

# Balanced Scorecard **REPORT**

INSIGHT, EXPERIENCE & IDEAS FOR STRATEGY-FOCUSED ORGANIZATIONS

ON BALANCE

Another **exclusive** excerpt from Kaplan and Norton's new book,  
*Strategy Maps: Translating Intangible Assets to Tangible Outcomes*

*Part Two of a Two-Part Series*

## Organization Capital: Leadership, Alignment, and Teamwork

By Robert S. Kaplan and David P. Norton

**We've said it often: managing strategy is synonymous with managing change. And it's through intangible assets — organization capital — that an organization mobilizes and sustains the change necessary to execute strategy. In Part I (BSR January–February 2004), we examined culture, the first of four components of organization capital. Here, we continue our discussion of the remaining three: leadership, alignment, and teamwork (knowledge sharing). Together, they help define the organization's *change agenda*.**

### Leadership

When a company changes its strategy, its people must do things differently as well. And it is the job of leaders at all levels of the organization to help employees identify and understand the changes needed to execute the new strategy and to motivate and guide them toward new ways of working.

In Part One, we introduced the concept of an organization *change agenda*. This type of agenda defines the specific shifts in organization climate required by the new strategy. Through our Balanced Scorecard (BSC) research database we've identified seven generic behaviors that executives have typically cultivated as part of their BSC implementations. (See *Figure 1*, left column.) Since each organization and its strategy are different, the organization change agenda must obviously be tailored to each situation. Another important function of the change agenda is that it helps clarify the leader's job.

To ensure that it gets the kind of leaders needed to execute the strategy, the organization should create a Leadership Competency Model. This model identifies the specific traits that leaders must exhibit to support the strategy and is derived directly from the organization change agenda.

*Figure 1* illustrates the Leadership Competency Profile for Finco, a disguised financial services company. Finco provides a complex array of financial instruments to corporate investors as part of its strategy of providing a "total customer solution." In reviewing the strategy, we identified eight behavioral changes that Finco leaders were responsible for mobilizing. As shown in *Figure 1*, the changes began with an emphasis on delivering "high-quality solutions that meet clients' business needs," to focus on delivering value to the

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client. Outstanding leaders were expected to practice this behavior themselves and inculcate it in others. The strategy also called for building long-term relationships. Helping clients solve problems required a more innovative environment than Finco had previously established, as well as a focus on results. Besides these five value-creating behaviors, leaders were also expected to build competencies that would improve the organization's ability to execute strategy: translating the vision ("shaping strategy") into discrete functional plans to which employees could align themselves; spurring open communications to build commitment; fostering teamwork and promoting knowledge transfer ("fostering organization learning") rounded out the list of desired leadership competencies.

Organizations will typically use employee surveys to see how an executive measures up against the ideal traits listed in the Leadership Competency Profile. A staffer might solicit information from subordinates, peers, and superiors about a leader's mastery of the critical skills; an external unit might also solicit such input. This feedback is used mainly for coaching and developing the leader, but an organizational unit can also aggregate the detailed (and confidential) data from the individual reviews to create a status report on leadership competencies needed throughout the organization.

### Alignment

Organizational change expert Peter Senge, in *The Fifth Discipline: The Art and Practice of the Learning Organization*,

**Figure 1. The Leadership Competency Model at Finco**

Organization Change Agenda (generic model)		Finco's Leadership Competency Profile
Behaviors that create value	• Focus on the customer	<ul style="list-style-type: none"> <li>• <b>Focus on client value</b> Outstanding leaders deliver high-quality solutions that meet clients' business needs</li> <li>• <b>Cultivate key relationships</b> Outstanding leaders build and maintain relationships that promote Finco's market presence</li> </ul>
	• Be creative and innovative	<ul style="list-style-type: none"> <li>• <b>Drive innovation</b> Outstanding leaders promote innovation; they are open to change</li> </ul>
	• Deliver results	<ul style="list-style-type: none"> <li>• <b>Deliver results</b> Outstanding leaders deliver superior results to all stakeholders</li> </ul>
Behaviors that help execute strategy	• Understand the mission, vision, and values	<ul style="list-style-type: none"> <li>• <b>Shaping strategy</b> Outstanding leaders understand how vision is implemented through function-related strategies that achieve sustainable competitive advantage</li> </ul>
	• Create alignment and creativity	<ul style="list-style-type: none"> <li>• <b>Building commitment</b> Outstanding leaders communicate openly, gaining support of others, to support Finco's vision and core values</li> </ul>
	• Communicate openly	<ul style="list-style-type: none"> <li>• <b>Fostering teamwork</b> Outstanding leaders create teamwork across individuals, organizations, and cultures</li> <li>• <b>Fostering organization learning</b> Outstanding leaders endure continuity of the business through knowledge transfer and increasing intellectual capital</li> </ul>

*The eight competencies identified in Finco's Leadership Competency Profile helped the company achieve its "total customer solution" strategy.*

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**Some references in the To Learn**  
More sections may require readers to join BSC Online. If you are not yet a member, we invite you to become one — membership is free. For details, visit [www.bscol.com](http://www.bscol.com).

Figure 2. Measuring Alignment and Teamwork: Typical Measures

Organization capital	Strategic Objective	Strategic Measure	Organization
<b>Alignment</b>	• Ensure all employees understand the strategy	• Percentage of employees who can identify the organization's strategic priorities (survey)	Healthcare (A)
	• Reinforce strategic direction and strengthen sense of urgency and purpose	• Percentage of employees with objectives tied to BSC	Mutual funds (B)
	• Align efforts through measurement and reward	• Percentage of employees with goals mapped to strategy (BSC)	Healthcare (C)
	• Align personal goals	• Percentage of staff with goals linked to BSC	National bank (D)
	• Create a motivated and prepared workforce	• Percentage of staff with personal BSC	Process manufacturing (E)
	• Empower employees	• Percentage of staff with training and development linked to BSC	City government (F)
<b>Teamwork (knowledge sharing)</b>	• Develop a learning organization	• Number of best practices identified • Output per employee	Chemicals (G)
	• Continually develop and transfer knowledge	• Hours of training per person	Mutual insurance (H)
	• Ensure communication of best-practice ideas	• Percentage of employees participating in the "work-out" process	Financial services (I)
	• Improve cross-company communication	• Percentage of staff using knowledge-sharing channels	Pharmaceuticals (J)
	• Create and utilize a common global system and process for sharing knowledge	• Currency of projects in knowledge bank (KB) • Number of hits to KB	Software (K)
	• Ensure availability of accurate, consistent information across the organization	• Percentage of targeted measures, data, and statistics accessible across the organization	Financial services (L)
	• Integrate employees	• Number of cross-division movements	Manufacturing (M)

Here's how a variety of actual organizations define and measure alignment and teamwork (knowledge sharing).

stresses that broad-based organizational change requires alignment in which all members of a team have a commonality of purpose, a shared vision, and an understanding of how their personal roles support the overall strategy. "Alignment is the necessary condition before empowering [the individual].... [Once aligned] the individual will empower the whole team."<sup>1</sup> An aligned organization encourages employee empowerment, innovation, and risk taking because individual actions are directed at

achieving high-level objectives. Encouraging and empowering individual initiative in an unaligned organization leads to chaos, as the innovative risk takers pull the organization in contradictory directions. The effect is similar to that of the self-declared job description of a new business school dean: "taking 60 puppy dogs for a walk without a leash."

