

1

Introduction to the Balanced Scorecard

Roadmap for Chapter 1 Before you can begin developing a Balanced Scorecard for your organization, we must ensure that you 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 seventeen years ago. You'll learn that our changing economy, which places a premium on intangible assets, demands more from our measurement systems. Financial measurements and their significant limitations will then be examined. The final factor escalating the growth of the Balanced Scorecard is the inability of most organizations to effectively execute their strategies. We'll 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, and look at the system from three different points of view: as a communication tool, measurement system, and strategic management system.

WHY MEASUREMENT IS SO IMPORTANT

One of the themes of this book is that regardless of what sector your organization represents, there is a role for measurement to improve your performance. So it is in the vein of connecting measurement to virtually any field of endeavor that I offer this historical account to begin our expedition together. 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, went aground and piled 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. Although 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 estimated 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 you're a sailor, today's instrumentation ensures that any failure of navigation may be pinned squarely on your own shoulders. But for those of you who spend your days leading public and non-profit organizations, 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 entrusted to you. To do that, you must demonstrate tangible results which are best captured in performance measures.

Over 150 years ago the Irish mathematician and physicist Lord Kelvin reminded us that "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?

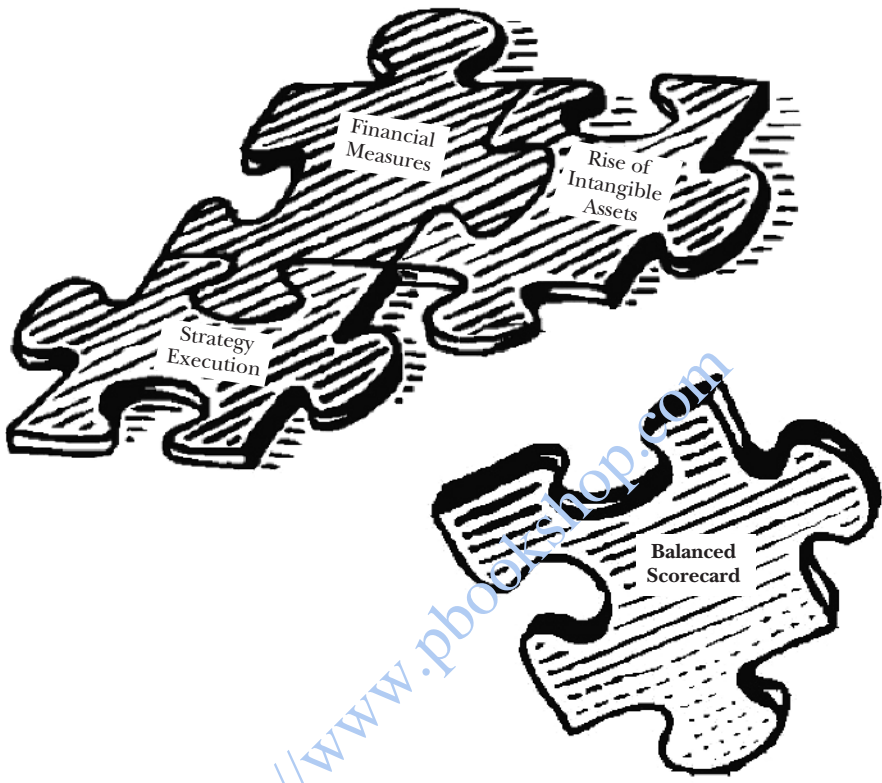
In the span of the Balanced Scorecard's lifetime—some 17 years—hundreds, if not thousands, of business ideas, fads, and fetishes have been paraded in front of a beleaguered, change-weary organizational world searching for the secret that will elevate them above the rest. Promising near instant success in a hyper-competitive world, most of these panaceas have come and gone with barely a whisper and yet the Scorecard drumbeat marches on, gaining momentum with each successive beat. The question is, why?

Before we explore the Balanced Scorecard in detail, it's important to examine some of the factors that have given rise to this proven framework for tracking organizational performance and executing strategy. Understanding these pillars of the Balanced Scorecard's success will not only enhance your appreciation of the tool, but the insights gained will also assist you as you begin implementing the system within your own organization. In the pages ahead, we'll examine these three factors that are fundamental to the success of any organization, whether public sector, nonprofit, or private: the increasing role of intangible assets in creating value in today's economy, our long-standing over-reliance on financial measures of performance to gauge success, and most importantly, the challenge of executing strategy. Let's 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 has revolutionized the management of performance (see Exhibit 1.1).

