CHAPTER 1

The Current State of the Balanced Scorecard

THE ROAD AHEAD

Note to self: Always turn off my e-mail program before working on the book. I've provided myself that reminder because my train of thought was just interrupted by a popup box in the corner of my screen. It gently notified me that a new e-mail was awaiting my immediate attention. Much like the ring of a telephone, the temptation overwhelmed me and I took a quick peek to see who had contacted me. It was a gentleman in Zimbabwe requesting additional information about the Balanced Scorecard. I'm happy to help him and will do so later in the day. Once I reply to his request, I'll file it along with those I've received from China, Fiji, South Africa, Singapore, Finland, the U.K., from small manufacturing firms in the Midwest, and large conglomerates in New York City, from civic governments in California, and nonprofits in Washington, D.C. As the roll call of nations and organization types outlined suggests, the Balanced Scorecard has become a full-fledged worldwide phenomenon. And this phenomenon knows no boundaries; it stretches around the globe and has affected virtually every type of organization known to exist.

There is little doubt that the Balanced Scorecard has joined the pantheon of successful business frameworks; that elite group possessing the dual, and highly elusive, qualities of broad-based appeal and proven effectiveness. The sheer breadth and volume of Scorecard implementations are testament to this fact. Popularity, however, does not guarantee successful outcomes for those treading this road, and in fact it has been suggested that a majority of all Balanced Scorecard initiatives fail.[1] The most commonly cited issues derailing Scorecard implementations are poor design and difficulty of implementation.[2] The purpose of this book is to assist you in clearing those hurdles with proven tools and techniques forged at the crucible of cutting-edge theory and practical experience. Pitfalls await those who are unprepared at any juncture in this journey, from poor planning to ineffective team design to inappropriate objective and measure selection, and many more. During our time together, we'll carefully study the essential elements of Balanced Scorecard implementation, offering tools you can use to ensure that your Balanced Scorecard will help you achieve success today and sustain that success for the long term.

Before we begin to critically examine your Scorecard implementation, however, it's important to step back and cast a trenchant eye on the tool itself. In this chapter, we'll review exactly why the Balanced Scorecard has reached an exalted position as the strategy execution choice of literally tens of thousands of organizations; what it is about this seemingly simple tool, above all others, that quickly captures the attention of senior executives and shop-floor employees alike; and finally, why it remains vitally relevant when hundreds of other potential business panaceas have come and gone.

WHY THE BALANCED SCORECARD HAS RISEN TO PROMINENCE

The reasons for the Scorecard's ascendance are many and varied, but principally I believe the tool's longevity can be traced to an ability to solve several fundamental business issues facing all organizations today. In the pages ahead, we'll look at four pervasive issues that are undoubtedly affecting your business even as we speak: (1) a traditional reliance on financial measures, (2) the rise of intangible assets, (3) the emerging pattern of reputation risk, and finally, (4) the difficulty most organizations face in executing strategy. Some of these issues are age old and have been the nemesis of organizations for decades—relying on financial measures and attempting to implement strategy. The others—a rise in intangible assets and the emergence of reputation risk—are new, and their effects are just now being perceived, evaluated, and monitored. What unites these potentially vexing agents of organizational distress, and serves as inspiration for all of us, is the proven ability of the Balanced Scorecard to overcome every one of them.

Financial Measures: Is Their Time Running Out?

When the uninitiated ask me to describe the Balanced Scorecard "in a nutshell," I get the ball rolling by asking them how most organizations measure their success. A short and reflective pause is typically followed by the confident suggestion of "revenue" or "profits." And they're right, most organizations—be they private, public, or nonprofit—gauge their success primarily by the measurement of financial yardsticks. It's been that way for literally thousands of years, and at the turn of the 20th century, financial innovations, such as the development of the return on equity formula, proved critical to the success of our earliest industrial pioneers, including DuPont and General Motors.

The decades have come and gone, with financial measurement continuing to reach dizzying new heights as the number-crunching savvy among us introduced increasingly sophisticated metrics for the analysis of results. The corporate world readily embraced these developments and, as the prodigious growth of our generally accepted accounting principles (GAAP, in accounting parlance) will attest, financial metrics became the de facto standard of measuring business success. But, as is often the case, too much of a good thing can lead to some unintended consequences. The unrelenting drive to achieve financial success as measured by such metrics as revenue and shareholder value contributed to a round of recent corporate malfeasance unlike anything ever witnessed in the long and storied history of commerce.

Leading the ignominious pack of corporate bad boys is, of course, Enron. Once the seventh largest company in the United States, where did their insatiable thirst for growth and financial success lead them? Right into bankruptcy court, dragging thousands of suddenly poorer and justifiably angry shareholders down the path with them. If we use history as a guide, we'll find that Enron is not the first to apparently run afoul of the law in its tireless pursuit of fortune. A cautionary tale comes in the form of Samuel Insull. Upon migrating to the United States from England in 1881, Insull, through an association with Thomas Edison, co-founded the company that would eventually become General Electric. From his base in Chicago, he assembled a portfolio of holdings that would make any would-be financial impresario envious: Commonwealth Edison, People's Gas, Indiana Public Service Company, and several more. At one point, he held 65 chairmanships, 85 directorships, and 11 presidencies.[3] Sadly, the good times were not destined to roll on forever, and the 1929 crash brought his empire down in a tumultuous thud. Humiliated, and seen as the personification of corporate greed, Insull fled the United States but was later dragged back to stand trial for securities fraud. He was ultimately, and surprisingly, acquitted, but gone were his fortune and reputation. He died, penniless, in a Paris subway station on July 16, 1938.