Achieving alignment is a two-step process. First, leaders must communicate the organization's high-level strategic objectives in ways that every employee can

understand. Second, leaders must ensure that individuals and teams have local objectives (with associated rewards) that, if achieved, contribute to achieving the targets of the high-level objectives. Leaders create strategic awareness through a multifaceted communications program involving a wide range of channels — brochures, newsletters, town hall meetings, orientation and training programs, executive talks, intranets, and bulletin boards. Organizations typically use employee surveys to determine whether employees

are aware of and understand the high-level strategic objectives. *Figure 2* shows how several organizations measure alignment. Organization A (*Figure 2*), a healthcare provider, uses a portion of its annual employee survey to quantify the percentage of employees who can identify the organization's strategic priorities. Other organizations sample employee awareness more frequently, measuring the effectiveness of their employee education program in the same way they would measure an advertising campaign aimed at potential customers.

Organizations also achieve strategic alignment by linking employees' individual objectives and the reward/recognition system to business unit and corporate objectives. Organization B, a mutual funds company, Organization C, another healthcare company, and Organization D, a national bank, all modified their personal goal-setting processes when they introduced the BSC. They educated employees about the organization's strategy and Balanced Scorecard, then asked them to link their personal objectives to the enterprise scorecard. The companies monitored the progress of this program by measuring the percentage of employees with objectives linked to the BSC. Organization E, a process manufacturing company, pushed the alignment idea further, requiring every employee to build his own Balanced Scorecard. Finally, Organization F, a city government, had already linked employee goals to the Balanced Scorecard. Currently in year three of its program, the organization now uses the Balanced Scorecard to align its training and development program to the strategy. It measures the percentage of staff with training and development linked to the BSC.

A sports team would never enter the field of play until every player understood the game plan; otherwise, there would be chaos. Organizations must make the same effort to ensure that every employee understands the strategy. The extent to which they succeed in achieving this alignment determines the value of their organization capital.

### Teamwork (Knowledge Sharing)

There is no greater waste than a good idea used only once. And there is no asset with greater potential for an organization than the collective knowledge of its employees. Many companies today use formal knowledge management systems to generate, organize, and distribute knowledge throughout the organization.<sup>2</sup>

Generating content involves identifying content that might be relevant to others in the organization and then getting people to submit the relevant material to an electronic database. Most organizations have to go through a cultural change to shift the employee mindset from one of hoarding knowledge to one of sharing ideas. Steve Kerr, chief learning officer at Goldman Sachs & Co. and former chief learning officer at General Electric (GE), has noted that a prime component of former CEO Jack Welch's management system was to break down the barriers — both vertical and horizontal — across the organization so that knowledge transfer could occur.<sup>3</sup>

Many organizations spend significant sums on formal knowledge management systems. These systems must provide easy access to users. A "push" system catalogs the needs of users and selectively distributes information, often via e-mail, when it recognizes its potential value to a user.

While this proactive approach can be somewhat obtrusive, it also recognizes that most employees are too preoccupied with their immediate tasks to take the time to search for existing company information that might be relevant and valuable to those very activities.

Knowledge management systems generally consist of:

- Databases and database management systems that collect and store the knowledge base
- Communication and messaging systems that retrieve and transmit the material
- A secure browsing feature that allows employees to search databases remotely, even from public access facilities, while protecting against unauthorized use.

The challenge is to find ways to motivate individuals to document their ideas and knowledge so that they can be available to others. The simplicity of this thought is belied by its difficulty to implement. Yet this difficulty did not dissuade most organizations in our BSC research database from identifying teamwork and knowledge sharing as a strategic priority in the learning and growth perspective of their BSCs.

*Figure 2* shows representative examples of the objectives and measures for best-practice knowledge sharing. Organization G, a chemical company, monitors the number of best-practice ideas that are identified and used. It also measures output per employee to assess the economic impact from knowledge sharing. Organization H, a mutual insurance company, uses its corporate university to transfer knowledge. It measures the number of hours of training received by each individual. Financial services company I monitors the percentage of employees who



transfer knowledge in a “work-out” process, patterned after the one created by Kerr and a team at GE.<sup>4</sup> Pharmaceutical company J and software company K use formalized knowledge management systems to transfer knowledge, and measure the level of system usage. Company K also monitors how up to date the material in its knowledge management system is. Financial services company L focuses on the comprehensiveness and currency of information in its performance databases. Rather than measuring the movement of ideas across the organization, manufacturing company M tracks the movement of key people who carry ideas, measuring the number of cross-divisional personnel assignments.

Organizations G through M in *Figure 2* measure knowledge sharing with input or process measures, not output or outcome measures, which are preferable. Either these organizations deem it too difficult to measure the outputs of knowledge sharing or they believe that these outputs show up in the form of improved performance elsewhere in their strategy maps. It seems, however, that organizations could do better at measuring outputs, using such metrics as “the number of new ideas transferred or adopted” or “the number of new ideas and practices shared with other teams and organizational units.” Jack Welch, famous for making learning an organizational priority at GE, would question division heads about new ideas they had adopted from other GE units and new ideas that had originated within their units that they shared during the year with other GE units. Such questioning, backed up by actual performance measures, powerfully reinforces a culture of teamwork and knowledge sharing.

## Organizational Capital: A Summary

The learning and growth perspective is the foundation of every organization’s strategy. The measures in this perspective are the ultimate lead indicators; they represent the organization’s intangible assets, which create value by their alignment to the organization’s strategy. That is why only the Balanced Scorecard, not financial measures, can quantify the value that intangible assets create.

Human capital is enhanced when development investments are concentrated in the relatively few strategic job families that implement the processes most critical to the organization’s strategy. Information capital is most valuable when it provides the vital infrastructure and strategic applications that complement human capital in promoting outstanding performance in strategic internal processes. The even more intangible organization capital — culture, leadership, alignment, and teamwork — is equally vital for successful strategy implementation. Organizations introducing a new value proposition must create a culture of customer-centric values. The transformation to the new strategy requires exceptional leadership throughout the organization. The new directions for the organization require that communication and performance management systems be aligned to what the organization wants to accomplish. Teamwork, in the form of information and knowledge sharing, is essential. The organization change agenda defines the target of this focus and alignment.

Some shy away from measuring these intangible assets — human capital, information capital, and organization capital — because by their very nature the measures will be “softer,” or more subjective, than the financial measures

conventionally used to assess organizational performance. The Balanced Scorecard movement has encouraged organizations to address this measurement challenge. Companies can now measure what they want, rather than wanting only what they can currently measure. And they’ve learned that just the simple act of attempting to measure the capabilities of employees, knowledge systems, and organization capital, no matter how imprecise, communicates the importance of these drivers in the value-creation process. The approaches described in this article illustrate how organizations have developed new ways to measure, and subsequently to create, their organization capital, thus stimulating the behavioral changes needed to become a successful Strategy-Focused Organization. ■

<sup>1</sup> Peter M. Senge, *The Fifth Discipline: The Art and Practice of the Learning Organization* (Doubleday/Currency, 1990).

<sup>2</sup> The content on knowledge management processes has been drawn from D. Garvin and A. March, “A Note on Knowledge Management,” *Harvard Business School Teaching Note* #396-031 (November 1997).