THE RISE OF INTANGIBLE ASSETS IN VALUE CREATION

As you read the heading for this section, what images flashed through your mind? An assembled throng of twenty-first century pocket-protector-wearing geeks at Google creating the next killer app of the Internet perhaps? Or maybe you wondered what the Red Bull-driven minds at Apple or Microsoft might dream up next? I can almost guarantee you didn't think about unloading timber ships at the London docks in 1970. But as much of a revolution occurred there as we're seeing in the halls of Silicon Valley today. In 1970, when a timber ship dropped anchor at the dock in London, it took 108 men about five days to unload it, equating to 540 man days. Today, that same ship would be stripped of its cargo in one, yes one, day. That's eight man days, meaning that over the past 37 years, workers have registered a whopping 98.5% improvement in the time to unload a ship. What could possibly account for this extraordinary enhancement? Steroid-popping stevedores? Hardly. The diminishing time requirement is a function of three things: containerization, modern processes for swift unloading, and enabling technology. Two out of those three are quintessential examples of

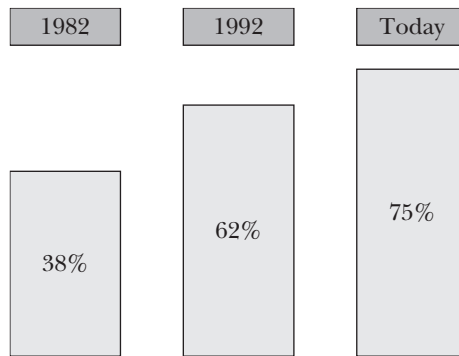
Exhibit 1.1 The Balanced Scorecard Solves Fundamental Business Issues



the power of intangible assets: processes and technology. They both emanate from and harness the only power we'll never run out of: brain power!²

From barnacle-laden docks to computer-controlled manufacturing facilities to meeting rooms around the world, this scenario is transforming the way work is done in today's organizations. While this switch is probably evident to anyone working in today's frenzied times, it is also borne out of research findings by the Brookings Institute. Take a look at Exhibit 1.2 that illustrates the transition in value from tangible to intangible assets. 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.³

Exhibit 1.2 The Increasing Value of Intangible Assets in Organizations

Adapted from *Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results, 2nd Edition*, Paul R. Niven (John Wiley & Sons, 2006).

Being keen-eyed denizens of the public and nonprofit sectors, I'm sure you noticed Ms. Blair's use of the term "corporations." Believe me, your organizations are being affected every bit as much as your corporate counterparts. The challenges represented by this switch are not going unnoticed in Washington, DC. 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."⁴ President George W. Bush, in his President's Management Agenda, echoes Walker's comments and adds that: "We must have a Government that thinks differently, so we need to recruit talented and imaginative people to public service."⁵ Talented people, armed with the tools necessary to succeed and operating in an environment conducive to growth and change is the recipe for twenty-first century success.

Unfortunately, our measurement systems have failed to keep pace with the rate of change occurring in the workplace. As we'll see in the next section of the chapter, our performance measurement systems have focused almost exclusively on financial measures, and more specifically, they've relied on counting tangible things—inventory, monetary exchanges, and so on. However, the new economy, with its premium on intangible value creating mechanisms, demands more from our performance measurement systems. Today's system must have the capabilities to identify, describe, monitor, and fully harness the intangible assets driving organizational success. As we will see throughout this book, particularly in our discussion of the Employee Learning and Growth perspective, the Balanced Scorecard provides a voice of strength and clarity to intangible assets, allowing organizations to benefit fully from their astronomical potential.⁶

Financial Measurement and Its Limitations

Despite the changes in how value is created today, estimates suggest that 60% of metrics used for decision-making, resource allocation, and performance management in the typical organization are still financial in nature.⁷ It seems that for all we've learned, we remain stuck in the quagmire of financial measurement. Perhaps tradition—where the measurement of all organizations has been financial—is serving as a guide unwilling to yield to the present realities. Bookkeeping records used to facilitate financial transactions can literally 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 machine-like 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 one hundred years, we've come a long way in our measurement of 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, suggesting that these measures may be better served to report on the stewardship of money entrusted to management's care rather than a means to chart the organization's future. 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. It is 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 computing pathways. 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.
- *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 success? As you know, anything can, and does, happen. A history of strong financial results is not indicative of future performance. As an illustration of this rear view mirror principle, look no further

than the storied *Forbes* lists, regaling spellbound executives since 1917 with drool-inducing tales of heroic capitalism. *Forbes* published a 70th anniversary issue in 1987, and of the 100 companies that graced the inaugural roll, 61 were dead and gone, with only memories of their former fiscal glory remaining. Of the 39 companies that existed, many were on life support, with only 18 still named on the list. Similar statistics can be trotted out for the Standard and Poor's 500 list of top companies. Forty years after it began in 1957, only 74 of the initial 500 companies existed. More than 80% failed to survive.⁸

- *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 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 long-term thinking.* If you face a funding cut, what are the first things to go in your attempt to right the ship? Many organizations reach for the easiest levers in times of crisis: employee training and development, or even employees themselves! The short-term impact is positive, but what about the long-term impact? Ultimately, organizations that pursue this tactic may be sacrificing their most valuable sources of long-term advantage and often to no avail. Recent research suggests that tools such as downsizing not only damages workers who are laid off, but destroy value in the long-term. One study found that downsizing in the corporate world never improved profits or stock market returns.⁹
- *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 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 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.