Since the dawn of the corporation with Sweden's Stora Enso in 1288, companies have walked the delicate line of providing prodigious societal benefits and causing immeasurable harm through questionable, and sometimes unconscionable, acts. Recognizing the need to keep corporations in check, Theodore Roosevelt, the 26th president of the United States, once remarked: *"I believe in corporations. They are indispensable instruments of our modern civilization; but I believe that they should be so supervised and so regulated that they shall act for the interests of the community as a whole."*[4] As the President who took a first step toward bringing big business under federal control by ordering antitrust proceedings against the Northern Securities Company, Roosevelt would likely have welcomed the introduction of the Sarbanes-Oxley Act in 2002. The Act has set some of the toughest corporate governance standards in the world, requiring companies to report on the reliability of their financial controls, and asking CEOs and CFOs to put themselves on the line and acknowledge responsibility for internal controls, verifying their effectiveness.

All companies required to file periodic reports with the Securities and Exchange Commission (SEC) are effected by the Sarbanes-Oxley Act. The sheer magnitude of the work associated with compliance is daunting. To give you some indication, Fortune 1000 companies have earmarked more than $2.5 billion this year in investigation and initial compliance-related work.[5] Proponents suggest that the Act represents the most far-reaching U.S. legislation dealing with securities in many years. While the Act contains many provisions, two are particularly relevant to our discussion. Section 906 of the Act requires certification by the company's chief executive officer (CEO) and chief financial officer (CFO) that reports fully comply with the requirements of securities laws and that the information in the report fairly presents, in all material respects, the financial condition and results of operations of the company. Basically, company executives must pledge that what is in their financial reports is accurate and true. The Act also requires plain English disclosure on a "rapid and current basis" of information regarding material changes in the financial condition or operations of a public company as the SEC determines is necessary or useful to investors and in the public interest.

Undoubtedly, many American investors will sleep more easily knowing the Sarbanes-Oxley Act is ever-present, threatening those even remotely considering anything outside the legal lines with the long arm (and increasingly sharp teeth) of federal prosecutors. But does the increased financial disclosure ensured by the Act really describe the value-creating mechanisms of the corporation? Does it provide us with insight as to how intangible assets are being transformed into real value for consumers and shareholders? To make an informed decision about any organization's true state of affairs, we require information that covers a broader perspective. This is the case whether we're talking about a multinational corporation, a local nonprofit health services organization, or any branch of the federal government. Ultimately, the Act makes reported financial numbers safer for our consumption and analysis, but it doesn't diminish the increasingly apparent limitations of financial metrics. Working in the early 21st century, many organizations are beginning to question the once unquestionable reliance on financial measures. Specifically, they note the following:

- *Financial measures are inconsistent with today's business realities.* When I ask my clients what drives value in their business, it is exceedingly rare for me to hear "machinery," "facilities," or even "computers." What I do hear in near unanimity from everyone in attendance are phrases such as, "employee knowledge and skills," "relationships with customers," and "culture." Intangible assets have become the driving currency of organizations wishing to effectively compete in the modern economy. However, beyond "goodwill," you would be hard pressed to find the valuation of such intangibles on a typical corporate balance sheet. Financial metrics are ill-suited to meet the demands levied by the true value-creating mechanisms of the modern business economy—intangible assets. In the next section of this chapter, we'll take a closer look at their steep rise in prominence.

- *You can't see where you're going when you look in the rearview mirror.* Don't try this at home: driving down the freeway with your gaze cast intently on the rearview mirror. Great view of where you've been, but what does it tell you about where you're going? Very little. Financial measures offer the same limited view of the future. A great quarter of financial success, a great six months, or even a great year are not indicative of what lies in store for you. The business pages are littered with stories of falls from grace by once-lofty companies. The legendary Fortune 500 bears witness to the inability of success to predict success. Two-thirds of the companies listed on the inaugural list in 1954 had either vanished or were no longer large enough to maintain their presence on the list's 40th anniversary.[6]
- *Financial measures tend to reinforce functional silos.* If you were to type "teams" into the search box of Amazon.com, how many hits do you think you'd get? Curious, I did just that and was astonished when the total popped up at over 125,000! Granted, not all of these books embrace the topic of cross-functional teams in the modern organization, but the staggering population of texts about teams lends credence to the well-known notion that in order to get anything done in today's environment, we must work together. Thus, in many respects, and in a growing number of organizations, work flows horizontally across the enterprise. Financial measures, however, are decidedly vertical in nature. A department's numbers are rolled into a business unit, and business units are consolidated into a massive corporate heap of digits. This reporting system does little to encourage cross-functional work patterns.
- *What's the first thing to get cut in a downturn?* Easy question, right? If yours is like most businesses, the first things flung overboard when the economic seas become choppy are those that won't be missed tomorrow or the next day—items like training, employee development, and research. Their effects typically aren't seen for months or even years, and thus they become simple targets for the instant gratification, "must meet the numbers this quarter" paradigm of most publicly traded companies. Focusing on short-term financial numbers can frequently cloud our judgment as to what is going to truly distinguish our business from competitors in the long term. While training

may be easy to cut today, what effect will that have on your workforce next year as you attempt to compete in ever-evolving markets?

- *Financial measures aren't always relevant.* We're constantly bombarded with messages about the speed of change these days. I'm guilty of reminding you myself, and did so in the last sentence! Why are these disturbing missives being fired in record numbers? Because it's true. Look at the disruptive technologies we've witnessed in just the past few years that have revolutionized the way business is conducted. Today, more than ever, we need performance information we can act on. Decisions can't be debated endlessly, and the luxury of waiting for complete information is just not an option. Financial measures frequently lack the action imperative necessary to make future decisions. Let's say you pick up your company's monthly income statement and see that sales are 5% off plan. Beyond the obvious, what does that mean, and more important, what do you do? Obviously, declining sales is an important indicator, but what led to that unenviable state of affairs, what was the *leading* indicator? That's the information we need, and fortunately that's what the Balanced Scorecard can supply.