<sup>3</sup> S. Kerr, “Transformational Leadership: Lessons in Mastering Change at General Electric,” presentation at the Balanced Scorecard Collaborative North American Summit (October 2002).

<sup>4</sup> The GE Work-Out, widely documented, is a methodology that fosters knowledge sharing and organizational problem solving among employees up, down, and across organizational levels.

## To Learn More

Among the many related articles that have appeared in BSR are:

“Measuring the Contribution of Human Capital,” July–August 2001 (Reprint #B0107A)

“Managing the Development of Human Capital,” September–October 2001 (Reprint #B0109A)

“Managing Strategy Is Managing Change,” January–February 2002 (Reprint #B0201A)

(all by David P. Norton) and

“Tear Down These Walls! How to Leverage Intellectual Capital,” by Dr. Steven Kerr, July–August 2002 (Reprint #B0207D)

Reprint #B0403A

# Follow the Money: IT Finance and Strategic Alignment

By Robert S. Gold, Vice President and Practice Leader for Strategic Information Technology Management, Balanced Scorecard Collaborative

**What makes businesses and their IT organizations poorly aligned? The reasons vary: leadership style, enterprise culture, organization structure, even history are typical. But to better understand the challenge in achieving strategy-focused IT, we should heed the advice of the secretive Watergate-era insider “Deep Throat” and follow the money.**

Deep Throat’s advice was simple: follow the money to unravel a mystery. Though hardly as dramatic as the Watergate scandal, the IT alignment enigma is worth investigation. So why follow the money? Most IT organizations I’ve worked with over the past 25 years have struggled with money questions: What is the optimal enterprise-wide spending level for IT? How should existing resources and new spending be allocated among competing business units (BUs)? How should the cost of shared infrastructure be allocated among those BUs?

While most enterprises struggle with such challenges as describing the return on IT investments and managing IT spending’s faster-than-revenue growth, a recent Balanced Scorecard Collaborative/*CIO Insight* survey shows there are no clearly preferred approaches to making IT financial decisions. Yet nearly half of non-IT business managers say their firm’s IT budgeting practices present an obstacle to

aligning IT with the enterprise’s strategic goals.<sup>1</sup>

Wise BU leaders understand that value creation depends on accomplishing the strategic change: to exploit new opportunities and existing capabilities, to defend against competitive threats, and to overcome deficiencies. But since every change involves new, enhanced, or changed information technology, *strategy execution cannot be accomplished without IT*. (This is my first principle of IT Strategic Alignment.) How the IT organization gets and spends its money affects the enterprise’s ability to create value.

C-level executives view IT costs in the aggregate. They see IT’s share of enterprise revenue and expense growing at an alarming rate. While this growth reflects the advancing strategic role of technology, they believe that IT spending is above its optimal level, without ever defining “optimal” or substantiating the figures. From this belief comes an appetite for ROI calculations that invariably prove unsatisfactory<sup>2</sup> and pressure to reduce overall IT spending. The tension between BU leaders who demand increased IT spending and C-level executives who seek to contain it is represented in Principle 2: *The demand for technology in the enterprise always exceeds the capacity of the enterprise to deliver*.

Finally, while there is no generally accepted evidence that increased technology spending creates com-

petitive advantage, common sense dictates that the *converse* is true: *Impairing technology spending ultimately impairs the ability of the enterprise to compete and create value* (Principle 3). In every enterprise, information technology and human capital are the necessary ingredients for value creation.

When it comes to the three categories of IT finance decisions — overall spending, resource allocation, and cost recovery — there is a remarkable absence of conventional wisdom. Some organizations have explicit spending caps, many others do not. Approaches to allocating discretionary IT spending vary widely. And while many organizations use some form of chargeback, others simply don’t bother. Each enterprise has a unique set of IT finance policies that are deeply rooted and hard to change — all of which are potentially significant drivers of IT alignment and effectiveness.

## Overall Spending

A firm’s overall IT spending falls into two pools: mandated and discretionary. Mandated spending is required to “keep the lights on,” to operate the business without any strategic change. The necessary level of this spending is defined by the intersection of two factors: the unit cost of hardware technology (which generally decreases over time) and the demand for existing technology (which generally increases as volume in the business grows), both of which are outside the control of the IT organization. Because mandated spending is the *product* of unit cost and demand, it is difficult to predict the amount and direction of change from one year to the next.<sup>3</sup>

Some organizations establish an annual overall IT spending cap before the IT budget is created. Discretionary spending is determined by the spending cap, minus mandated spending. However, the *demand* for discre-

### Gold’s Principles of IT Strategic Alignment

**Principle 1:** *Strategy execution cannot be accomplished without IT.*

**Principle 2:** *The demand for technology in the enterprise always exceeds the capacity of the enterprise to deliver.*

**Principle 3:** *Impairing technology spending ultimately impairs the ability of the enterprise to compete and create value.*

tionary spending is independent of the IT budget. It derives from BU strategy (Principle 1) and the increased technology intensity arising from necessity: the enterprise simply *must* have e-mail to communicate, it *must* have Web sites to reach its customers, and it *must* play by the strict technology rules of other enterprises (e.g., Wal-Mart's supply chain management disciplines) to survive. These necessities eat into the discretionary pool.

So next year's demand for IT is the sum of mandated and discretionary spending, both of which are difficult to predict. When a cap is imposed, discretionary spending is even more constrained and thus affects strategy execution. The constraint sets off a downward spiral for the organization:

- Fierce competition among BUs for scarce IT resources, which leads to
- dissatisfaction with IT when constrained resources result in project delays, which leads to
- blame placed on the IT organization for lackluster BU performance, which ostensibly justifies
- deliberate or unauthorized IT spending and the decentralization of IT, which results in
- higher technology costs from lost economies of scale and uncoordinated efforts.<sup>4</sup>

But remember: not all firms cap their IT spending. Our survey shows that capping spending does, indeed, have an impact. Among those respondents who rated their firm's performance as "industry leading," about two-thirds have no cap, while among those who rated firm performance "below average," more than half have a cap. Those without a spending cap are less susceptible to Principle 3. But the absence of a cap doesn't mean lack of control. An alternative to the

spending cap is a discipline of demand-forecasted mandatory spending and strategy-driven resource allocation.

It is no more appropriate to impose a limit on mandatory spending than it would be to stop using telephones on the day the annual telephone budget is exceeded. The money will be spent regardless, and the effect of exceeding the budget is to further constrain discretionary spending. I am not advocating a blank check for mandatory spending.

Effective mandatory cost management is accomplished through activity-based costing: grouping and tracking related costs into commodity units (such as desktops or gigabytes of database storage) and managing change in these unit costs consistent with industry benchmarks. At the same time, the demand for these commodity units can be forecast by recognizing and tracking predictors of demand (e.g., employee count is an indicator of desktop computer demand)<sup>5</sup> and by managing capacity to best capture scale economies and avoid excess capacity.

### Resource Allocation

Principle 2 says that some prospective IT opportunities won't be funded. This is a good thing because each opportunity will ultimately deliver a different level of benefit to the enterprise. In some cases the net "benefit" can be zero or even less! Of course, the trick is to pick only those opportunities with the greatest benefit. Perhaps the least effective place to make these critical decisions is inside the IT organization. IT leaders don't have enough information to understand the complete costs and benefits of an

IT investment. In some organizations, the BU manager submits a cost-benefit analysis for IT projects above a set dollar threshold. But there are also "complementary changes" in associated business processes, organization structure, and human capital that are rarely accounted for.<sup>6</sup> Likewise, the benefit of an IT investment is realized in the BU and the enterprise, not in the IT organization itself. IT leaders are ill-equipped to establish or validate estimates of the benefit of IT investment to a BU.