Thus far, I've taken a hard line on financial measures of performance. We just reviewed their many limitations, and with only a modicum of exaggeration, it could be suggested that a single-minded focus on financial

success may be among the causes for the epidemic of scandals currently plaguing the corporate world. So, 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, and 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. Most importantly, 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, I knew I would come across many references to strategy. After all, strategy is probably among the most discussed and debated topics in the world of organizations. Of course, it's not just organizations that wrestle with strategy—the concept is one that has truly 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 as there are academics, writers, and consultants to muse on the topic. In fact, a favorite book of mine on the subject nicely summarizes both the confusion and the ultimate quest of those pursuing the strategy development challenge: *Strategy Safari*.¹⁰ I enjoy conjuring up that image of strategy—picturing myself cutting through the dense forest of research, attempting to find my quarry: the holy grail of strategy.

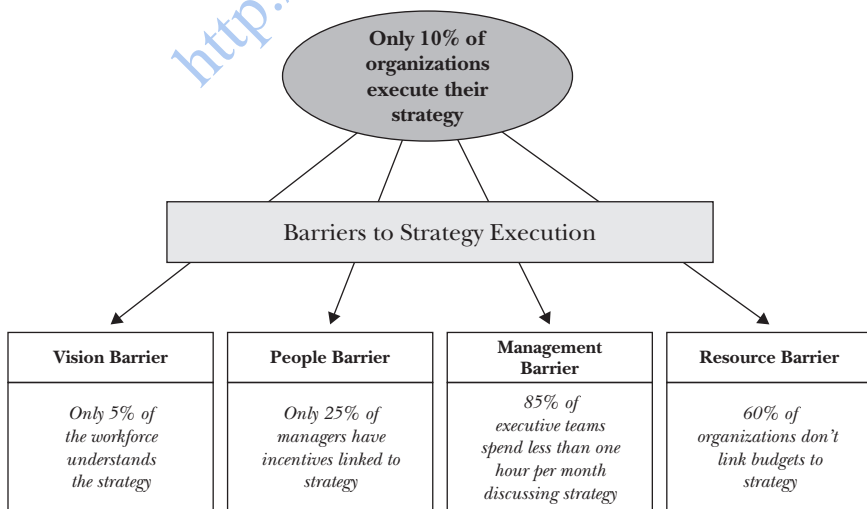
One thing strategy gurus seem to agree on is this: despite the challenges of creating a strategy, ultimately it is more important and valuable to demonstrate the ability to execute the strategy. It's one thing to sit down and craft what is seemingly a winning strategy, but successfully implementing it is another thing entirely. For those who can execute, the rewards are significant. In the for-profit world, a 35% improvement in the quality of strategy implementation, for the average firm, is associated with a 30% improvement in shareholder value.¹¹ While shareholder value is not the end game of your

organization, 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. A 1999 *Fortune* magazine story suggested that 70% of CEO failures were not a result of poor strategy, but rather of poor execution.¹² More recently, The Center for Creative Leadership has reported that 40% of CEOs fail in their first 18 months.¹³ 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 are terms whose benefits executives and managers alike frequently espouse. 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 communicating their most important messages—vision and strategy—to their most important constituents: employees.

An earlier section discussed the fact that many financial measures were developed at the turn of the twentieth century. Transport yourself back there 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 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

Exhibit 1.3 Barriers to Implementing Strategy



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

vision and strategy have been the least bit relevant or helpful in your task? Probably not. But today the world is an entirely different place. Value is created largely from intangible assets such as customer knowledge and information-rich networks. If you're going 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.

The People Barrier For decades, debate has raged on 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.

The Resource Barrier 60% 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 articulation 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? Do they even possess any, or are they simply spinning their wheels and wasting precious resources in the process. We'll return to the important topic of budgets in Chapter 10.

The Management Barrier Have you ever heard the phrase “management by walking around?” It suggests an approach of staying close to your employees by speaking with 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,” that is taking the necessary break to examine things from a larger perspective.