I've charged financial measures with a litany of offenses in the previous paragraphs, so you may be wondering if they even belong in a Balanced Scorecard. The answer is yes, because despite their limitations, no Balanced Scorecard is complete without financial measures. This is the case whether you're reading this as the CEO of a large company, the executive director of a nonprofit, or the senior manager of a state government. An old song reminds us that "money makes the world go round," and so it is with the organizational world. In many cases, the ultimate arbiter of corporate success is financial. Nonprofits and public-sector organizations must also be cognizant of the financial ramifications of their actions and steward their funds in the most efficient manner. This section simply reminds us that financial measures must be balanced with the drivers of future financial success and security. Considered alone, they offer limited value. However, when reviewed in the context of data supplied by nonfinancial measures, they are suddenly imbued with the power of information that can transform decision making and ultimately lead to even greater success.

The Rise of Intangible Assets

The story of intangible assets can sometimes best be told through the prism of your family history, so let me tell you a bit about the Niven clan. My grandfather cut his teeth on the Canadian prairie building railroads for Canadian Pacific. You talk about old economy—the tools of his trade were literally hammer and shovel. It was honorable work, back-breaking of course, but honorable. My father took a different route, opting to be an entrepreneur. He ran a soft-drink business for most of my formative years. Imagine the delight of a youngster whose dad's product is soda pop! Yes, as the "sugar king" I was quite the popular kid in the neighborhood. Dad didn't confine his management to a desk; he was out there on the front lines slinging soda cases from dusk until dawn six days a week. The means of production was a rickety assembly line that produced as many delays and mysterious wheezing sounds as it did soda.

Fast-forward many years, and you have me. I've spent my entire career in some sort of analysis or consulting role, working with others, sharing information and knowledge in an attempt to drive results. I've never swung a pick or hoisted a soda case; in fact, I recently turned 40, and my mother still says I haven't worked a day in my life! Such is the fate of the knowledge worker, and if you're anything like me, that's probably an apt descriptor. In today's economy, things like employee knowledge, relationships with customers, and cultures of innovation and change generate success—in other words, intangible assets.

The power of intangibles manifests in the valuations we see in modern organizations. Margaret Blair of Washington's Brookings Institute explains:

> If you just look at the physical assets of the companies, the things that you can measure with ordinary accounting techniques. These things now account for less than one-fourth of the value of the corporate sector. Another way of putting this is that something like 75% of the sources of value inside corporations is not being measured or reported on their books.[7]

Just 20 years ago, the value of intangible assets in a typical organization rested at around 38%. The value has virtually doubled in the past 20 years. In the United States, spending on intangibles has also grown astronomically, and at around a trillion (yes, trillion!) dollars a year is on par with what companies spend annually on physical assets.[8]

What's become glaringly apparent is that intangible assets are quite different from the "property, plant, and equipment" that have populated fraying general ledger sheets for the better part of the past hundred years. For starters, they may not have a direct impact on financial results. Take training, for example: Many studies have demonstrated that training is positively correlated with financial success, but can we safely say there is a true one-to-one, cause-and-effect relationship evident? Chances are the financial results are a second- or even third-order effect of the training. Perhaps quality improves as a result of better-trained employees. Customers respond favorably to enhanced quality and buy more of the product, which in turn generates financial returns.

There are other differences as well: Tangible assets (as noted previously) are rigorously quantified on our financial statements. Intangible assets, however, can be maddeningly difficult to put a price on. Just what is the value of an innovative culture that consistently delivers new products faster than its competitors?

Tangible assets can be easily duplicated; your company may buy a new machine that increases productivity, but it won't be long before competitors are beating a path to the same supplier. However, intangibles in your possession cannot be bought or duplicated. Relationships with customers that have been cultivated through years of trust and mutual benefit are something your competitors will undoubtedly covet but find it exceedingly tough to beat.

Finally, and this is my favorite, tangible assets depreciate with use. That new computer you bought last week may have the luster of a sparkling diamond now, but just give it a year or two (if that) and then see how much it's worth. Conversely, intangible assets actually appreciate with purposeful use. Consider knowledge sharing: Every time you communicate with a colleague and she expands that knowledge, the circle has been enlarged. Multiply that by dozens, hundreds, or thousands of colleagues on innumerable topics, and the dizzying ramifications will make your head spin. I can scarcely think of a more encouraging fact.[9]

History and tradition yield about as easily as iron bars, so it's not surprising that the rise of intangibles has put tremendous pressure on our performance measurement systems. The antiquated devices employed by most companies simply don't have the capacity to identify, describe, monitor, and provide feedback on these most critical value-creating elements. Going forward, however, there simply is no choice. If 75% of value is generated from intangibles, then we absolutely must develop the ability to measure effectively. As you'll see throughout the book, the Balanced Scorecard has gallantly risen to this vital measurement challenge. In fact, a hallmark of the framework is its ability to track intangible assets and provide intelligence on their transformation into results.

A story from the Balanced Scorecard implementation of the U.S. Army's Medical Department (AMEDD) illustrates the power of the Scorecard in transforming intangible assets. When Lt. General James Peake began his command of AMEDD, he quickly noted: "we recruit soldiers but retain families." Keeping those families happy meant AMEDD had to provide outstanding medical care, and as a result, "quality, compassionate healthcare" became a key objective on the strategy map. The objective sounded noble, but what effect would it have on decision making and action in the field? The test came soon after in the form of a pregnant woman whose unborn child was threatened with a serious neurological defect. Careful diagnosis led to the recommendation of a costly surgery that held the promise of saving both mother and child, but initially the reimbursement was declined because the procedure was deemed experimental. A team of Army medical experts was soon convened, and the promise of compassionate care was put to the ultimate test. After careful reflection the decision was reversed, payment approved, surgery performed, and amid the great joy of all, a beautiful baby girl was born completely free of any complications. As Major General Patrick D. Sculley describes it:

> A commander and many consultants went the extra mile, realizing that the initial "no" would have been far more than just a hassle for the family. They wanted to deliver the compassionate care we aspire to on our Scorecard. I'm proud of the way AMEDD could cut through all the red tape and make an informed and appropriate decision.[10]

