THE BALANCED SCORECARD

Translating Strategy Into Action

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MAIN IDEA

The Balanced Scorecard is a new business management system which links the achievement of long-term strategic goals with day to day operational requirements. It combines traditional financial measures of success (which are lagging indicators because they always measure past performance) with initiatives designed to generate business in the future (represented by leading indicators).

The Balanced Scorecard also articulates and clarifies why the organization is structured the way it is, and the future direction of the company in such a way that employees, managers and shareholders can have a shared vision which is consistent with the organization's operations.

The payoff for developing a Balanced Scorecard is business strategy can be turned into action.

Traditional financial reporting systems were developed for trading companies and industrial age companies, and measure the events of the past. They do not, however, accurately capture the drivers of future financial performance for modern corporations.

Specifically, a company's ability to create value in the future will be driven by four key factors:

1. The Financial Perspective
To succeed financially, how should the company appear to its shareholders?

2. The Customer Perspective
To achieve the company's vision, how should it appear to its customers?

3. The Internal Business Process Perspective
To provide services which meet customer and shareholder expectations, what business processes must the company excel at?

4. The Learning and Growth Perspective
To achieve the company's vision, how will the company sustain its ability to change and improve?

These four factors are all included in a Balanced Scorecard.

1. The Financial Perspective
The long-term financial goal of any business enterprise is to provide superior returns on the capital invested.

2. The Customer Perspective
At the conclusion of planning the customer perspective, business managers should have a clear picture of the business segments and the specific customer profiles within those segments they are targeting. They should also have developed a clear idea of how the value proposition offered to customers by the company will be structured.

3. The Internal Business Process Perspective
Every business has a value chain by which value is created and delivered to the customer. The balanced scorecard approach makes managers align the various steps of the value chain with specific strategies to meet shareholder and customer expectations more directly.

4. The Learning and Growth Perspective
The objectives in the learning and growth perspective highlight the infrastructure which must be developed for excellent outcomes to be achieved in the other three perspectives. Specifically, any organization's ability to meet ambitious financial, customer and internal-business-process objectives will be directly proportional with the organization's capacity to learn new skills and grow the business.

A good Balanced Scorecard is more than a mixture of financial and non financial measures --it should tell the story of the organization's commercial strategy in a unique blend of:
1. Outcome measures
2. Performance driver measures
3. Cause-and-effect relationships

Broadly speaking, there tend to be four main barriers to implementing the Balanced Scorecard in the ongoing management system of an organization:
1. Visions and strategies that are not actionable
2. Strategies not linked to goals
3. Strategies that are not linked to resource allocation
4. Feedback that is tactical rather than strategic

1. THE BALANCED SCORECARD CONCEPT

Main Idea

Traditional financial reporting systems were developed for trading companies and industrial age companies, and measure the events of the past. They do not, however, accurately capture the drivers of future financial performance for modern corporations.