Many would argue there is literally no time to slow down, not even for a minute. Undoubtedly, we live in an era of brutally 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 what we deem as “defects” when results do not meet budget expectations. Instead, these meetings must be used to discuss, learn about, and debate our strategy.

THE BALANCED SCORECARD

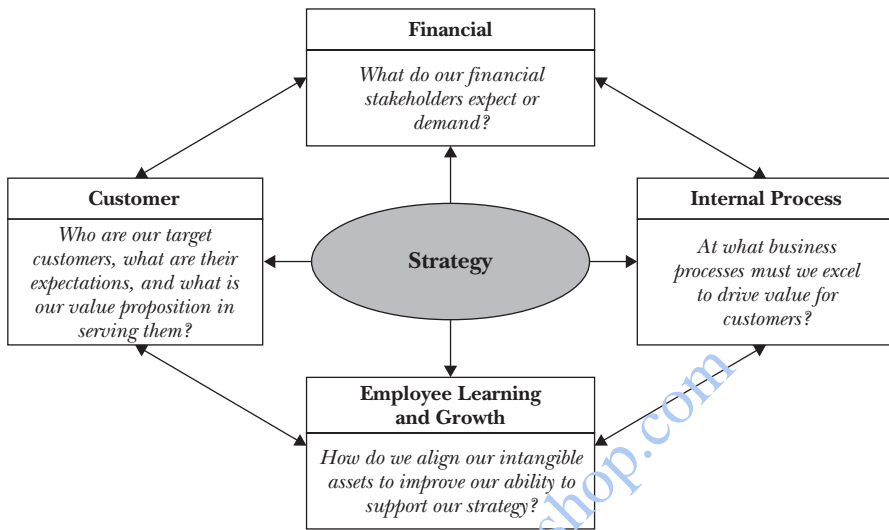
When sharing Balanced Scorecard concepts with audiences for the first time, it’s at this point in my presentation that I show a slide depicting a poor soul standing defenseless under three black clouds pelting him with rain. The clouds are labeled “the rise of intangible assets,” “our over-reliance on financial measures,” and “the difficulty of executing strategy.” Just as my clip art friend is being doused with no defense against the elements, organizations too are vulnerable to the storm clouds of twenty-first century commerce. But their umbrellas, the traditional methods of monitoring and managing performance, are ill-equipped to navigate us through the changes we face on a seemingly daily basis. As the title of my slide says, “Clearly a Change is Needed!”

A change has come, one that has literally revolutionized the way organizations around the globe measure performance, monitor operations, and ultimately execute their unique strategies. The powerful transformation to which I’m referring comes in the form of the Balanced Scorecard: a tool that balances the historical accuracy and integrity of financial numbers with the drivers of future fiscal success; a tool that provides both visibility and insight into intangible assets; and finally, a tool that has been proven to help organizations successfully combat and overcome the barriers of executing strategy.

In the remainder of this chapter, we will begin our exploration of the Balanced Scorecard by discussing its origins, reviewing the conceptual model of the Scorecard, and considering what separates the Balanced Scorecard from other systems. The model is presented graphically in Exhibit 1.4.

Origins of the Balanced Scorecard

The Balanced Scorecard was developed by Robert Kaplan, an accounting professor at Harvard University, and David Norton, a consultant also from the Boston area. In 1990, Kaplan and Norton led a research study of a dozen companies 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. 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

Exhibit 1.4 The Balanced Scorecard

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

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 several *Harvard Business Review* articles, "The Balanced Scorecard—Measures that Drive Performance."¹⁴

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 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*.¹⁵ Since that time, the Balanced Scorecard has been adopted by more than 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 accumulating from all corners of the globe as eager public and nonprofit sector leaders apply the Balanced Scorecard, enhancing their capacity, strengthening their core processes, and better serving their constituents. While empirical evidence of

Scorecard use and efficacy outside the private sector remains relatively scarce, in one public sector study funded by the Sloan Foundation, 70% of respondents agreed that their governmental entity was better off since implementing performance measures.¹⁶

What Is A Balanced Scorecard?

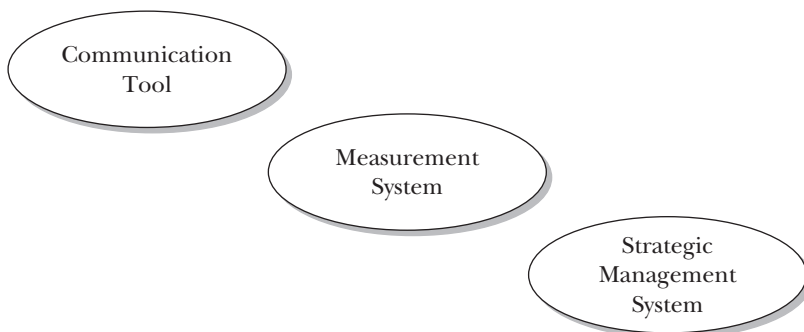
We can describe the Balanced Scorecard as a carefully selected set of measures derived from an organization's strategy. The measures selected for the Scorecard represent a tool for leaders to use in communicating to employees and external stakeholders the outcomes and performance drivers by which the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