**The decision to fund an IT opportunity is really a decision about the fate of the associated business strategy. By empowering IT to make these hard decisions, senior enterprise management is, in fact, abdicating its proper role.**

While it is beneficial for IT leaders to exercise the discipline of cost-benefit analysis, they are still the wrong people to make the decisions.<sup>7</sup> The decision to fund an IT opportunity is really a decision about the fate of the associated business strategy (Principle 1). By empowering IT to make these hard decisions, senior enterprise management is, in fact, abdicating its proper role. The solution for IT leaders is simple: get out of the business of making strategic decisions on behalf of the enterprise. Devotees of the Balanced Scorecard know that organizations struggle with executing strategy because it is so difficult to describe and communicate. One way to think about strategy is that it describes how the organization creates value. To describe how the organization will create value in the future is to identify the changes the organization must make — its chosen path to its desired future state. It is these deliberate changes that should dictate how the organization will allocate scarce IT resources.



### The Prescriptions in a Nutshell

- Eliminate overall spending caps on IT expenditures.
- Divide the IT budget into mandatory spending (to keep the business running) and discretionary spending (investments to improve the business).
- Manage mandatory spending by tracking unit costs, industry benchmarks, and forecasted demand.
- Integrate discretionary IT spending decisions with their associated business cases, considering all costs and benefits that accrue to the enterprise or BU.
- Depoliticize and rationalize discretionary decisions by taking them out of the hands of the IT organization.
- Align discretionary spending decisions with enterprise and BU strategy.
- Track actual discretionary costs and benefits against forecasts to better manage strategic initiatives and improve forecasting.
- Allocate and recover IT costs completely and transparently from each part of the enterprise, according to actual consumption.

### Cost Recovery

Where does the money for IT expenditures actually come from? Our survey revealed that about 50% of companies treat the cost of IT as a corporate overhead expense. Of the remainder, three out of four base chargeback on actual resource usage, while the rest use a fixed allocation approach (typically weighted by enterprise revenue or some other proxy). While chargeback use doesn't predict enterprise performance, the decision has important ramifications for strategic alignment.

In those enterprises without chargeback, BU leadership tends to view IT as "free," since IT expense doesn't offset BU revenue. BU leaders request more of the IT organization than it can deliver (Principle 2), which increases

the likelihood that IT resources will be spent on a low-value opportunity and that delivery on higher-value opportunities may be needlessly constrained (Principle 3).

Treating IT costs as corporate overhead also creates an accounting issue. In an enterprise with multiple BUs, the IT component of each BU's operating cost is not accurately reflected in each BU's results. When an allocation proxy is used, a BU that is a relatively heavy IT user is likely to see its true cost understated, while a BU that's a lighter user would bear a disproportionate burden, effectively cross-subsidizing its sibling. Only in those enterprises where IT costs are fully understood and allocated can the true financial performance of each BU be fairly considered.

Effective chargeback requires a far higher measurement and reporting burden than overhead or allocation approaches. The myriad approaches to implementing chargeback are each a compromise of the conflicting objectives of simplicity, transparency, and accuracy.<sup>8</sup> Experience shows that effective chargeback happens where: there is a limited number (fewer than 25) of chargeable elements; definitions of these elements are understood and held constant over time; customers periodically participate in a transparent rate-setting process; and the IT organization and BUs partner to develop accurate demand forecasts.

### A Shared Commitment to Change

The first step to improving strategic alignment of IT is for IT leadership to open a candid and constructive dialogue with C-level executives and BU leaders. Each enterprise has arrived at its unique approach to IT finance decisions through years of practice and inertia. The widespread dissatisfaction with

funding decisions and alignment warrants a fresh examination of the problem and a shared commitment to change. Executives should develop a common vocabulary to evaluate the impact of IT funding decisions on the enterprise's effectiveness. Together, they can challenge the effects of overall spending caps or of simply treating IT expense as overhead. Together, they can consider whether current practices serve the best interests of the whole enterprise — or if they constrain the enterprise. Together, they can commit to not just following the money but to managing IT spending for competitive advantage. ■

<sup>1</sup> "How Does IT Funding Affect Alignment?" CIO Insight—Special Issue: Alignment, Fall 2003.

<sup>2</sup> Only 10% of those IT managers responding to our survey expressed complete satisfaction with their IT ROI calculation, while 78% say that it could be improved. The remaining 12% say that calculating ROI is simply impossible.

<sup>3</sup> Try to imagine accurately predicting what you'll spend next year on gasoline. You'd need to predict the number of miles you'll drive, as well as the price of gasoline. Neither is easy to forecast. Now try to imagine storage cost in your firm: What will be the effective cost per gigabyte? How many gigabytes will be required? Total storage cost will be the product of these two.

<sup>4</sup> Robert S. Gold, "Building the IT Organization Balanced Scorecard," BSR September–October 2002 (Reprint #B0209D).

<sup>5</sup> This is a very simple example. A sophisticated organization would track the many potential predictors of demand and use statistical analysis to determine and select those predictors best correlated with actual demand.

<sup>6</sup> Erik Brynjolfsson and Lorin M. Hitt, Computing Productivity: Firm-Level Evidence, MIT Sloan Working Paper 4210-01, June 2003 (available at [ssrn.com/abstract=290325](http://ssrn.com/abstract=290325)).

<sup>7</sup> Jeanne W. Ross and Peter Weill, "Six IT Decisions Your IT People Shouldn't Make," Harvard Business Review, November 2002.

<sup>8</sup> For a broad overview on contemporary approaches to IT chargeback, see Terence A. Quinlan and Susan J. Quinlan, eds., Readings in Chargeback for Information Technology, Santa Barbara, Calif.: IT Financial Management Association, 2003. Available at [itfma.com](http://itfma.com).

Reprint #B0403B



# IT Transformations Spur Enterprisewide Strategic Alignment

By Serena E. Frank, IT Program Management Officer, Harcourt

**Today's economic realities have not spared most information technology organizations from severe budget cuts. Yet IT's internal clients, who likewise must juggle fewer resources and unrelenting demand, view technology as the very means for closing the gap between reduced funding and higher revenue targets. So how can IT — poised between this classic rock and a hard place — meet the heightened challenges of serving the enterprise? Having faced these challenges as an IT strategy professional at two very different companies, the author found the Balanced Scorecard and the Strategy-Focused Organization (SFO) principles<sup>1</sup> to be indispensable. Better still, the BSC-supported IT strategic transformations brought unexpected benefits to both enterprises.**

I admit it: the IT organization is probably not the easiest place to undertake a BSC program. But for an enterprise with limited BSC experience, it may be the only place to start. At two companies I've worked for, that's where we started. Despite the gaps in strategy and process we uncovered within IT and the setbacks we experienced along the way, I discovered a powerful benefit. IT's unique position — supporting and enabling the entire organization, even one in which strategic alignment is not very evolved — allowed us to influence enterprisewide strategic transformation in ways perhaps other units or functional areas never could.