Reputation Risk

Can you recall where you were on June 13, 2002? I was at home that day, and began my morning as I frequently do, by reading the Wall Street Journal. One headline that day jumped out at me above all others: "ImClone's Ex-CEO Arrested, Charged with Insider Trading."[11] The article described the sorry tale of Samuel Waksal, who had been arrested for allegedly relaying information to family members that the Food and Drug Administration was about to reject his firm's cancer drug, Erbitux. Buried deep within the text was this seemingly innocuous reference to a friend of Waksal's: *"Also implicated is Martha Stewart, who sold 3,928 shares on December 27th the day before ImClone announced the FDA's rejection."*[12] That single sentence was reported to headlines and cable news shows around the world in what seemed like a nanosecond. The government soon shifted its investigative rigor into high gear, and Ms. Stewart was destined for a prodigious fall from grace. Since the implications, and later her arrest, Omnimedia's market value has plummeted, with hundreds of millions of dollars evaporating. It seems like only yesterday that Martha Stewart was ringing the bell of the New York Stock Exchange, a symbolic gesture that signaled her glittering status as a newly minted billionaire. As of this writing, everyone's favorite domestic diva is completing her sentence of five months in prison, to be followed by another period of house arrest, which should offer her plenty of time to consider the perils of reputation risk.

Reputation is truly the ultimate intangible asset, one that must be constantly polished to a sparkling finish in this era of ever-increasing corporate oversight. Earlier in this section, I noted the difficulty in quantifying the worth of an intangible asset. So it is with reputation. However, the stakes here are sky-high, as recent estimates suggest that 5% to 7% of a large corporation's market capitalization is represented by brand value.[13] When we're talking billions of dollars and the ever-watchful eyes of an increasingly suspicious public and hypervigilant regulators, organizations must act and safeguard their reputations. The importance of reputation has not been lost on Wal-Mart, the world's largest retailer. In a teleconference with market analysts, CEO Lee Scott suggested that Wal-Mart management had failed in efforts to repair a reputation tarnished by discrimination cases and charges of worker mistreatment. Many analysts believe bad publicity and the related hit to reputation may be the retailing behemoth's greatest obstacle to store expansion and further growth.[14]

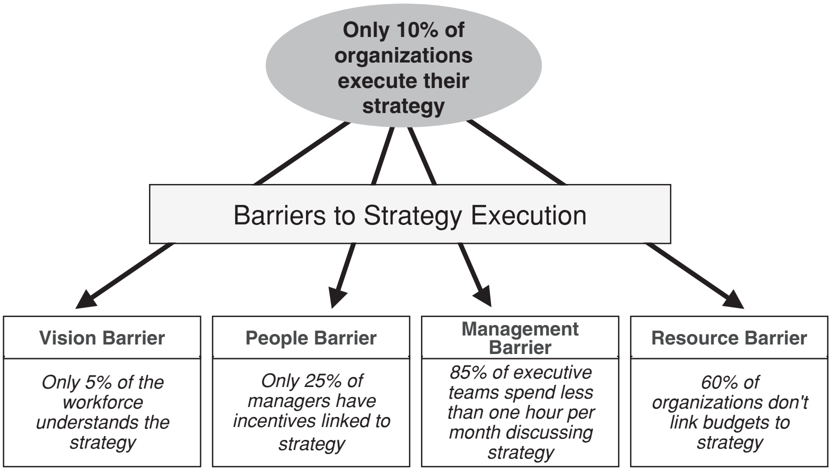
In order to protect reputation, it must be managed, and to manage reputation, it must be measured. Enter the Balanced Scorecard. As previously discussed, a principal benefit of the Scorecard is its ability to shed new light on intangible assets, removing the shroud of mystery and displaying them in the cold light of rational analysis. Leading indicators such as the number of negative news stories or number of audit findings can go a long way toward steering boardroom discussions in a new and provocative direction as leaders openly address this vital asset and put in place mechanisms to protect it for generations to come.

Strategy: It's All About Execution

What do the following words and phrases have in common: *positioning, design, power, emergent, cognitive, learning, cultural, environmental, configuration, disruptive, five forces, and value innovation?* Despite the wide swath of language they cut, each represents a school of strategic thought.[15] The field of inquiry that is strategy has produced enormous volumes of information and insight over the past five decades. Every single piece of work produced, despite the often esoteric jargon, contains at least a few nuggets of extremely practical and valuable information, but the sheer volume of material often leaves us scratching our heads and wondering aloud, "Just what is strategy, anyway?" Every person reading this book could undoubtedly provide a unique response to that question, and while that may lead to initial confusion, the spirit of discovery and debate it spawns holds promise for all of us. While we may never reach a consensus on exactly what strategy is (or is not), one thing most pundits and practitioners alike tend to agree on is the fact that strategy execution is more important than strategy formulation.

It's one thing to sequester yourself and your team away in an off-site location for a few days of chocolate chip cookies and excruciating debate that leads to a fresh new strategy, and another thing entirely to bring that plan to life. But breathing life into the plan on a day-to-day basis is what spells the difference between winning and losing on the front lines of business. As an old Talmudic dictum teaches us, "study is not the essence, but action."[16] And to the victors, go the spoils. One study suggested that a 35% improvement in the quality of strategy implementation for the average firm was associated with a 30% improvement in shareholder value.[17] Sadly, the execution of strategy often falls woefully short, which not only leads to severe bottom-line maladies but can also crumble the often wafer-thin credibility held by senior management when a new plan is introduced. An oft-quoted *Fortune* magazine study from 1999 found that 70% of CEO failures came not as a result of poor strategy, but the inability to execute.[18] So why does strategy execution prove so elusive for the typical enterprise? Scorecard architects Robert S. Kaplan and David P. Norton believe the answer lies in the form of four barriers that must be surmounted before strategy can be effectively executed (Exhibit 1.1):