A simple definition, however, cannot reveal everything about the Balanced Scorecard. In my work with many organizations, and in conducting Scorecard best-practices research, I see this tool as three things: a communication tool, a measurement system, and a strategic management system. In the following sections, we'll examine each of these Scorecard uses, but first let's consider the four perspectives of performance, perhaps the most fundamental aspects of the Balanced Scorecard (see Exhibit 1.5).

Balanced Scorecard Perspectives

The etymology of the word perspective is from the Latin *perspectus* "to look through" or "see clearly," which is precisely what we aim to do with a Balanced Scorecard—examine the strategy, making it clearer through the lens of different viewpoints. For any strategy to be effective, it must contain descriptions of financial aspirations, markets served, processes to be conquered, and of course the people who will steadily and skillfully guide the ship to success. Thus, when measuring our progress, it would make little sense to focus on just one aspect of the strategy when in fact, as Leonardo da Vinci reminds us "Everything is connected to everything else."¹⁷ To compose

Exhibit 1.5 What is the Balanced Scorecard?



an accurate picture of strategy execution, it must be painted in the full palette of perspectives that comprise it. Therefore, when developing a Balanced Scorecard we use the following four: Customer, Internal Processes, Employee Learning and Growth, and Financial.

When building your Balanced Scorecard, or later when it is up and running, you may slip and casually remark on the four “quadrants” or four “areas,” but as colloquial and seemingly inconsequential as this slip appears, I believe it has serious ramifications. Take for example the word quadrant. The Oxford dictionary begins its definition by describing it as a quarter of a circle’s circumference. The word reflects the number four and in that sense is almost limiting to the flexible approach inherent in the Scorecard. You may wish to have five perspectives or only three. With its focus on viewing performance from another point, perspective is far more representative of the spirit of the Balanced Scorecard and I encourage you to be disciplined in the use of this term.¹⁸

The Balanced Scorecard as a Communication Tool. Strategy Maps

When Kaplan and Norton originally developed the Balanced Scorecard, their creation was a direct response to what some might realistically describe as the tyranny of financial measures. These dollar-based metrics seemed to wield unlimited power yet were utterly incapable of gauging value in what has become known as the “new economy”—one in which intangibles rule and execution of strategy is everything. The Balanced Scorecard posited a simple yet revolutionary idea: complement the financial numbers (which will always be required of any enterprise) with the drivers of future financial success represented by such disparate but critical elements as innovation, customer satisfaction, and employee engagement.

The Balanced Scorecard represented a profound and simple idea, but as with many such notions, it was not always easily implemented. Pioneers of the system, while anxious to develop the breakthrough metrics that would ensure strategy execution, often struggled when it came to actually articulating what they would track in each of the perspectives. For many, the challenge lay in translating vague and obtuse strategy dictums such as “quality service” or “product development” into meaningful measures, since the nebulous nature of such terms could lead to any number of suitable metrics based on one’s individual interpretation. Early Balanced Scorecard adopters faced this challenge and found themselves instinctively spanning the strategy/measures chasm with a discussion of *objectives*, or what needed to be done well, in order to implement the essence of the strategy. So, rather than beginning the Scorecard process with the sometimes futile effort of creating measures, they first asked themselves, “What do we need to do well in order to execute?” Splitting the chore in this way added a level of granularity to the strategy thereby rendering the task of creating associated performance