At the IT organization of a top entertainment company, we brought in the BSC to measure performance and improve our alignment with the business. At first, executive support was strong. Mapping the strategy brought the organization's often conflicting factions closer and helped us synchronize top priorities. But support soon began to disintegrate. Leaders lost faith because, even before any data was collected, it was apparent that many key "competency"<sup>2</sup> objectives were

not being met. So executives decided that significant prerequisite initiatives were needed. With two major IT projects already under way, we were stretched thin. Though they recognized the value of the BSC initiative, executives couldn't commit the necessary resources at that time.

It was the lack of clearly defined strategies in our business units that initially drove our IT strategic alignment project. But while our business units recognized the need for strategy definition and measurement-based management, they didn't know where to start. With the IT effort languishing, I decided to take another tack: I became an internal strategic planning consultant. I knew the only way to get our IT organization on track — and to advance alignment between IT and the company's businesses — was to help get our strategic house in order. Within three months, SFO efforts were under way at 10 business units. Within several months, the company implemented the BSC. One year later, the IT organization was revisiting the original project, largely thanks to the strategic planning successes of our "clients."

## Diagnosing Our Ills

At the second IT organization, part of an educational publishing and testing company, the burning platform for adopting the SFO principles was entirely different. The company had recently been acquired, so transition issues predominated. The idiosyncrasies of the publishing industry were also a factor. Academic publishing is a seasonal, cyclical, tradition-bound industry. Printed textbooks still predominate in the K–12 segment, and while electronic products have had a slow market development, to remain competitive publishers must be technologically prepared for their wider acceptance through new thinking, new processes, and new technologies. The textbook "adoptions" in such influential states as California, Texas, and Florida involve multi-year, multimillion-dollar revenue streams. In "open territory" states, publishers must sell directly to counties, school districts, and, in some cases, individual schools. So where the IT organization of the past could focus solely on internal clients and transaction processing, today's IT organization must be more business savvy and focused on the external client.

We were far from that point. Our IT organization suffered from multiple (though entirely common) ills: minimal process definition, communication problems, and low morale. Nearly every project manager served simultaneously as business analyst, project manager, and support manager — roles that each require specific skills, techniques, and behaviors. Asking an individual to wear all three hats was both ineffective and demoralizing. Furthermore, project delivery efforts did not follow a consistent methodology. Development standards were ambiguous or not followed. There were no formalized communication channels for infrastructure and systems support. Not surprisingly,

client relationships became contentious. The seasonality of our business forced IT projects to be calendar-driven, thus undermining our project-planning activities. Demand for IT services was unmitigated and driven by the loudest voice. Clearly, we had to address certain strategic objectives before we could even begin to tackle an entire strategy map's worth.

As IBM's then-new CEO Lou Gerstner noted as he faced salvaging an organization on the brink, "A vision is the last thing we need right now." Stabilizing the company, streamlining processes, and reducing waste came first. Likewise, at my organization, we had to meet our basic tactical needs before we

could worry about strategy and measurement.

### Our Transformation Game Plan

Although this was not the right time to undertake a full-blown SFO initiative, we crafted our IT transformation program based on the BSC strategy map framework. Besides assessing and analyzing the core issues, we worked to forge a foundation of trust.

As a newcomer, I took advantage of my objectivity. I spent several weeks studying the organization and its culture, people, history, and business processes. I interviewed fellow IT leaders, staff, and as many internal clients as possible, learning about their processes and projects. Using the Balanced Scorecard as a

diagnostic tool, I summarized my findings according to BSC perspective. (See *Figure 1*.)

Clearly, we needed a comprehensive transformation, one that focused on improving product and service delivery capabilities — expertise fundamental for any IT organization.

So, in the first quarter of 2003, the IT leadership team launched the "Phoenix IT Transformation," a six-stage process that, like the SFO process, is still evolving — and whose stages are each interdependent.

**Stage 1. Methodology and Process.** We began by creating methodologies for system delivery and project management, a fundamental step we felt would help foster cultural change. We formed a Methodology and Tools Council consisting of representatives from each of the six IT teams within the company (e.g., Back Office Applications, Network, System Services). By leveraging our in-house knowledge, we quickly got everyone on board. Almost immediately, communication among the diverse factions improved. The old finger-pointing, "us-them" mentality began to transform, reflecting a newfound common purpose, shared understanding, and empathy for one another's challenges.

**Stage 2. Policies and Standards.** Next we tackled time tracking, project-status reporting, and architectural standardization. Though simple, these procedures proved difficult to adopt. Until management uses — and enforces — new practices, the staff will usually resist. Only when our executives began instituting a formal governance process (Stage 5) did the value of such practices become apparent — and did everyone begin to use them in earnest.

**Stage 3. Organization Alignment.** This involved creating new job "families" — job descriptions,

**Figure 1. A BSC Diagnosis of the IT Organization's Problems**

FINANCIAL	Lack of true cost accounting for IT efforts	<ul style="list-style-type: none"> <li>IT costs not tracked or allocated back to business units</li> <li>No time tracking</li> <li>IT staff is viewed as "free" resource, despite several rounds of layoffs</li> </ul>
	IT seen as cost center	<ul style="list-style-type: none"> <li>Executives seek budget reductions from IT, rather than providing funds for investment</li> <li>Clients want to minimize cost of IT services yet still compete for attention and resources</li> </ul>
CLIENT (internal)	Relationship based on service-provider, not strategic-partner, model	<ul style="list-style-type: none"> <li>IT viewed as transaction-processing, back-office function</li> <li>Clients use own resources for developing client-facing technology (e.g., Web sites)</li> </ul>
	Lack of governance to prioritize service requests	<ul style="list-style-type: none"> <li>As the arbiter of resources, IT is doomed to disappoint</li> </ul>
PROCESS	Unclear and undocumented processes	<ul style="list-style-type: none"> <li>Project management and resource allocation not documented</li> </ul>
	Ineffective communication channels within IT and with stakeholders, clients, etc.	<ul style="list-style-type: none"> <li>Development and system support teams do not regularly discuss project needs</li> <li>Clients circumvent established triage points for service</li> </ul>
ORGANIZATIONAL LEARNING & GROWTH	Low morale	<ul style="list-style-type: none"> <li>High turnover</li> </ul>
	Job multitasking	<ul style="list-style-type: none"> <li>Project managers tasked with simultaneously providing operational support, project delivery, and client interface</li> </ul>
	Lack of disciplined process for coaching and feedback	<ul style="list-style-type: none"> <li>Performance is largely undocumented</li> </ul>

*These findings represent highlights from the author's assessment.*

required competencies, skills, and learning paths, all grouped by level — that would align with key organizational processes (and that actually tied directly to the process perspective themes in our strategy map).<sup>3</sup> It was also the most sensitive portion of the transformation because it entailed the inevitable and painful personnel changes that make emotions run high and temporarily undermine morale. But this step was critical; project managers had been losing efficiency with all their multitasking, which thwarted their effectiveness in *all* areas.

**Stage 4. Skills Development.** By embarking on skills development, we were finally able to make headway in improving morale. Now we were *investing* in people's skills rather than evaluating them. We provided methodology, project management, and requirements management<sup>4</sup> training, as well as leadership and communication skills. We underwent personality analysis to better understand ourselves and others, using the results for an IT stewardship exercise and role-playing. The result? Attitudes and communication skills improved all around.