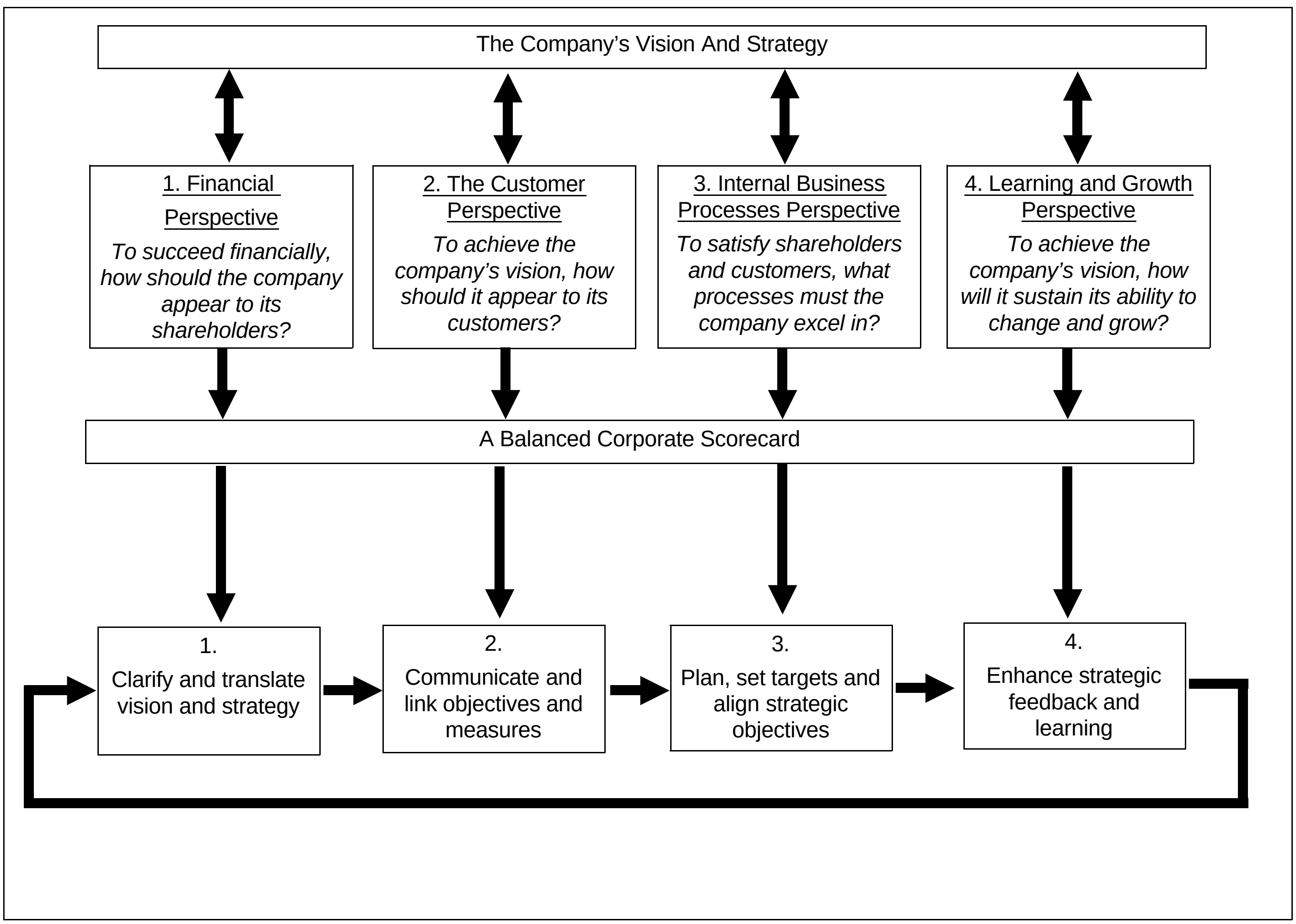
Specifically, a company's ability to create value in the future will be driven by four key factors:

1. The Financial Perspective
   To succeed financially, how should the company appear to its shareholders?
2. The Customer Perspective
   To achieve the company's vision, how should it appear to its customers?
3. The Internal Business Process Perspective
   To provide services which meet customer and shareholder expectations, what business processes must the company excel at?
4. The Learning and Growth Perspective
   To achieve the company's vision, how will the company sustain its ability to change and improve?

These four factors are each represented in the balanced scorecard.

Once a company has developed a balanced corporate scorecard, it can then be used as a strategic management system to manage strategy over the long-term. This involves four steps:

1. The senior management translate the strategy of the business unit into specific strategic objectives
   1. Financial targets
   2. Customer targets
   3. Internal business process targets
   4. Learning and growth targets
2. Next, the specific strategic objectives and systems by which they will be measured are communicated throughout the entire business unit so everyone is aiming for the same targets and objectives.
3. Then, managers must identify what changes will be required if the specified targets are to be met. Plans must be developed on how the organization will implement those changes, resources must be budgeted and allocated and the mechanisms for achieving those targets must be put in place to enable the company to succeed.
4. Finally, the balanced scorecard approach encourages feedback -- management can receive specific information about how the organization is progressing towards the achievement of its targets. This feedback, in turn, may cause some realignment of the targets to be made at intermediate stages, until the final format of the company's strategy is decided upon and implemented.



