CHAPTER ONE

What Exactly Is a Balanced Scorecard?

COPYRIGHTED MATERIAL

ORIGINS, AND A BRIEF HISTORY, OF THE BALANCED SCORECARD

Although its conceptual roots run deep, through work conducted by management thinkers and practitioners from Peter Drucker to Abraham Maslow, including French accounting scholars who developed a similar approach in the 1930s, the Balanced Scorecard as we know it today was invented by two men, Robert Kaplan and David Norton.

The world was introduced to the concept in a 1992 *Harvard Business Review* article, "The Balanced Scorecard—Measures that Drive Performance."[1] That article was based on a research project conducted by Norton's consulting firm, which studied performance measurement in companies whose value creation was highly dependent on intangible assets.[2] As strident advocates for the power of measurement to drive focus and accountability, Kaplan and Norton were convinced that if organizations were to derive the maximum value from their investments in intangible assets, those same intangibles had to be integrated into their measurement systems. At the time, virtually all organizations were measuring financial results, and many were also collecting data on generic customer metrics, such as satisfaction and market share, along with measures

of quality and efficiency. With the inclusion of measures tracking intangible assets such as employee skills and engagement, it appeared that management could now confidently cover their measurement bases.

A significant problem existed, however. Many companies that collected data from these diverse areas failed to link the measures together in a meaningful and coherent pattern, instead choosing to select an ad hoc group that simply represented different aspects of the firm's operations. Despite their efforts, most received few benefits. In fact, some early adopters of quality metrics, for example, actually saw their share prices fall dramatically. Kaplan and Norton provided two immediate and profound enhancements. First, they codified the collection of metrics, calling it a Balanced Scorecard and provided a succinct taxonomy that ensured consistency in application. Rather than simply collecting measures that spanned a firm's operations, Kaplan and Norton created the four-perspective framework of:

1. Financial
2. Customer
3. Internal processes
4. Learning and growth

Organizations now possessed a vocabulary for balanced measurement that was previously absent. The measures chosen to populate each perspective were not selected at random but, in Kaplan and Norton's second major contribution, directly translated from the organization's strategy, which endowed them with context for discussion, analysis, and learning. Now, instead of relying on generic financial and nonfinancial indicators, companies could analyze their unique strategic path and create performance measures that would clearly indicate whether or not they were in fact executing their chosen strategy. This seemingly simple, and in hindsight obvious, pronouncement was the breakthrough that was to set the Balanced Scorecard on an astonishing trajectory of acceptance and success. Executives the world over had lamented the difficulty of executing strategy but, with the Balanced Scorecard, Kaplan and Norton put strategy at the center of the firm's orbit by embedding it directly into the measurement process.

Not all was perfect in Balanced Scorecard land, however. Some early adopters struggled with the selection of appropriate performance measures, and received scant benefits from their investment in the Scorecard system. Key to their frustration was finding context for the selection of measures that would gauge strategy execution, and this quickly led to another milestone

innovation on the Balanced Scorecard's path—the introduction of strategic objectives. Organizations began prefacing their discussion of measures with that of objectives, concise statements of what they had to do well in each of the four perspectives to execute successfully. So, rather than beginning the process by asking, "What measures are best for us?" they started by asking what they needed to do well in each perspective, and strategy maps were born.

Fast-forward 20 years, several books from Kaplan and Norton, myself, and others, and tens of thousands of successful implementations later, and we find that the Balanced Scorecard is one of the world's most popular management frameworks.[3]

The model's ascendance has not been confined to private sector firms, as both government and nonprofit organizations have steadily migrated to the Balanced Scorecard in order to improve focus, more effectively allocate scarce resources, and, of course, execute strategy. So widely accepted and effective has the Scorecard been that the *Harvard Business Review* hailed it as one of the 75 most influential ideas of the twentieth century. Amid all this acclaim, however, challenges inevitably arise, and the Balanced Scorecard faces an interesting one. In reaching such delirious heights of success it has become synonymous with measurement in the minds of many, regardless of how much (or little) knowledge they actually possess regarding the framework itself. Therefore, many misconceptions, often dangerous and irresponsible, exist and can sometimes derail success. Beginning with the next section of this chapter, and continuing throughout the book, we'll thoughtfully explore the terrain that is the Balanced Scorecard, tackling the misconceptions, exposing the myths, and, most importantly, ensuring you possess the know-how necessary to build an authentic Balanced Scorecard that can transform your business.