**Stage 5. IT/Business Governance.** How could we convince our business executives, who were already struggling to meet their business objectives with constrained resources, to also “run” IT? Why would anyone want to compete for resources through a seemingly complex, often protracted process? However, governance is critical to the overall success of an enterprise, and its benefits are undeniable. We had to focus our scarce resources on delivering results for the top business priorities. We recognized the need for governance but struggled with identifying the right participants (tech-savvy, strategic-thinking business executives with the time to invest) and then figuring out how to get them to commit.

In August 2003, we launched our governance effort but lacked data and a clear sense of process. Then the company suffered significant turnover in leadership. Recently, we were able to begin working on a more formal approach to governance, armed with project portfolio data, a solid prioritization process, a proposed structure, and a mandate from the C-suite.

Our governance structure is three-tiered. The CxOs and unit presidents set strategic direction and allocate resources among seven business process boards (such as product, inventory/manufacturing, customer, and financial). The boards maintain a technology road map tied to business capabilities and from which they spawn projects. These projects are steered by at least one business and one IT sponsor who manage scope and change. This structure provides a balance between the cross-business-unit representation needed for effective prioritization and the functional expertise needed for detailed decision making. Now, with clearly defined roles, methodology, and governance, we are focused on doing the “right” work, the “right” way.

**Stage 6. Strategic Management.**

The final step: using the Balanced Scorecard for strategic management. It would tie together all previous steps and provide a framework for continuous improvement, as well as a basis for communicating IT's value to the business. We held executive interviews to communicate the strategic management process and to gather input for a draft IT strategy map. Then we held a half-day strategy mapping session that included IT leaders and some internal clients. As a result, our strategy map is now complete with draft measures, and we expect to produce a full-fledged scorecard during the first quarter of 2004. The Strategy-Focused Organization framework should enable us, through meas-

urement, communication, and continuous improvement, to sustain the benefits of the IT transformation.

After hearing about our BSC effort, a corporate-level strategist invited me to participate in an effort to establish common objectives and measures across our parent company's four diverse businesses. As a result, we have established Balanced Scorecards for sourcing and fulfillment. So the cycle of introducing SFO principles; BSC perspectives; and objectives, measures, targets, and initiatives continues.

At both companies, the SFO principles were adopted first in IT, enabling it to become an organizational leader in strategic management. Then our internal clients emulated IT's SFO-guided strategic management approach. All this was possible because IT is uniquely positioned to influence and enable the business. The obstacles we in IT had to overcome to transform our organization helped the broader enterprises realize — and begin to remedy — their fundamental misalignment. These experiences prove that not only can IT take the lead with a BSC effort, but it can also contribute significantly to all-around organizational alignment. ■

<sup>1</sup> The five principles of the Strategy-Focused Organization, as promulgated by Kaplan and Norton, are: (1) mobilize change through executive leadership; (2) translate the strategy into operational terms; (3) align the organization to the strategy; (4) motivate to make strategy everyone's job; and (5) govern to make strategy a continual process.

<sup>2</sup> In an IT strategy map, the Competency theme within the customer perspective relates to basic support and service. IT organizations usually address competency issues before dealing with the Contribution theme, related to innovation and strategic partnership.

<sup>3</sup> See “Strategic Job Families” by Kaplan and Norton, BSR November–December 2003 (Reprint #B0311A).

<sup>4</sup> One of the most difficult and elusive skills in technology is identifying system requirements and ensuring that they are developed into the system and tested, and that personnel are trained.



# The Need for a Venture Scorecard

By Gary A. Bolles, Independent Consultant and Writer



**The Balanced Scorecard is a proven tool for established companies working to align themselves to achieve strategic goals. But early-stage companies have unique challenges that make implementing such processes far more difficult. The solution? A Venture Scorecard, a set of processes for continually aligning smaller, more dynamic organizations to allow them to leverage the value of the scorecard through their various stages of growth. By providing a credible gauge of strategy execution progress — which can differentiate ventures — the BSC can provide a boost to venture investing in the post-tech bubble era, when capital is harder to raise.**

Continually honing strategic goals, keeping aligned to strategy, and communicating with stakeholders are difficult processes for even the most mature organizations. But these activities present tremendous hurdles for early-stage ventures. To explore potential ways to overcome these challenges, it's important to understand the characteristics that define ventures, their goals, and the influences affecting their ability to reach those goals.

Early-stage ventures fall into one of three broad categories. *Independent for-profits*, which can be backed by venture investors, have a strong impetus to either quickly establish themselves in the marketplace — working toward specific milestones to achieve profitability — or to continue having access to capital. *Corporate “intraventures” and joint ventures*, typically structured as internal, quasi-independent “skunkworks” projects or as spinoff ventures of one or more parent organizations, often share the same development characteristics of independent for-profits, with the added need to coordinate management directives from their parent companies. *Independent nonprofits and not-for-profits* have multiple, different — and

sometimes competing — goals: building a sustainable business, providing benefits to one or more constituencies, and, at times, delivering measurable environmental benefits. For this reason, they are sometimes called double-bottom-line or even triple-bottom-line organizations.

Each of these ventures is typically influenced by the needs of five kinds of stakeholders. The first kind, *suppliers of capital*, includes investors, parent companies, and donors. Some funding sources want only assurances that the venture is meeting its goals, while others seek input into the company's strategic direction and may even require direct influence over major decisions. The goals of funding sources vary, from wanting the value of the investment to increase, to ensuring that some specific social or marketplace outcome is achieved. For the venture, meeting the needs of its capital suppliers is usually vital to ensuring continued access to capital.

Next are *customers*. They need to know the organization can reliably deliver the products and services it promises. Customers recognize that they are not only providing revenue but are aiding the venture with early references. Members of the venture's *board*

*of directors* need the most complete picture possible about organizational performance but are often constrained by their own time limitations, and by the amount of information the venture is able to regularly provide. Much like suppliers of capital, *strategic partners* want assurances that their resource investments will bear fruit.

Finally, *employees* need direction and information — arguably more than established organizations — to help them keep focused on helping to achieve the organization's goals.

## The Unique Management Challenges Ventures Face

In terms of organizational management, early-stage ventures have a variety of advantages over mature organizations. Their manageable scale makes it easier for entrepreneurs to focus resources and gather information. Their clarity of purpose speeds strategy modification and execution. Early ventures typically employ generalist skill sets, hiring adaptable employees who can wear different hats as needed. Ventures are much closer to constituents, often having much greater customer contact. All of these advantages provide the ability to be flexible and agile, adapting rapidly to new information and opportunities.

Yet start-ups also have three unique characteristics that can impede their ability to even leave the gate.

1. *Resource constraints.* Start-ups rarely possess all the resources needed at any stage of development. They are constantly at risk that their larger competitors will see the opportunity on which the start-up is focused and shift significant resources to attack that market. As a result, the inefficient allocation of resources can mean death to an early-stage venture.
2. *Lack of performance metrics.* A mature customer base can be



readily segmented and analyzed, allowing the organization to continually determine new areas of focus. But early-stage ventures rarely have consistent metrics from customer-related activities. As a result, products and services are often developed in a vacuum, and the feedback loops of customer response are often fractured and inefficient.

*3. Multiple masters.* Often, the key stakeholders of early ventures have radically different, and at times competing, strategic goals and decision-making processes. For example, directors may have different views on how rapidly a company should achieve profitability. Or, the two parent companies of a joint venture may end up with competing views of the markets their progeny should first attack.