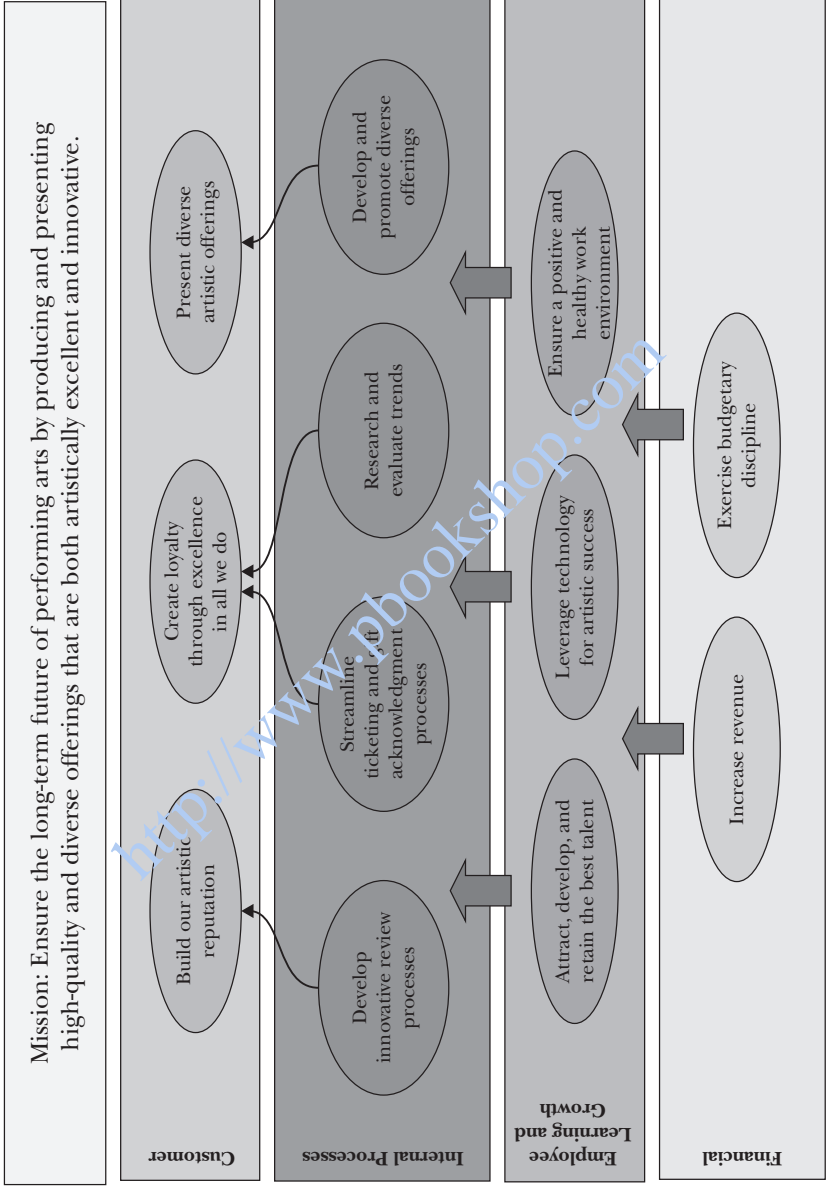
measures that much simpler. For example, if the strategy devoted a section to new service development, stressing the need to bring new services to customers at a faster rate, this narrative was translated into the simple objective of “accelerate new service development,” which may be accurately measured by the new service development life cycle.

As with any business tool, the Balanced Scorecard has a vocabulary of its own, and earlier, I distinguished between two of the most important terms you’ll find in the Scorecard lexicon: objective and measure. Understanding the definitions of these terms is critical should you hope to derive the maximum benefit from your efforts. An objective is a succinct statement, normally beginning with a verb, describing what we must do well in each of the four perspectives in order to implement our strategy. Examples vary widely but could include: “Improve service delivery time,” “Leverage partnerships,” and “Close our skills gap.” Strategy Maps are comprised entirely of objectives. Tracking our success in achieving the objective is the domain of the measure, a (typically) quantitative device used to monitor progress.

If you’ve already started your own Balanced Scorecard glossary of terms, something I strongly recommend, here’s what I would offer for Strategy Maps: *a one-page graphical representation of what you must do well in each of the four perspectives in order to successfully execute your strategy.* Let’s break that definition down. First, why do we use the term map, and not “Strategy Sheet” or “Must-Do List?” A map serves the function of getting us from point A to point B, outlining the pathways of our journey that ultimately lead to our chosen destination. So it is with the Strategy Map, we’re defining the pathways (objectives) that will lead us to the execution of our strategy. When charting your course on a map, you move sequentially from one location to the next and the Strategy Map serves a similar function. The objectives appearing on the Map should not be viewed as isolated elements but should be woven together, taking you on a journey that leads to the execution of your strategy.

Why just one page for the Map? One page is critical; many strategic plans suffer from severe information overload for readers—dozens if not hundreds of pages of dizzying graphs, numbing narratives, and 8-point Excel financial tables. This isn’t the strategy binder, it’s the map—one simple page telling your strategic story. Finally, “graphical representation,” means the Map is drawn as a picture, not a list of bulleted points that would cause even the most earnest student of your strategy to glaze over at first glance. As you’ll see when we explore Strategy Maps in detail in Chapter 7, your creativity will be tapped to the fullest when creating this document, bringing the strategy to life and creating a powerful communication tool signaling to everyone in the organization what you must do well in order to execute your unique strategy. A sample Strategy Map, representing a fictitious performing arts organization is shown in Exhibit 1.6.