EXHIBIT 1.1 **The Barriers to Implementing Strategy**



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

- *Vision barrier.* Suggests a scant 5% of the typical workforce understands the strategy. As discussed earlier, success in executing a strategy is the product of execution. Execution results from action, action from understanding, understanding from awareness. Right in the middle of that simple equation lies understanding. St. Augustine once remarked, *"one prays for miracles, but works for results."* Leaders who develop strategies and fail to take the requisite time and allocate the appropriate resources to ensure awareness and understanding are doing just that—praying for miracles. Each day your employees are faced with choices: how to handle a customer situation, what to budget for the forthcoming year, how to staff, and a hundred others of practical importance. Informed action is virtually impossible without a sound knowledge of the organization's strategy.
- *People barrier.* Incentive compensation systems have become wildly popular in the corporate world, and with good reason. Linking pay to performance drives focus and alignment around common themes. Problems emerge as a result of the actual construction of the rewards systems, however. Typically, the incentive is linked to a short-term financial target, and that can lead to some less-than-rational decision making as managers seek to maximize short-term gain, often at the expense of long-term sustainable success.
- *Management barrier.* On the topic of brevity in communication, Mark Twain once opined, "I tried to write a short letter, but it was too hard so I wrote a long one." It's a great line, and one that rings absolutely true. In the organizational world, it's difficult to boil things down to their essence, and as a result we tend to spend time on the periphery of issues rather than tackling

the core. Management meetings manifest this point well. Rather than examining the blueprint we've developed for success (i.e., the strategy), teams will spend hours debating line items on the income statement such as gross revenue or cost of sales. These are undoubtedly important contributors to success, but are they necessarily strategic?

- *Resource barrier.* Raise your hand if you love budgeting. I'm guessing not a single person will derive any aerobic benefit from that question! Budgets are much-maligned these days, with critics calling their very existence into question. We'll examine the topic of budgets in greater detail in Chapter Seven, but for now suffice it to say that if your budget is not linked to your strategy, then where exactly is it aligned? Strategy should always be the guiding hand in creating the budget, and simple questions employed in crafting them: Based on our strategy, what initiatives will distinguish us from our rivals, and what are the associated resource requirements?

One of the many joys of writing books is having the opportunity to begin a dialogue with people from around the world on a topic of common interest. Since the publication of my first book (*Balanced Scorecard Step by Step: Maximizing Performance and Maintaining Results*), I've received calls and letters from readers around the globe, who have shared their stories and provided feedback on the text. Among the comments I cherish most are those suggesting that my books are "practical and simple." In this age of complexity and constant change, it's comforting to find something that is nonthreatening and approachable. When I reflect on those sentiments, I believe it's not simply my literary style, but the topics I discuss.

Everything I've shared with you thus far in this book is something you face every day—using often outdated financial metrics, harnessing intangible assets, protecting your reputation, and attempting to execute your strategy. These concepts are not particularly challenging from an intellectual standpoint, rather they are "practical and simple." But they are also profoundly important to the success of your business and have led organizations of every conceivable shape and size to embrace the Balanced Scorecard. In the next section, we'll briefly examine the Scorecard model and begin to determine exactly why it has become the tool of choice for those attempting to beat the overwhelming odds and effectively execute their strategies.

THE BALANCED SCORECARD

Origins and Background

The Balanced Scorecard was developed in 1990 by two men: Robert Kaplan and David Norton. Interestingly, Kaplan is an accounting professor at Harvard

University. Given his profession, you might suspect that he had a vested interest in safeguarding the vaunted position of financial numbers, but Kaplan was a visionary; he realized that financial numbers alone would not be enough for organizations attempting to thrive, or even compete, in the 21st century. To that end, he and Norton organized a research study of a dozen companies, attempting to discern best practices in performance measurement. Out of that study, the Balanced Scorecard was born. Just as a person is born and matures, so too has the Balanced Scorecard—from measurement system to strategic management system to a powerful communication tool describing and articulating strategy. We owe a tremendous debt of gratitude to the work of Kaplan, Norton, and their many colleagues who have researched, codified, and published many leading Balanced Scorecard works.

The basic premise behind the Balanced Scorecard is a simple, yet profound, one. Financial measures are, and always will be important, but they must be supplemented with other indicators that predict future financial success. With that as their goal, Kaplan and Norton developed the Balanced Scorecard framework, shown in Exhibit 1.2.

At the center of the diagram we see the words *vision* and *strategy*. Unlike traditional performance measurement systems, which have financial controls at their core, the Balanced Scorecard begins with an organization's vision and strategy. We seek to *translate* the vision and strategy into performance measures, which can be tracked and used to gauge our success in the successful implementation of vision and strategy. This is accomplished by determining objectives and measures in each of the Scorecard's four interrelated perspectives: Financial, Customer, Internal Processes, and Employee Learning and Growth.