2. HOW TO BUILD A BALANCED SCORECARD FOR A BUSINESS ENTERPRISE

1. Financial Perspective

To succeed financially, how should the company appear to its shareholders?

Main Idea

The long-term financial goal of any business enterprise is to provide superior returns on the capital invested.

Supporting Ideas

For most business organizations, the financial goals will be most clearly defined, and usually consist of:
1. Increasing revenues
2. Improving productivity
3. Lowering costs
4. Enhancing asset utilization
5. Reducing risk

Most business owners are also familiar with the differing financial demands that occur whenever a company is in a:
1. Growth stage -- requiring high levels of investment
2. Sustain stage -- where maintaining market share is important
3. Harvest stage -- where the main goal is to maximize cash flow

The appropriate financial strategy during each of these stages will be different, and will be along three main themes:
1. Revenue growth and product mix
2. Cost reduction / Productivity improvement
3. Asset utilization / Investment strategy

Therefore, the appropriate drivers of financial performance will take into account the business's stage of development and strategic theme:

	Strategic Theme		
	Revenue Growth & Product Mix	**Cost Reduction / Productivity**	**Asset Utiliz. Invest. Strategy**
Growth Stage	Segmental sales growth Revenue from new products	Revenue per employee	Investment (% of sales) R&D (% of sales)
Sustain Stage	Market share Cross selling Revenues- new applications Profitability	Indirect Expenses Rate of cost reduction	Working capital ratios Asset utilization rates
Harvest Stage	Profitability Percentage of unprofitable customers	Costs per unit of output and per transaction	Payback Throughput

2. The Customer Perspective

To achieve the company's vision, how should it appear to its customers?

Main Idea

At the conclusion of planning the customer perspective, business managers should have a clear picture of the business segments and the specific customer profiles within those segments they are targeting. They should also have developed a clear idea of how the value proposition offered to customers by the company will be structured.

Supporting Ideas

To measure a company's performance from the customer perspective, the following measures can be used:
1. Market share
2. Customer retention level
3. Number of new customers acquired
4. Level of customer satisfaction achieved
5. Customer profitability

Companies should set specific targets in each of these areas, and develop marketing, operational, logistical, product and service targets which support and enhance those targets.

These measures, however, are lagging measures -- they only reflect past performance rather than future intentions. To address this, managers should also focus on the value proposition the company delivers to its customers.

There are three classes of attributes which make up the value proposition:

1. Product and service attributes
   The functionality of the product or service, its price and its quality.
2. Customer relationship
   The delivery of the product or service, response time and how the customer feels about interacting with the company on an ongoing basis.
3. Image and reputation
   The intangible factors that attract a customer to a company.

Managers then focus on developing and delivering a superior value proposition to their targeted customer segments by selecting specific objectives and measures in each of these three classes.

Key Thoughts

"Clearly, if business units are to achieve long-run superior financial performance, they must create and deliver products and services that are valued by customers. Beyond aspiring to satisfying and delighting customers, business unit managers must, in the customer perspective of the Balanced Scorecard, translate their mission and strategy statements into specific market- and customer-based objectives. Companies that try to be everything to everybody usually end up being nothing to anyone."

-- Robert Kaplan and David Norton

3. Internal Business Processes Perspective

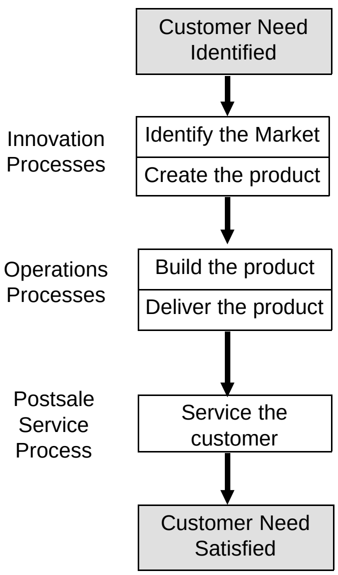
To satisfy shareholders and customers, what processes must the company excel in?

Main Idea

Every business has a value chain by which value is created and delivered to the customer. The balanced scorecard approach makes managers align the various steps of the value chain with specific strategies to meet shareholder and customer expectations more directly.