BALANCED SCORECARD PERSPECTIVES

You may be wondering why the section following the origins of the Scorecard is not, "What is a Balanced Scorecard?" Before I outline the model it's important to understand the four distinct, yet related, perspectives of performance that bring it to life—Financial, Customer, Internal Process, and Learning and Growth—as they form the scaffolding upon which the entire Balanced Scorecard is constructed.

The etymology of the word perspective is from the Latin *perspectus*: "to look through" or "see clearly," which is precisely what we aim to do with a Balanced Scorecard—examine the strategy, making it clearer through the lens

of different viewpoints, and therefore more amenable to execution. Any strategy, to be effective, must contain descriptions of financial aspirations, markets served, processes to be conquered, and the people who will steadily and skillfully guide the ship to success. Thus, when assessing our progress it makes little sense to focus on just one aspect of the strategy when in fact, as Leonardo da Vinci reminds us, "Everything is connected to everything else."[4] To compose an accurate picture of strategy execution it must be painted in the full palette of perspectives that comprise it. Therefore when developing a Balanced Scorecard we use the following four:

1. Financial
2. Customer
3. Internal processes
4. Learning and growth

When building a Balanced Scorecard, or later when it is up and running, you may slip and casually remark on the four quadrants or four areas, or even the four buckets. As colloquial and seemingly inconsequential as this slip of the tongue appears, I believe it has serious ramifications. Take, for example, the word quadrant: the Oxford dictionary begins its definition by describing it as a quarter of a circle's circumference. The word reflects the number four, and in that sense it is almost limiting to the flexible approach inherent in the Scorecard—you may wish to have five perspectives or only three. The Balanced Scorecard views performance from many points of view and I encourage you to be disciplined in your use of this term. Now let's take a brief tour of those four perspectives, beginning with customer.

Customer Perspective

The customer perspective of the Balanced Scorecard must answer three questions:

1. Who are our target customers?
2. What do they expect or demand of us as an organization?
3. What is our value proposition in serving them?

Sounds simple enough, but each of these questions offers many challenges to organizations. Most organizations will state that they do in fact have a target customer audience, yet their actions reveal an all-things-to-all-customers

strategy. As strategy guru Michael Porter has taught, this lack of focus will prevent an organization from differentiating itself from competitors.

Determining customer expectations or demands is often the least problematic of the three questions. Most organizations today, regardless of size or location, have many channels to view customer interactions and gather feedback. Chief among them are social media (Facebook, Twitter, and so on), which often provide customers a place to scream , especially when companies fall short of expectations.

Clearly articulating the firm's value proposition is perhaps the most challenging, and vital, of the three tasks in this perspective. Virtually all organizations will choose one of three disciplines, as articulated by Treacy and Wiersema in their book *The Discipline of Market Leaders*:[5]

1. **Operational Excellence:** Organizations pursuing operational excellence focus on low price, convenience, and often no frills. Walmart provides a great representation of an operationally excellent company.
2. **Product Leadership:** Product leaders push the envelope of their firm's products. Constantly innovating, they strive to simply offer the best product in the market. Apple is an example of a product leader in the field of electronics.
3. **Customer Intimacy:** Doing whatever it takes to provide solutions for customer needs helps define the customer-intimate company. They don't seek 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.

I've cited the work of Treacy and Wiersema; however, these ideas have been with us for many years, and have been advocated under different labels by a number of scholars and practitioners. For example, the idea of low cost has been explained as: cost leadership (Porter), operational excellence (Treacy and Wiersema), exploitation (March), and defender (Miles and Snow). Differentiation goes by many names as well: product differentiation (Porter), product leadership/customer intimacy (Treacy and Wiersema), exploration (March), and prospector/analyzer (Miles and Snow). Regardless of the labels applied, the value-proposition concept represents the essence of strategic choice, and, as such, must be clearly represented in your Balanced Scorecard.