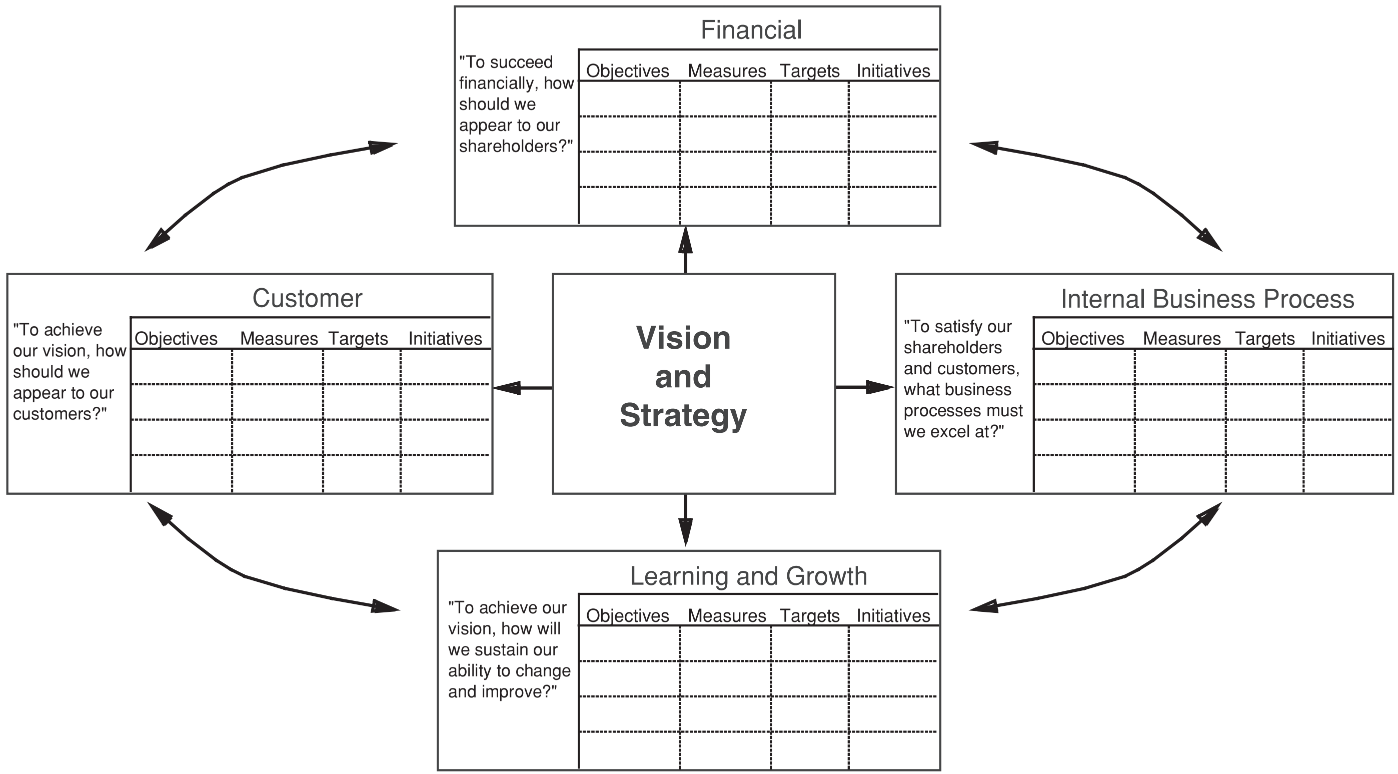
Financial Perspective

Financial measures are an important component of the Balanced Scorecard in the for-profit, public, and nonprofit worlds. In the for-profit domain, the measures in this perspective tell us whether our strategy execution—which is detailed through measures chosen in the other perspectives—is leading to improved bottom-line results. In the nonprofit and public sectors, financial measures ensure that we're achieving our results, but doing so in an efficient manner that minimizes cost. We normally encounter classic *lagging* indicators in the Financial perspective. Typical examples include revenue, profitability, and asset utilization.

Customer Perspective

When choosing measures for the Customer perspective of the Scorecard, organizations must answer two critical questions: "Who are our target customers?" and "What is our value proposition in serving them?" Sounds simple enough, but both of these questions offer many challenges to organizations. Most organizations will state that they do in fact have a target customer audience, yet their actions

EXHIBIT 1.2 **The Balanced Scorecard**



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reveal an "all things to all customers" strategy. Strategy guru Michael Porter suggests this lack of focus will prevent an organization from differentiating itself from competitors.[19] Choosing an appropriate value proposition poses no less of a challenge to most organizations. Many will choose one of three "disciplines" articulated by Treacy and Wiersema in *The Discipline of Market Leaders*.[20] They are:

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

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

Internal Processes Perspective

In the Internal Processes perspective of the Scorecard, we identify the key processes at which the organization must excel in order to continue adding value for customers. Each of the customer disciplines outlined previously will entail the efficient operation of specific internal processes in order to serve our customers and fulfill our value proposition. Our task in this perspective is to identify those processes and develop the best possible measures with which to track our progress. To satisfy customers, you may have to identify entirely new internal processes rather than focusing your efforts on the incremental improvement of existing activities. Service development and delivery, partnering with the community, and reporting are examples of items that may be represented in this perspective. We will examine the development of performance measures for Internal Processes in greater depth during Chapters Four and Five.

Learning and Growth Perspective

If you expect to achieve ambitious results for internal processes, customers, and financial stakeholders, where are these gains found? The measures in the Learning and Growth perspective (also referred to as the Employee Learning and Growth perspective) of the Balanced Scorecard serve as the enablers of the other three perspectives. In essence they are the foundation on which this entire house of a Balanced Scorecard is built.

Once you identify measures and related initiatives in your Customer and Internal Process perspectives, you can be certain of discovering some gaps between your current organizational infrastructure of employee skills (human capital), information systems (information capital), and climate (organizational capital) and the level necessary to achieve the results you desire. The measures you design in this perspective will help you close that gap and ensure sustainable performance for the future.

Like the other perspectives of the Scorecard, we would expect a mix of core outcome (lag) measures and performance drivers (lead measures) to represent the Learning and Growth perspective. Employee skills, employee satisfaction, availability of information, and alignment could all have a place in this perspective. Many organizations I've worked with struggle in the development of Learning and Growth measures. It is normally the last perspective to be developed, and perhaps the teams are intellectually drained from their earlier efforts of developing new strategic measures, or they simply consider this perspective "soft stuff" best left to the Human Resources group. No matter how valid the rationale seems, this perspective cannot be overlooked in the development process. As I mentioned earlier, the measures you develop in the Learning and Growth perspective are really the enablers of all other measures on your Scorecard. We'll discuss objectives and measures for this perspective in Chapters Four and Five.