Exhibit 1.6 Example Strategy Map for a Fictitious Performing Arts Organization



Creating Objectives for the Four Perspectives of a Strategy Map

As a preview of what's to come later in the book, let's take a glimpse of what you might consider when populating each of the four perspectives of your Strategy Map with objectives.

Customer Perspective When choosing objectives for the Customer Perspective of the Strategy Map, organizations must answer three critical questions: "Who are our customers?" "What do our customers expect or demand from us?" and finally, "What is our value proposition in serving them?" Sounds simple enough, but each of these questions offers many challenges. Most organizations 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 says that this lack of focus will prevent an organization from differentiating itself from competitors.¹⁹ Understanding what customers truly value can pose no less of a challenge. Without near constant feedback and communication, we're often left gazing hopefully into a crystal ball to determine customers' wishes. Finally, choosing an appropriate value proposition also represents a formidable test to most organizations. What is a value proposition? It simply represents how you propose to add value for your customers, what makes you stand out from others. When considering this important point many will choose one of three "disciplines" articulated by Treacy and Wiersema in their bestselling book, *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. 3M is an example of a product leader in the private sector, a company long known for breakthrough products that frequently solve needs we didn't even know we had. Who could now live without Post It Notes, for example?
- *Customer intimacy.* Doing whatever it takes to provide solutions for unique customer's needs help define the customer intimate company. These organizations 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 you possess particularly strong attributes, and maintain at least threshold standards of performance in the other disciplines. McDonald's, for example, is a truly operational excellent organization, but that doesn't stop them from continually introducing new menu items. In Chapter 7, we will take a closer look at the Customer Perspective, and identify what specific steps your organization should take to develop customer objectives. Included in our 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 Strategy Map, 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 above will entail the efficient operation of specific internal processes in order to serve our customers and fulfill our value proposition. Our task in this perspective is to identify those processes and develop the best possible objectives with which to execute our strategy. 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 objectives for Internal Processes in greater depth in Chapter 7.

Financial Perspective Financial objectives are an important component of the Strategy Map, in the for-profit, public, and nonprofit worlds. In the for-profit domain, the objectives in this perspective represent the end in mind of our strategic story, typically culminating in objectives such as "Increase shareholder value," "Grow revenues," and "Lower costs." In the nonprofit and public sectors, financial objectives ensure we're achieving our results, but doing so in an efficient manner that minimizes cost. Typical examples include: "Expand revenue sources," "Contain costs," and "Utilize assets effectively." We will return to have another look at financial objectives during Chapter 7.

Employee Learning and Growth Perspective If you want to achieve ambitious results for internal processes and customers, where are these gains found? The objectives appearing in the Employee Learning and Growth Perspective of the Strategy Map are really the enablers of the other perspectives. In essence, they are the foundation upon which this entire house of a Strategy Map is built. Once you identify objectives 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 objectives you design in this perspective will help you close that gap and ensure sustainable performance for the future.

Many organizations I've worked with struggle in the development of Employee Learning and Growth objectives. It is often the last perspective developed and it's likely that the teams are intellectually drained from their earlier efforts of developing new strategic objectives, or they simply consider this perspective "soft stuff" best left to the human resources group. No matter how valid the rationale seems, this perspective cannot be overlooked in the development process. As I mentioned earlier, the objectives you develop in the Employee Learning and Growth perspective are really the enablers of all other measures on your Map. As with the other three perspectives, we will re-examine this important topic in Chapter 7.

The Balanced Scorecard as a Measurement System

Many organizations have inspiring visions and compelling strategies, but 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."²¹ The Balanced Scorecard system 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 of the Strategy Map and measures chosen to represent those objectives on the Balanced Scorecard. Rather than focusing on financial control devices that provide little in the way of guidance for long-term employee decision-making, the Scorecard system uses measurement as a new language to describe the key elements in the achievement of the strategy.

Measures for the Balanced Scorecard are derived from the objectives appearing on the Strategy Map, which itself serves as a direct and clarifying translation of the organization's strategy. These two links in the chain of success remind me of the old song "Love and Marriage"—you can't have one without the other. A Strategy Map may prove to be the most inspirational document you've ever produced but without the accountability and focus afforded by accompanying performance measures, its value is specious to say the least. Conversely, performance measures serve as powerful monitoring devices, but without the benefit of a clear and compelling Strategy Map, much of their contextual value is lost. It would not be an exaggeration to suggest that measurement is at the very heart of the Balanced Scorecard system, it's in the tool's very DNA, and has been from its inception in 1990. Strategy Maps communicate the strategic destination, while performance measures housed within the Balanced Scorecard monitor the course allowing

us to ensure we remain on track. We'll return to the vital concept of measurement in Chapter 8.²²

Before we move on, a quick check. Are you confused over the difference between a Strategy Map and a Balanced Scorecard? If so, this is the time to clear things up because it's a crucial distinction that you must understand should you hope to use this tool effectively. Step number one in the overall process is creating a Strategy Map that tells the story of your strategy (on one page, remember) through the use of objectives—concise statements of what must be done well in each of the four perspectives. Once you've developed a clear and compelling Map, you will create performance measures for each of the objectives. You'll use the measures to hold yourself accountable for achieving the objectives and ultimately executing your strategy. The measures are housed in a Balanced Scorecard since they are the ultimate arbiters of success, providing the actual score for us to tally and analyze.

