

Introduction to the Balanced Scorecard

A balanced scorecard is a format for describing activities of an organization through a number of measures for each of (usually) four perspectives. A good scorecard documents a strategic logic: cause and effect relationships between current activities and long-term success. As companies and other organizations increasingly depend on their intangible assets, scorecards are becoming a vital tool for management control.

Since its first appearance in early 1992, the concept of the balanced scorecard has been widely adopted as a new approach to management control and performance management both in business and government. A scorecard is an easy-to-understand generic format for describing the ambitions or achievements of an organization. It has proved useful for:

- » communicating strategic intentions, as companies increasingly need to involve managers and employees;
- » discussing activities that are motivated by strategic aims rather than current necessities, such as development of competencies, customer relationships, and IT, and how these will pay off in the future; and
- » monitoring and rewarding such activities.

These aims are equally important in business firms pursuing long-term profitability and in non-profit making organizations, such as government agencies. Compared to other ways of describing what an organization does or should do, balanced scorecards have two distinguishing features:

- » one is the almost simplistic format of the scorecard itself, where a restricted number of measures are used for each of four perspectives on a business activity: its *financial* performance, its *customer interface*, its *internal processes*, and its *learning and development*; and
- » another is the insistence that perspectives and measures should be “linked”. The particular efforts we make in order to learn, or improve our processes, or make customers happier, must be based on our conviction that these will cause future success. The links in a good scorecard will show our “business logic”: how doing the right things now is expected to produce long-term rewards. In this way, scorecards translate strategy into terms that are meaningful for members of an organization in their everyday activities.

Brand recognition, competencies, processes, etc., are all part of an organization’s *intangible assets*. The benefits of scorecards will be greatest in organizations where these are especially important, and in particular when many organization members are involved in maintaining and utilizing them. Assets such as customer relations, procedures, brand

names, databases, etc., used to show up only as costs in planning documents and reports. Gradually, new metrics have been introduced, such as customer satisfaction, cycle times, and brand recognition. A well-designed scorecard provides a unifying perspective for these concepts, showing the intended relation between them and future revenues.

The current interest in scorecards reflects the increasing dependence of *all* organizations on their intangible assets, *and* of the need to engage employees in the pursuit of strategies where the long-term development of such assets is a key to business success. This need will be most apparent in organizations where many employees have customer contacts and where long-term success is highly dependent on interaction with customers and other external contacts. Such organizations need to spend time and effort learning about their environment, improving databases and systems, and creating positive attitudes towards the organization among all stakeholders. Scorecards will guide and focus these activities.

Accepted and widely taught metrics such as “return on capital employed” are of limited interest in such organizations. Take, as examples, two companies that are currently the world’s largest in terms of number of employees and market value, respectively, Wal-Mart and Exxon Mobil.¹ The stock market values Wal-Mart at more than four times its equity value. This premium is now sometimes called *intellectual capital*, implying that a reason for this valuation is the realization that there are intangible assets that are not shown on the balance sheet. Even for a company with its own production plants like Exxon, the premium is one and a half time the assets shown on the balance sheet. Owners hold management responsible for developing the total shareholder value, not just the balance sheet, and there is currently a debate how new metrics describing intangibles should be added in external reporting.

Inside these companies the need for change will be even more apparent. Management control is still often based on financial numbers very similar to those in external reports. These numbers give very little guidance to managers whose most important decisions concern customer relations, competencies, brands, systems, etc. Resources spent on these show up as expenses rather than assets. When management control is exclusively financial, there will be a temptation to

neglect spending on intangibles, although management rhetoric may identify them as essential in preparing for the future.

So, how should we plan and control such assets, when traditional accounting gives us little guidance, and maybe even a distorted and misleading image? This concerns not only world-famous organizations such as the ones just mentioned above. The problem is even larger for start-ups who have to convince their banks that a first-year accounting loss is really a necessary investment in customer contacts and program code. How can anyone know the difference between waste and essential investments in intangibles when both show up as costs?

A large number of books have been published, with titles such as *Knowledge Management*, *Intellectual Capital*, and *Learning Organizations* - all attempts to get a grip on how to control the invisible. Scorecards are an essential part of this control. Intangible assets are of growing importance to all businesses, and to government and non-profit making organizations. *Balanced scorecards are important in adding a strategic dimension to management control, but particularly in encouraging discussion about intangible assets.*

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NOTES

1 According to the Fortune 500 list published in April 2004.