These limitations encourage several negative behaviors by entrepreneurs that can threaten the start-up's viability. Entrepreneurs continually shift direction based on new information or new problems. Lacking the volume and quality of information enjoyed by their counterparts at mature organizations, they often become uncertain whether the strategy du jour is the right one. Result: frequent changes in direction. Entrepreneurs chasing the wrong strategy can also find themselves directing scarce resources at the wrong problems. While employees may have the skill sets to attack problems, their efforts may not achieve strategic results. Finally, because the satisfaction of each stakeholder directly affects the satisfaction of other stakeholders, venture management has a strong incentive to provide different information to different constituencies. For example, to encourage a customer to commit to product delivery, that customer might be told that a new round of funding is near. At the same time, an investor might be told that a

customer is about to commit to product delivery, to encourage the investor to contribute to the funding. Moreover, consistent reporting mechanisms linked directly to strategy are few, if nonexistent. Most often, however, such communications are a low priority for entrepreneurs, preoccupied as they are with establishing the business.

### The Case for a Consistent Venture Management Methodology

To entrepreneurs, overcoming these challenges isn't simply an intellectual exercise. If an early venture fails to achieve its strategic goals in the necessary time frame, the company can be out of business — with all stakeholders, including the entrepreneur, on the losing end. What's needed is a methodology that can help start-ups achieve their strategic goals at each stage of development, providing the best possible framework for strategy execution. Call it a system for the “strategy-focused venture.”

Yet process is typically the enemy of the entrepreneur. Developing consistent, replicable steps for performing the work of the organization is antithetical to the entrepreneur's way of thinking. And that's generally appropriate, because too much process can be the death of early ventures, constricting their ability to make rapid decisions and move more nimbly in the marketplace than their mature counterparts. In fact, implementing process methodologies at the raw start-up stage — a few entrepreneurs and an idea — probably isn't smart. For an infant company, strategy is necessarily fluid; with few people involved, strategy development

can't afford to follow a rigorous management process. However, as ventures rapidly begin acquiring assets — capital, personnel, and customers — that's when a more disciplined approach to executing based on strategy ought to begin, perhaps as early as with a few dozen employees or when a first product ships.

### The Venture Scorecard

To help overcome their competitive and internal managerial challenges, entrepreneurs need a Venture Scorecard to provide clear steps for managing growth businesses at various stages. Building on the wealth of knowledge compiled through years of Balanced

**Mature companies can look to metrics such as market share analyses and price-earning ratios, but start-ups have very little information to determine if a strategy is the right one. This is especially true when it comes to customer information.**

Scorecard use, as well as on research that could be conducted with a variety of organizations that have successfully grown from early venture to profitable companies, a Venture Scorecard would articulate a methodology that adapts standardized scorecard practices to the unique requirements of early-stage ventures.

Though much research remains to be done, one can envision several clear characteristics of such a methodology.

**Perspectives adjusted for stage.** The framework for articulating strategic priorities must be continually modified based on the stage the company is at and stakeholder dynamics. Just as nonprofits such as the Boston Lyric Opera and New Profit, Inc. needed to demonstrate their

highest needs for accountability by moving the customer perspective of their BSCs to the top, over financial and shareholder objectives,<sup>1</sup> start-ups deep into their initial research and development cycles may need to give the learning and growth perspective top priority until their technological assumptions are proven.

### **Metrics adjusted for stage.**

Because priorities will shift dramatically as ventures develop assets, the metrics for the management of those assets must change as well. The ingenious processes used by raw start-ups to determine customer needs must mature as data from real customers becomes available. And though happy customers can remain an evergreen goal, the characteristics of customer satisfaction in early, “high-touch” sales and support processes may change substantially once a venture matures to deliver more mass-market products.

**Clear links to stakeholder requirements.** A Venture Scorecard must reflect stakeholder priorities in the right framework. For joint ventures, the strategic requirements of parent companies need to be clearly articulated and may carry such weight as to warrant another customer category, or even to have strong linkages to the parents’ own scorecards. Independent start-ups must use their scorecards to get suppliers of capital to agree on issues such as the balance between gaining market share and achieving profitability, and nonprofits must use their scorecards to balance their double- or triple-bottom-line goals. Yet entrepreneurs shouldn’t forget that their stakeholders must be part of the priority assignment process. Stakeholders must agree among themselves on their respective priorities, or start-up management will find itself unable to solve the multiple masters conundrum.

**Spare, yet dynamic.** A Venture Scorecard must not require laborious effort on the part of entrepreneurs or it will never be used. Instead, it must be simplified based on the start-up’s resources at various stages. In the venture’s earliest period, a Venture Scorecard should require little supporting documentation or implementation plans. Over time, however, as the venture grows, additional steps must be added to ensure that the right level of detail is available to execute the strategy properly and that the rapid cycles of strategy redevelopment can slow to more appropriate review periods.

### **Strategy-Focused for Success**

A Venture Scorecard can alleviate a variety of venture woes. By providing consistent strategy development steps while keeping the overhead associated with management processes to a minimum, it can allow entrepreneurs to continue to leverage the venture’s natural advantages of flexibility and agility. Such a scorecard can help to keep the start-up strategy focused, adjust performance metrics, better allocate sparse resources, and balance stakeholder requirements. A Venture Scorecard can resolve much of the information asymmetry that plagues start-ups by serving as the standard information exchange mechanism between entrepreneurs and stakeholders. And, as ventures mature, a Venture Scorecard can easily be adapted to become a traditional Balanced Scorecard, helping companies that have matured to avoid the kinds of seismic strategy alignment processes that befall businesses that come late to the scorecard approach. By adding performance measurement and monitoring ability at the micro level, the venture BSC could conceivably help spur venture investing at the macroeconomic level — no small benefit in an era

of constrained capital and limited entrepreneurial development. ■

<sup>1</sup> “The Balanced Scorecard and Nonprofit Organizations” by Robert S. Kaplan, BSR November–December 2002 (Reprint #B0211A).

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## **I N T H E N E W S**

### **B R I E F S**

#### **Employees’ lack of strategic awareness**

is a major cause of strategy execution failure, according to BSCol’s Dana Goldblatt, in “Using Strategic Communications to Execute Strategy” ([www.SmartPros.com](http://www.SmartPros.com)). Goldblatt outlines the key components of a formal communications program and common challenges, offering a case study of **Handleman**

**Company’s** communications efforts....Get your **strategy map whiteboard** now! *CIO Insight’s* November 2003 issue featured a whiteboard by David Norton on strategy maps — still available at [www.cioinsight.com](http://www.cioinsight.com). This four-page schematic shows how an organization can align IT to enterprise strategy....

**Critical Success Factors plus BSC = marketplace power:** Researchers at Tilburg University in the Netherlands found that an integrated framework combining the BSC and critical success factors helps organizations resolve the “tension between strategy implementation and strategy formulation” — of particular benefit to companies operating in dynamic markets with fast-changing customer needs. The six-year study was written up in “Strategic Control,” in *Long Range Planning* (August 2003)....Following the **City of Brisbane’s** BSC success, numerous Australian municipalities and government agencies have adopted the BSC. In December, the regional utility **Western Water** was named **Australian Public Sector Organization of the Year** for its model business management approach and BSC system.