Supporting Ideas

For most companies, the internal business processes that make up the value chain are:



Innovation processes are critical to the future success of the business. They focus on what benefits consumers may value in the future, and how to deliver those benefits in unique ways.

Operations processes deal with the efficient, consistent and timely delivery of existing products and services to customers.

Postsale service processes include payment processing and warranty or service activities to ensure customers enjoy the quality of their experience in purchasing from the company.

The Balanced Scorecard approach is that internal process performance demands should be derived from the expectations of the specified external constituencies. Specific measurement parameters can be specified and monitored that reflect performance in each of the innovation, operations and postsale service processes.

Key Thoughts

"The process of deriving objectives and measures for the internal-business process perspective represents one of the sharpest distinctions between the Balanced Scorecard and traditional performance measurements systems. Traditional systems focus on controlling and improving existing responsibility centers and departments. In the Balanced Scorecard, the objectives and measures for the internal-business process perspective are derived from explicit strategies to meet shareholder and targeted customer expectations. This sequential, top-down process will usually reveal entirely new business processes at which a business must excel."

– Robert Kaplan and David Norton

4. Learning and Growth Perspective

To achieve the company's vision, how will it sustain its ability to change and grow?

Main Idea

The objectives in the learning and growth perspective highlight the infrastructure which must be developed for excellent outcomes to be achieved in the other three perspectives. Specifically, any organization's ability to meet ambitious financial, customer and internal-business-process objectives will be directly proportional with the organization's capacity to learn new skills and grow the business.

Supporting Ideas

The three principal categories for excellence in this perspective:

1. Employees
   The capabilities of the employees are of vital importance, particularly since so much routine work is now automated. Employee skills must be closely aligned with corporate objectives. The generic measures for employees are employee satisfaction, retention and productivity. Frequently, reskilling the work force will also be a priority.
2. Systems
   Information systems -- which provide rapid, timely and accurate information that can be used when interacting with customers -- are a requirement for companies aspiring to grow.
3. Organizational alignment
   Highly skilled employees using advanced information systems will be unproductive unless they have freedom to make decisions and take action. Therefore, the system needs to allow employees to take the initiative to create satisfied customers.

The learning and growth perspective requires sufficient investment to be made in the people, the systems and the processes that increase organizational capabilities. These capabilities are of special importance because the ability to grow in the future will be directly dependent on the organization's capabilities in this area.

Key Thoughts

"The Balanced Scorecard stresses the importance of investing for the future, and not just in traditional areas for investment, such as new equipment and new product research and development. Equipment and R&D investments are certainly important but they are unlikely to be sufficient by themselves. Organizations must also invest in their infrastructure -- people, systems and procedures -- if they are to achieve ambitious long-term financial growth objectives. Ultimately, the ability to meet ambitious targets for financial, customer and internal-business-process objectives depends on the organizational capabilities for learning and growth."

– Robert Kaplan and David Norton

What Makes for a Successful Balanced Scorecard?

Main Idea

A good Balanced Scorecard is more than a mixture of financial and non financial measures --it should tell the story of the organization's commercial strategy in a unique blend of:
1. Outcome measures
2. Performance driver measures
3. Cause-and-effect relationships

Supporting Ideas

1. Outcome measures
   Outcome measures are lagging indicators -- they reflect the outcome of management decisions taken in the past. They are important, however, because ultimately everything on the Balanced Scorecard will be linked to financial results. Financials, however, just don't represent the entire story.
2. Performance driver measures
   Performance drivers reflect the uniqueness of the organization and its commercial strategy. They're also leading indicators --when teamed with outcome measures, they highlight where a commercial strategy is being implemented successfully to generate expanded business with existing and new customers.
3. Cause-and-effect relationships
   A worthwhile Balanced Scorecard retains a strong emphasis on outcomes, especially financial results such as return-on-capital-employed and economic-value-added. Therefore, there should always be a direct relationship between an improvement program and the ultimate financial performance if the Balanced Scorecard is to be successful from a corporate perspective.

   A strategy can be described as a theory about cause and effect. Cause-and-effect relationships, on the other hand, can be described as if-then statements -- if one condition is created, then the results will be those specified.