The Evolution of the Balanced Scorecard

When Kaplan and Norton developed the Balanced Scorecard some 15 years ago, they were basically attempting to solve a measurement problem: How can we balance the historical accuracy and integrity of financial metrics with the drivers of future financial success? The Balanced Scorecard proved to be an eloquent solution and was ultimately hailed as one of the 75 most influential business ideas of the 20th century by the *Harvard Business Review*. As is the case with any idea whose utility has been forged at the hands of actual practitioners with a real need, the Balanced Scorecard benefited greatly from the constant tinkering and experimentation of organizations bent on deriving ever-greater benefits from the tool.

The second generation of the Balanced Scorecard manifested as what has been termed a "strategic management system," which simply implies linking short-term actions to long-term strategy by way of the Balanced Scorecard. Budgeting and compensation were the logical processes to benefit from a union with the Balanced Scorecard, and so it was as organizations began to find innovative methods of developing budgets linked to strategy, and incentive systems based on balanced metrics of performance.

Perhaps the greatest virtue of the Balanced Scorecard framework is its undeniable power as a communication tool. With the advent of strategy maps in the mid-1990s, organizations discovered a potent new method of clearly and simply describing their strategies in a coherent way to data-rich but information-starved employees. Attempting to discern how strategy could be enacted had for years been an exercise of groping hopelessly in the dark, but with the introduction of the strategy map and Balanced Scorecard, a light literally appeared. No longer is strategy some poorly understood treatise bandied about by executives, but instead it is transformed into simple objectives and measures that drive real people to real behaviors leading to real results.

IS THE BALANCED SCORECARD HERE TO STAY?

Let's put all of our cards on the table and begin with an examination of the "f word." No, not that "f word," the other, far more disturbing one—*fad*. I've been getting the question from conference participants, clients, and readers for the better part of the last 10 years: Is the Balanced Scorecard a fad? Far from resenting this query, I welcome it and the spirit of discourse and discovery it engenders. And why shouldn't we question the longevity of the Balanced Scorecard? In this era of global communication and networks, new ideas flourish and spread faster than chicken pox through a kindergarten class. The metaphor is intentional because many ideas seem to spark more organizational suffering than breakthrough results as originally conceived. Additionally, the longevity of business ideas is gradually diminishing. Back in the 1950s and '60s, the average life of a management theory was around 15 years, whereas today the average idea has a shelf life of approximately three years.[21] Even if you choose to believe in the value of new ideas, where do you begin? Why, just in the last several years, you could:

> Flatten your pyramid, become a horizontal organization, and eliminate hierarchy from your company. You can empower your people, open your environment, and transform your culture. You can listen to your customers, create a customer-focused organization, and commit to total customer satisfaction. You can do the "vision thing," write a mission statement, and put together a strategic plan. You can improve continu-

ously, shift your paradigms, and become a learning organization. You can devote yourself and your company to total quality management. Or you can reengineer your corporation.[22]

Have you sampled any of the tempting delights of this menu? If so, you're certainly not alone. However, as a result of many highly publicized flops, we've become increasingly skeptical of new ideas promising to be the panacea we've been searching for in our quest for business success. But before we write off the entire management idea factory as out of touch or "pie in the sky," let's cast a more critical eye on what goes on when an idea is adopted by an organization.

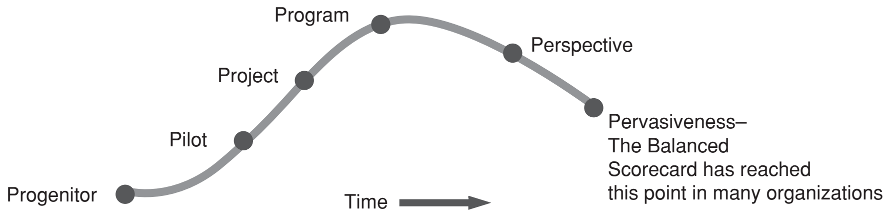
There is little doubt that some among us are simply idea chasers, rushing wildly from one unproven business nostrum to the next, with little thought of the practical utility of the idea for this business at this time. I believe that virtually all ideas out there contain at least a kernel of value if judiciously implemented in the face of a real business need. Therefore, the first question you should ask yourself when considering the adoption of a new idea or technique (including the Balanced Scorecard) is: "What business need will this tool help us solve right now, and in the future?" If you can't provide a compelling response to that question, one you can sell to your employees who will be looking to you for guidance and leadership, then you must seriously reconsider your intentions. Even if you have a driving business need, a "burning platform," you may still fall victim to lackluster implementation. Frequently, this problem is the real culprit in the ongoing drama being played out in companies around the world. All too often a new idea is sold convincingly, ushered in enthusiastically, but given inadequate resources and lacking the ongoing commitment from senior management to give it any legitimate opportunity to bear fruit.

The Life Cycle of Ideas

As you may have guessed, I'm a fan of new ideas. In fact, I agree with composer John Cage, who once remarked: *"I can't understand why people are frightened of new ideas. I'm frightened of the old ones."*[23] So you can imagine my delight when I recently discovered an entire book dedicated to the topic. *What's the Big Idea?* goes deep into a discussion of business ideas and the gurus who spearhead their acceptance. In an interesting section early in the book, the authors outline the cycle of a successful business idea within an organization.[24] The five phases are outlined in Exhibit 1.3.

Every idea has a *progenitor*, which is represented either by the person introducing the idea to the organization or preceding ideas that sparked interest in the current movement. Once introduced, ideas generally start small in the form of a *pilot*, a limited-scale implementation in one area of the organization. Pilots are conducted to test the rigors of the idea in the real world and to determine if they

EXHIBIT 1.3 The Life Cycle of a Business Idea Within the Organization



Adapted from material presented in "What's the Big Idea," Thomas H. Davenport and Laurence Prusak, *What's the Big Idea* (Boston, MA: Harvard Business School Press, 2003).

are appropriate for a wider release throughout the company. Typically, those working on the pilot are the only group aware of the idea, and resources both in the form of budget and management attention tend to be scant.

