through the measurement of these vital indicators that they can accurately reflect their progress on an ongoing basis. The Balanced Scorecard is a powerful tool that enables any organization to pinpoint and track the vital few variables that make or break performance.

This chapter delineated the factors that have led to the increased importance and use of the Balanced Scorecard. The first is a steady climb in the number of accounting and business scandals plaguing the organizational world. While the majority of these debacles affect the for-profit world, the public and nonprofit sectors are not immune. Concerned citizens, regulatory bodies, and legislative authorities are demanding an increase in disclosure of material organizational performance. The second component of the Scorecard's rise in prominence is our almost exclusive reliance on financial measures of performance. Traditionally, the measurement of organizations has been financial; however, our dependence on financial measures of performance has come under criticism in recent years. Critics suggest financial measures are not consistent with today's environment, and that they lack predictive power, reinforce functional silos, may sacrifice long-term thinking, and are not relevant to many levels of the organization. Successfully implementing strategy is the third and final key issue facing the enterprise. Four barriers to strategy implementation exist for most organizations: a vision barrier, people barrier, resource barrier, and management barrier.

The chapter also described how the Balanced Scorecard balances the historical accuracy and integrity of financial numbers with the real drivers of future success. The framework enforces a discipline around strategy implementation by challenging executives to carefully translate their strategies into objectives, measures, targets, and initiatives in four balanced perspectives: Customer, Internal Processes, Learning and Growth, and Financial. While originally designed in 1990 as a measurement system, the Balanced Scorecard has evolved into a Strategic Management System and powerful communication tool for those organizations fully utilizing its many capabilities. Linking the Scorecard to key management processes such as budgeting, compensation, and alignment helps overcome the barriers to implementing strategy. While originally conceived with the for-profit enterprise in mind, the Balanced Scorecard has been applied with tremendous success in nonprofit and governmental agencies around the world.

Finally, the chapter stressed the importance of the word "balance" in the Balanced Scorecard. It represents the balance between:

- Financial and nonfinancial indicators
- Internal and external constituents of the organization
- Lag and lead indicators

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