Key Thoughts

"Every measure selected for a Balanced Scorecard should be an element of a chain of cause-and-effect relationships that communicate the meaning of the business unit's strategy to the organization."

– Robert Kaplan and David Norton

"A good Balanced Scorecard should have an appropriate mix of outcomes (lagging indicators) and performance drivers (leading indicators) that have been customized to the business unit's strategy."

– Robert Kaplan and David Norton

"Ultimately, causal paths from all the measures on a Balanced Scorecard should be linked to financial objectives."

– Robert Kaplan and David Norton

"The best Balanced Scorecards will tell the story of the strategy so well that the strategy can be inferred by the collection of objectives and measures and the linkages between them. Those companies that can translate their strategy into their measurement system are far better able to execute their strategy because they can communicate their objectives and their targets. This communication focuses managers and employees on the critical drivers, enabling them to align investments, initiatives and actions with accomplishing strategic goals."

– Robert Kaplan and David Norton

How can a Corporate Scorecard be Adapted to Various Business Organizations?

Main Idea

The Balanced Scorecard, to be useful, must reflect the structure of the business organization to which it applies. Therefore, instead of applying only to a stand alone business unit, it must apply equally well to:
1. Corporations that consist of a collection of business units
2. Joint ventures and alliances
3. Support departments in corporations
4. Not-for-profit and government enterprises

Supporting Ideas

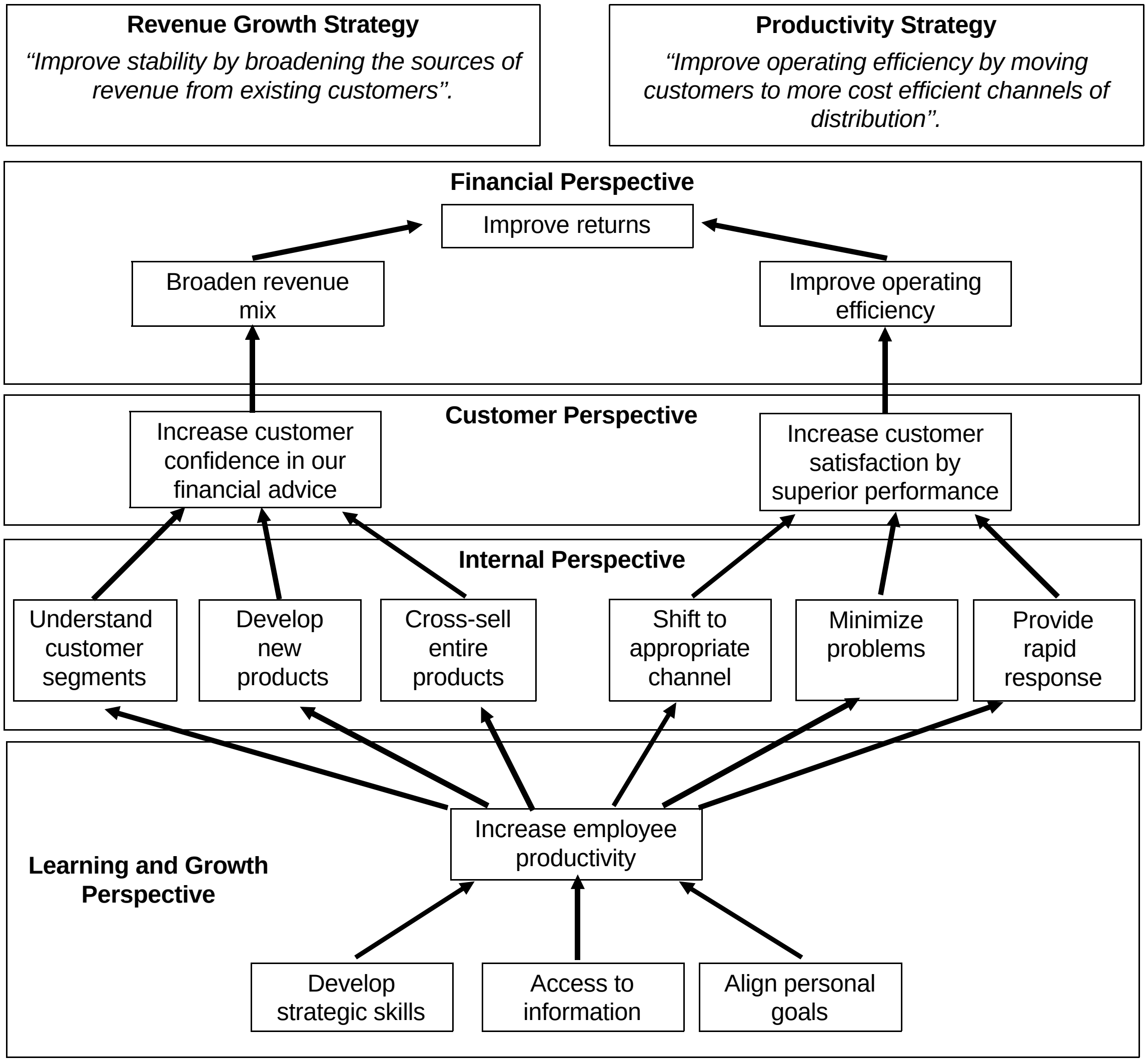
1. Corporations that consist of a collection of business units
   In most cases, the best approach is to develop a corporate level Balanced Scorecard which establishes the themes, financial measures and targets each strategic business unit within the corporation is expected to adhere to.