The confusing part, to me at least, is that we call the entire system a "Balanced Scorecard" when in fact it is composed of both Strategy Maps of objectives and Balanced Scorecards of measures. Chronology should shoulder the blame for this perplexing situation. As previously discussed, when Kaplan and Norton developed this system, the notion of Strategy Maps wasn't even a glint in their eye. They were focused entirely on solving a measurement issue and through their efforts, and those of the pioneering firms with which they worked, the Balanced Scorecard was born. Several years later, the concept of Strategy Maps emerged primarily from the struggles of early Scorecard adopters. The two have been working harmoniously together ever since, and while we may call the entire framework the "Balanced Scorecard," and I will do so throughout the book, you need to keep in mind that it contains both objectives on the Strategy Map and measures in the Scorecard. And guess what? There's even more to the system: targets and initiatives. But don't worry about them yet, we'll have plenty of time to explore both in the following chapters, and you'll discover how they blend seamlessly into the overall fabric of the system.

The Balanced Scorecard as a Strategic Management System

For many organizations, the Balanced Scorecard has evolved from a communication and measurement tool to what Kaplan and Norton have described as a "Strategic Management System."²³ While the original intent of the Scorecard system was to balance historical financial numbers with the drivers of future value for the firm, more and more organizations experimented with the concept and 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 we 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 (on the Strategy Map), 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 Strategy Map and Scorecard, an executive group may determine that "superior service" translates to the objective "provide fast turnaround." That may then be translated into the measure of "response time to inquiries." All employees can now focus their energies and day-to-day activities toward the crystal clear goal of response times rather than wondering and debating about the cliché "superior service." Using the Balanced Scorecard system 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 Overcomes the People Barrier To successfully implement any strategy, it must be understood and acted upon at every level of the firm. Cascading the Scorecard means driving it down into the organization, giving all employees the opportunity to demonstrate how their day-to-day activities contribute to the company's strategy. In this way, organizational "ranks" distinguish their value-creating activities by developing Scorecards that link to the highest-level organizational objectives.

Through cascading, you create a line of sight from the employee on the front line 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 9, 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's rewards directly to the areas in which they exert influence. All employees can now focus on the performance drivers of future value, and what decisions and actions are necessary to achieve those outcomes.

Strategic Resource Allocation Overcomes the Resource Barrier Developing your Balanced Scorecard provides an excellent opportunity to tie resource allocation and strategy. When we create a Balanced Scorecard, we not only think in terms of objectives, measures, and targets for each of our four perspectives, but just as critically, we must consider the initiatives or action

plans we will put in place to meet our Scorecard targets. If we create long-term stretch targets for our measures we 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 numbers and add or subtract an arbitrary 5%. 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 tremendous 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 to 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 Map and Scorecard, you should review all the initiatives currently underway in your organization to determine which are truly critical in 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 10 is devoted to a greater review of this topic and provides guidance on how you can link your budgets to strategy.

Strategic Learning Overcomes the Management Barrier In today's rapidly changing environment, we 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 us with 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 our strategy.

Much has been written in recent years about knowledge management strategies within organizations, and many schools of thought exist. One common trait of all such systems is the desire to make the implicit knowledge held within the minds of your workforce explicit and open for discussion and learning. We live in the era of the knowledge worker, the employee who—unlike his organizational predecessors who relied on the company's

physical assets—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.²⁴ Sharing Scorecard results throughout the organization provides employees with the opportunity to discuss the assumptions underlying the strategy, learn from any unexpected results, and dialogue 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% said they were aware of, and understood, the strategy. One year following a full Balanced Scorecard implementation, that number had risen to 87%! 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 open book.

In my work with the Balanced Scorecard over the last 12 years, I have come to believe that its greatest power and potential lies in the opportunity to improve management learning and discussion through an improved meeting structure and process. We will examine this critical topic in greater detail in Chapter 11.

NOTES

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4. 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.

5. Found at: www.whitehouse.gov/omb/budget/fy2002/mgmt.pdf

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