# Five Easy Steps for Developing Your BSC Measures

By Andrew J. Pateman, Manager, Balanced Scorecard Collaborative

**Having trouble choosing performance measures for your scorecard? The process needn't be painful or interminable. First, forgo perfection. Then, follow these five steps — lessons culled from actual BSC implementations — and you'll be ready to move from scorecard building to actual use.**

Organizations developing Balanced Scorecards often experience problems with selecting measures. The common lament? That measure development and selection is complicated and takes too long.

This reaction is understandable but, thankfully, avoidable. These problems usually stem from a perfectionist mindset about the role of performance measures. Many scorecard project teams believe that performance measures must be empirically perfect and statistically sound with no room for ambiguity. They also think measures must be comprehensive — that they need to track every process and every new product.

While perfectly suitable for an organization's financial measures, this quest for perfection tends to fail when applied to more subjective or nebulous areas such as customer feedback, human capital improvement, and internal processes — indeed, the majority of measures in a typical scorecard. Here are five easy steps for developing your scorecard measures, honed from our work with many successful BSC implementations.

## Step 1. Develop the Proper Mindset

Building a Balanced Scorecard demands that organizations possess a flexible and creative mindset when developing measures. They must recognize that:

- Measures drive the behavioral changes demanded by the

strategy. They will cause your people to act differently, processes to improve, and new investments to be made.

- Measures enable executive-level discussion about progress and help answer the question “Are we on the right track?” Good measures enable you to ask better questions, rather than give you neat answers.
- Measures are tools you use to create a climate for action and to support robust strategic dialogue. Successful organizations understand this and have no fear about experimenting with their measures, imperfections and all.

## Step 2. Develop a Strategy Map

Without a strategy map, you only have half a scorecard. The strategy map not only describes your strategy, but it also ensures that the key outcomes and drivers of value remain at the center of what gets managed. The strategy map is the “source code” for your measures and provides a context in which to organize them.

A properly constructed map contains strategic objectives. Each objective describes a desired strategic outcome or the drivers of those outcomes. Each objective on your map is measured.

To create a good strategy map, your executive team must be very clear about the intent of each objective. Why is it part of the strategy? What change is required

to drive success in it? Who is accountable for driving the change(s)? What will success look like?

Executives need to sit down together and work out these questions during a strategy map workshop. Skipping this step ensures your project team will flounder as it struggles to guess what the leadership team's intentions are.

## Step 3. Define Your Strategic Objectives

Once you understand exactly how each objective contributes to the strategy, describe its purpose in writing. This can typically be accomplished in three to five sentences, but a longer explanation is fine. (See *Figure 1*, next page.)

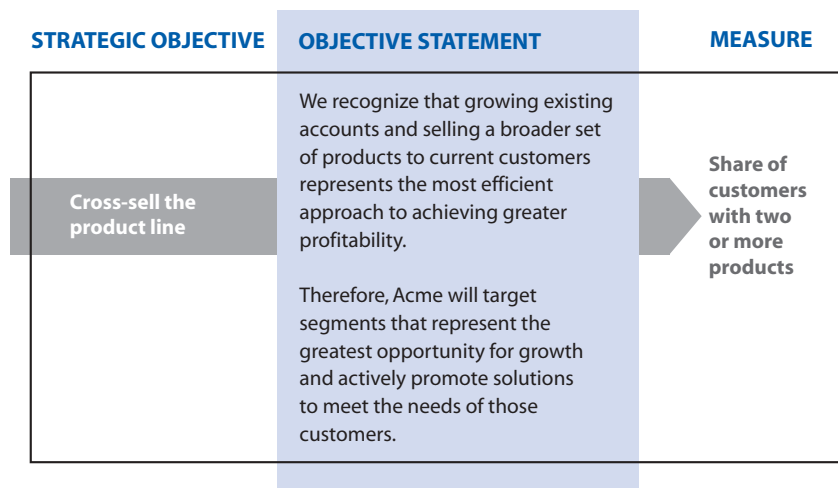
Defining your strategic objectives gives you a record of what executives have committed the organization to achieving. Generic objective definitions are harmful because they inhibit your ability to adequately describe how you intend to operationalize your strategy.

While strategy can be expressed in broad terms, operationalizing strategy requires specifics. If, for example, you're striving for “market leadership,” the scorecard compels you to define that term and decide how it will be delivered to the marketplace. Your definitions provide the necessary clarity and focus. Do not begin developing measures until each objective on your strategy map is clearly defined and validated by the executive team.

## Step 4. Brainstorm Potential Measures

With each objective clearly understood, you have established the scope and boundaries of what needs to be measured. You have homed in on how each objective contributes to executing

Figure 1. A Proven Approach to Devising Measures



*A well-defined objective is the best source of potential measures.*

strategy and what executives want to discuss. Now the project team is ready to brainstorm potential measures. There are generally between two and five possible measures for every objective on your strategy map. For each objective, the project team should review the following:

- What behavioral change does this objective demand? What improvements are required (e.g., faster, slower, more accurate; better market knowledge, greater customer involvement)?
- What will executives need to discuss regarding this objective?

With these thoughts in mind, there are many sources of measures. First, there are those for the measures you already collect. If you are getting outside help, ask your consultant. Chances are, she has good ideas and knows your issues. There is no lack of books and articles on performance measures. Don't be shy about using them.

Assuming four BSC perspectives and approximately 15 to 25 objectives, expect the brainstorming to yield anywhere from 30 to 50 potential measures.

### Step 5. Filter and Select Measures

This final step has two parts. First, the project team must streamline the large list of potential measures to ensure only the best ones remain. Second, the executive team must use this list to select the 15 or 25 measures that will make up their scorecard.

To streamline the large list, the project team filters every potential measure using the following criteria:

- Will the measure help decision makers understand strategic performance and communicate results to employees?
- Is the measure quantifiable and repeatable?
- Can the measure be updated frequently enough to be meaningful, such as on a monthly or quarterly basis?
- Can quantifiable improvement targets be established?
- Does the measure encourage and codify accountability?

You are now ready to have your executive team select the final roster of measures from the list of potentials. We suggest holding a half-day executive workshop for the selection process, in which

executives collectively decide which measures to apply to each objective.

Selecting measures is not as difficult as you might think. With an open and flexible mindset, a willingness to experiment, and comfort with a certain degree of ambiguity, your scorecard will quickly become integral to your organization's success. ■

### To Learn More

*Besides Kaplan and Norton's major works — The Balanced Scorecard, The Strategy-Focused Organization, and Strategy Maps — there are numerous books that provide guidance on performance measures. We do not claim any of the following to be definitive and urge readers to consult online booksellers, fellow BSC practitioners, and other sources.*

Performance Measurement and Control Systems for Implementing Strategy, by Robert Simons, and Cost and Effect, by Robin Cooper and Robert S. Kaplan, provide a useful survey of the field. Also: Winning Score and Keeping Score, both by Mark Graham Brown; Balanced Scorecard Step-by-Step, by Paul R. Niven; Measuring Business Performance, by A.D. Neely; and Performance Drivers: A Practical Guide to Using the Balanced Scorecard, by Nils-Göran Olve et al.

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#### Coming Up In BSR

- Making strategy a core competency: introducing the role of the strategic management officer
- BSC Hall of Fame organization Crown Castle International's BSC success story
- Leadership development expert Jay Conger on mobilizing your organization for strategic change
- Organizing for success: establishing a program management office for your BSC effort
- Tips for leaders: how to present your strategy map
- Creating a strategy-focused workforce: aligning personal goals to the BSC