   Once those corporate level themes are in place, each strategic business unit is then able to develop its own version of the Balanced Scorecard, with each unit developing its own strategy and measures which are consistent with the corporate theme but tailored to meet the specific operational requirements of that individual business unit.
2. Joint ventures and alliances
   In many joint ventures and alliances, defining the goals that both parties have for the venture is quite difficult. Therefore, developing a Balanced Scorecard that can be used to define the agenda and measures on which the joint venture will operate can be a very worthwhile exercise.

   A joint venture Balanced Scorecard can facilitate the creation of unique and sustainable added value as a consequence of working together. The linkage between an outcome and its associated performance drivers may be very illuminating and worthwhile for both parties to the venture.
3. Support departments in corporations
   A Balanced Scorecard for corporate staff groups (maintenance, purchasing, human resources, information technology, finance, etc.) can be very worthwhile. It allows the corporation to identify where low-cost or differentiated services are being offered, and which services can be outsourced without impact on the commercial competitiveness of the corporation.

   A Balanced Scorecard lets those staff groups develop and communicate a strategy based on the value proposition they deliver to other corporate business units. It also provides a mechanism by which internal business processes can be aligned over a large number of groups.
4. Not-for-profit and government enterprises
   Developing a Balanced Scorecard can also deliver enhanced focus, greater motivation and increased accountability in government and not-for-profit organizations. In fact, a Balanced Scorecard can be used to explain the rationale for their very existence -- namely, to serve customers rather than to incur expenditure up to their budgetary limits. A Balanced Scorecard is also useful to these groups to communicate to external constituencies the outcomes and performance drivers by which the group can and should be judged.

Example of a Balanced Scorecard -- The Metro Bank



Metro Bank's Corporate Scorecard

Strategic Objectives	Strategic Measurements: Lag Indicators	Lead Indicators
Financial		
F1. Improve returns	Return on investment	
F2. Broaden revenue mix	Revenue growth	Revenue mix
F3. Reduce cost structure	Deposit service cost charges	
Customer		
C1. Increase customer satisfaction	Share of segment	Depth of relationship
C2. Increase satisfaction after the sale	Customer retention	Survey of customer satisfaction levels
Internal		
I1. Understand our customers		
I2. Create innovative products	Revenues from new products	Product development cycle
I3. Cross-sell products	Cross-sell ratio	Hours spent with customers
I4. Shift customers to cost-effective channels	Channel mix change	
I5. Minimize operational problems	Service error rate	
I6. Provide responsive service	Time from request to fulfillment	
Learning		
L1. Develop strategic skills		Strategic job coverage ratio
L2. Provide strategic information		Information availability ratio
L3. Align personal goals	Employee satisfaction	Personal goals alignment (%)
	Revenue per employee	