Once the pilot has been deemed a success, the idea is generally transformed into a *program*, gaining the attention of most senior managers and beginning to attract resources as it spreads throughout the company. The idea is said to have gained *perspective* once it has become part of the everyday routine of the company. While the idea has gained "mind share" in a large percentage of the population, people are still conscious of the idea as they practice it. The final stage in the internal life cycle of a business idea is that of *pervasiveness*. Gone are the consulting projects, conferences, and gurus, which may have originally trumpeted the idea. At this point in its evolution, the idea has become ingrained in the fabric of the organization and is practiced without being overtly discussed.

Organizations that have successfully implemented the Balanced Scorecard have reached the stage of pervasiveness, one in which the Scorecard provides a transparent background for virtually every facet of the operation. The tool has become part and parcel of the everyday running of the company, and while people may be cognizant of the theoretical dimensions of the framework, those underpinnings are simply accepted and no longer expounded in a variety of forums. At this point the Balanced Scorecard has become the cornerstone of management practices, guiding reporting, budgeting, performance appraisal, and frequently, incentive compensation. Organizations implementing the Scorecard could do worse than contemplating this end state of pervasiveness as an initial goal of the implementation. One of my clients did just that. At the outset of their journey, they declared success as *"every employee having the ability to articulate our strategy and how their role contributes to the success we will be achieving in executing our plan."*[25] They realized early on that success lay in commitment, rather than compliance to the notion of the Balanced Scorecard. Once employees were committed through a guiding rationale, extensive communication, and ongoing management support, they would embrace the Scorecard and use it to its full capacity, ultimately resulting in knowledge, focus, and alignment throughout the organization.

The Balanced Scorecard Is on Sound Footing for Longevity

Many business observers suggest that the overwhelming majority of business ideas aren't entirely new.[26] This suggestion most likely results from that uniquely human phenomenon to build on the work of others using the latest data and information to improve or adapt ideas to fit current and anticipated circumstances. In simpler terms, we like to tinker. And let's be thankful for that trait because it has made possible everything from the Constitution under which we live to the modern conveniences of daily life we take for granted. The Balanced Scorecard was put forth by Kaplan and Norton early in the 1990s as a revolutionary idea for measuring organizational performance. I would suggest, however, that the basic tenets of the model map very well to work done by management scholars years, and sometimes decades, earlier. While constantly evolving through the work of academics and practitioners alike, the Balanced Scorecard is on solid theoretical footing, which supports its potential as a business tool for the ages.

Peter Drucker is one of the most widely read and heralded management thinkers of our time. His ideas and musings on the art and science of business have helped shape management direction throughout the world for the past 60 years. Drucker's "The Theory of the Business"[27] argues that all organizations—whether they know it or not—operate under a set of assumptions about market, customers, competitors, technology, competencies, and other fundamental dynamics. The assumptions in all areas must fit one another to produce a valid theory, they must be known and understood throughout the organization, and they must be tested constantly. A Balanced Scorecard approach is remarkably analogous. The "fit" to which Drucker refers is reflected through the cause-and-effect relationships in the Balanced Scorecard. In using the Scorecard as a communication tool, organizations are ensuring that their strategy is known and understood throughout the organization, as Drucker asserts must be the case with any valid theory. Finally, just as assumptions must be tested constantly in Drucker's model, Balanced Scorecard results must be analyzed on an ongoing basis and used to learn about the effectiveness of strategy execution.

In a similar vein, there are striking similarities between the notion of cause and effect as demonstrated in the Balanced Scorecard and the idea of "syndrome dynamics" as put forth by Abraham Maslow. Most of us are familiar with the name Maslow from college courses during which we were introduced to the iconographic "hierarchy of needs." So it may come as a surprise to learn that Maslow also spent time studying organizations, resulting in several provocative ideas, including syndrome dynamics.[28] The basic principle of syndrome dynamics is this: Organizations are "embedded" in their immediate communities; this immediate community is embedded in the larger community, which in turn is embedded in the country, which is embedded in the Western world, and so on. I would suggest that each of the four perspectives of the Scorecard represents syndromes in Maslow's vernacular. The Scorecard perspectives—Financial, Customer, Internal Processes, and Employee Learning and Growth—are contained and structured within the organization. Consistent with Maslow's theory, they share functional relationships in the sense that demonstrable causes and effects can be listed. In fact, the organization would be unable to function without any one of these elements and the myriad of assumed relationships that underlie them.

Finally, no discussion of the Balanced Scorecard's roots would be complete without a reference to the Tableau de Bord, a performance measurement system that emerged in France at the turn of the 20th century. Originally developed by process engineers attempting to improve their production processes by better understanding cause-and-effect relationships (sound familiar?), the Tableau de Bord was soon used by top management as a set of critical indicators used to assess performance in achieving strategic outcomes.[29] Like the Balanced Scorecard, indicators comprising a Tableau de Bord are best generated from a translation of the organization's mission.

Answering the Question

And now the answer you've all been waiting for: Is it or is it not a fad? Based on the undeniable results derived from thousands of organizations of every conceivable type and size in every corner of the globe, and on the constant evolution of the tool to meet the demands and rigor of new practitioners, no, I do not believe the Balanced Scorecard is a fad.

Perhaps the Balanced Scorecard is better wrapped in another colloquialism, "good common management sense." Despite the constant cries of unrelenting change swirling about us, there remain core elements of business that must be managed: strategy, planning, measurement, reporting, and so on. Regardless of what awaits us in the days and years ahead, these pillars will remain, and the Balanced Scorecard (or whatever moniker it's given in the future) will be there, standing resolutely awaiting the challenge of translating inspiring visions and strategies into the day-to-day actions carried out by employees everywhere in making those dreams a reality.

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