3. HOW TO USE A BALANCED SCORECARD AS A STRATEGIC MANAGEMENT SYSTEM

Broadly speaking, there tend to be four main barriers to implementing the Balanced Scorecard in the ongoing management system of an organization:
1. Visions and strategies that are not actionable
2. Strategies not linked to goals
3. Strategies that are not linked to resource allocation
4. Feedback that is tactical rather than strategic

Barrier #1
Visions and strategies that are not actionable

Main Idea

If an organization cannot translate its vision and accompanying mission statements into terms that can be understood by everyone and acted upon, the organization's business programs will be disjointed and inefficient.

Supporting Ideas

In this situation, different groups will pursue different objectives which represent their own personal interpretations of where the organization should be heading.

With any luck, the process of developing a Balanced Scorecard for this type of organization may provide the necessary framework by clarifying strategic objectives and identifying the critical drivers of success. The process of developing a Balanced Scorecard may develop consensus among management of the direction the organization should move. Ideally, the Scorecard should translate that vision into strategic themes that can then be communicated throughout the entire organization.

Key Thoughts

"Company managers have discovered that the scorecard enables them to bridge a major gap that formerly existed in their organizations: a fundamental disconnect between the development and formulation of strategy and its implementation. The disconnect between strategy formulation and strategy implementation is caused by barriers erected by traditional management systems -- the systems organizations use to:
- Establish and communicate strategy and directions;
- Allocate resources;
- Define departmental, team and individual goals and directions;
- And provide feedback."

– Robert Kaplan and David Norton

"The goal of a scorecard project is not to develop a new set of performance measures. The measurement framework in the Balanced Scorecard should be deployed to develop a new management system. This distinction between a measurement and a management system is subtle but crucial. The measurement system should only be a means to achieve an even more important goal -- a strategic management system that helps executives implement and gain feedback about their strategy. The scorecard provides a new tool for senior executives to focus their organizations on strategies for long-term success, an important task that until now has been difficult to accomplish. The Balanced Scorecard embeds financial measurement in a more balanced management system that links short-term operational performance with long-term strategic objectives."

– Robert Kaplan and David Norton

Barrier #2
Strategies that are not linked to organization, team and individual goals

Main Idea

The Balanced Scorecard concept will add value to the organization only if:
1. It is communicated effectively to every employee.
2. The strategy is translated into goals for business units.
3. There's alignment of compensation and achievement of goals.

Supporting Ideas

In one survey, 74% of senior executives had their compensation linked to the organization's annual goals, but less than 33% had incentive compensation linked to achievement of goals. At lower levels of management, frequently less than 10% of employees have any link between their compensation and achievement of goals.

The Balanced Scorecard provides an ideal opportunity for organizations to reinforce the link between achieving scorecard objectives and compensation programs. Those links can be either explicit (using a predetermined formula) or applied judgementally by the management. Strengthening that link provides advantages for both employees and management.

In a similar vein, the development of a Balanced Scorecard also provides the ideal opportunity for companies to educate and involved the people who will ultimately be responsible for executing the strategy -- the employees. By involving all employees in the development process, everyone has the background information they require to contribute effectively.

Some ideas on how to get every person in the business organization aligned with the shared vision and common direction of the Balanced Scorecard:

1. Run communication and education programs that all employees can participate in. This should be ongoing, and should focus on the strategic objectives and the progress made to date in working towards the predetermined goals and objectives.
2. Periodic goal setting programs should be undertaken, on an interval that is logical for the organization. This process should focus on translating the organization's strategic objectives into personal and team objectives that are correctly aligned.
3. The ultimate motivation is the incentive and reward systems. Ideally, the stronger the link between compensation and the achievement of strategic objectives, the better. Over the long-term, employees will do exactly what their compensation system rewards them for doing.

Note the alignment process must also take place in all directions simultaneously -- upwards to corporate boards and shareholders as well as downwards to the bottom of the employee pool at the entry level.

Key Thoughts

"Alignment and accountability will clearly be enhanced when individual contributions to achieving scorecard objectives are linked to recognition, promotion and compensation programs."

– Robert Kaplan and David Norton

Barrier #3
Strategies that are not linked to the allocation of long- and short-term resources

Main Idea

When the budgeting process is separate from the Balanced Scorecard exercise, problems arise. Therefore, operational budgeting must be closely aligned with strategic planning if it is to succeed.

Supporting Ideas

A four step process that integrates the Balanced Scorecard with operational budgeting is:

1. Set ambitious or "stretch" targets.
   The Balanced Scorecard will identify cause-and-effect relationships that can be exploited to achieve breakthrough increases in performance. Take advantage of this opportunity to move the organization forward with purpose.
2. Identify and justify strategic initiatives.
   When a gap exists between current performance and the strategic objective, managers can set priorities for capital investments and action programs that will close those gaps. In addition, managers can also move resources away from programs that will not have any noticeable impact on the achievement of the specified strategic objectives.
3. Identify important cross-unit strategic initiatives.
   For large business organizations, Balanced Scorecard budgeting can enable managers to identify and fund initiatives that will deliver tangible benefits towards the achievement of the strategic objectives of other business units within the organization. Frequently, these type of programs are hard to quantify and measure.
4. Direct link between resource allocation and budgets.
   With the Balanced Scorecard approach, managers can link the company's strategic plan directly to the application of discretionary funds. In addition, milestones can be specified for the coming budget period. The organization's progress towards its strategic objectives can then be tracked using the milestones as way points.

These four processes all have the cumulative effect of increasing the managerial commitment to the achievement of the organization's vision. They also provide a practical framework by which progress can be measured and accounted for.

Key Thoughts

"When organizations make the critical transition from vision to action, they experience the real excitement and gain the real value from developing a Balanced Scorecard. The initial development of a scorecard should always lead to an ongoing series of management processes that ultimately mobilizes and redirects the organization. Each management process involves linking the Balanced Scorecard to drive some aspect of longer-term, strategic, balanced behavior."

– Robert Kaplan and David Norton

"Executives use the many elements of their management systems to orchestrate their agendas. By building the management system around the scorecard framework, they can achieve the ultimate payoff -- translating strategy into action."

– Robert Kaplan and David Norton

Barrier #4
Feedback that is tactical rather than strategic

Main Idea

Feedback on how the strategy is being implemented and whether it is working is very valuable but only rarely delivered. The Balanced Scorecard approach provides an excellent framework around which meaningful strategic performance reviews can be developed.

Supporting Ideas

Feedback is essential if an organization is to test and readjust its strategy as necessary. This is best achieved with a three step strategic learning process:

1. The development of a common strategic framework.
   The Balanced Scorecard provides a consistent enterprise wide strategic framework in clear, consistent operational terms. Everyone in the organization can use the same framework.
2. A feedback process that collects performance data.
   The strategy can be tested, validated and modified as necessary using the cause-and-effect relationships embedded in the Balanced Scorecard. The management can then establish how changes in performance drivers impact on outcomes consistently and systematically, allowing for fine tuning and optimization.
3. A team based problem solving process.
   Again, the Balanced Scorecard is ideal for use in a team based business environment. Ideally, cross functional teams should be used, in order to avoid any tendency to revert to functional specialization. The Balanced Scorecard should be developed by a team drawn from throughout the organization, and performance monitored by that same team.

Key Thoughts

"Companies initially adopt the Balanced Scorecard for a variety of reasons, including clarifying and gaining consensus on strategy, focusing organizational change initiatives, developing leadership capabilities at strategic business units and gaining coordination and economies across multiple business units. In general, organizations can achieve these targeted objectives with the development of an initial Balanced Scorecard. But the development of the scorecard and, especially, the process among senior managers to define the objectives, measures and targets for the scorecard, ultimately reveals an opportunity to use the Balanced Scorecard in a far more persuasive and comprehensive manner than originally intended. The Balanced Scorecard can be the cornerstone of an organization's management system since it aligns and supports key processes. Further, by integrating the Balanced Scorecard into the management calendar, all management processes can be aligned with and stay focused on implementing the organization's long-term strategy."

– Robert Kaplan and David Norton