Internal Process Perspective

In the internal process perspective of the Scorecard we identify the key processes at which the firm must excel in order to continue adding value for customers,

and ultimately shareholders. Each of the customer disciplines outlined above will entail the efficient operation of specific internal processes in order to serve customers and fulfill a chosen value proposition. For example, a product-leading company like Apple may focus on processes that include research and innovation, while an operationally excellent company such as Walmart emphasizes supply chain operations. Finally, Nordstrom's customer-intimacy discipline will dictate a focus on processes such as customer knowledge and retention.

The primary challenge with this perspective is to limit the number of processes included to just the truly strategic that drive the chosen value proposition, fulfill customer demands, and ultimately stoke the economic engine. When prompted, even small companies could list dozens of processes necessary to operate effectively. However, upon close inspection and using strategy as the prism, it should become clear that while necessary, most of the processes are not vital to the execution of the chosen strategy, and therefore do not belong on the Balanced Scorecard, which, we must constantly remember, is a tool for executing strategy.

Learning and Growth Perspective

If you want to achieve ambitious results for internal processes, customers, and ultimately shareholders, where are these gains found? The learning and growth perspective of the Balanced Scorecard supplies the enablers—almost exclusively intangible in nature—of the other three perspectives. In essence, this perspective represents the foundation upon which this entire house of a Balanced Scorecard is built.

The learning and growth perspective is typically populated with three areas of capital: human, information, and organizational.[6] No strategy, regardless of its seemingly unimpeachable brilliance, can be executed without people, and thus our first order of business in this perspective is to ensure our organization possesses the human capital, skills, competencies, and talents necessary for effective execution. In addition to people, all companies today, regardless of size, rely upon robust information technology systems for everything from transactional data processing to strategic decision-making support. We must ensure our investments in information technology are consistent with, and support, our unique strategy. Finally, it is imperative in the modern corporate world to ensure our organizations are capable of growth and change, which are absolute imperatives to enduring success. Under the umbrella of organizational capital we examine crucial components of success such as culture, teamwork,

and knowledge sharing. These quintessentially intangible dimensions of performance must be transformed into tangible value should we hope to reap the rewards promised in our strategic plans.

Many organizations I've worked with struggle with the learning and growth perspective. It is normally the last perspective to be developed, and perhaps the teams are intellectually drained from their earlier efforts, or they simply consider this perspective soft stuff best delegated to the human resources group. No matter how valid the rationale seems, this perspective cannot be overlooked in the development process. As mentioned earlier, the learning and growth perspective provides the enablers for the rest of the Scorecard. Think of it as consisting of the roots of a tree that will ultimately lead through the trunk of internal processes to the branches of customer results, and finally to the leaves of financial returns.

Financial Perspective

Financial yardsticks are a critical component of the Balanced Scorecard, especially so in the for-profit world. This perspective tells us whether our strategy execution efforts—detailed extensively in the other perspectives—are leading to improved bottom-line results. We could focus all of our energy and capabilities on improving customer satisfaction, quality, on-time delivery, employee-skills development, or any number of things, but without an indication of their effect on the organization's financial returns they are of limited value. Think of the financial perspective as representing the end in mind of your strategic story; everything contained elsewhere in the Scorecard should be driving enhanced financial results.

We'll return to the four perspectives throughout the remainder of the book, most notably during the discussion of strategy map objectives and performance measures. Speaking of which, now is the time to see how those terms fit into the broader system that is the Balanced Scorecard (see Exhibit 1.1).

WHAT IS A BALANCED SCORECARD?

My trusty Merriam-Webster Collegiate Dictionary defines the word *system*: "A regularly interacting or interdependent group of items forming a unified whole." That is a wonderful way to think of the Balanced Scorecard, because it's not one single thing, but a number of elements that combine to create a powerful unified whole. The Balanced Scorecard system, which is designed to

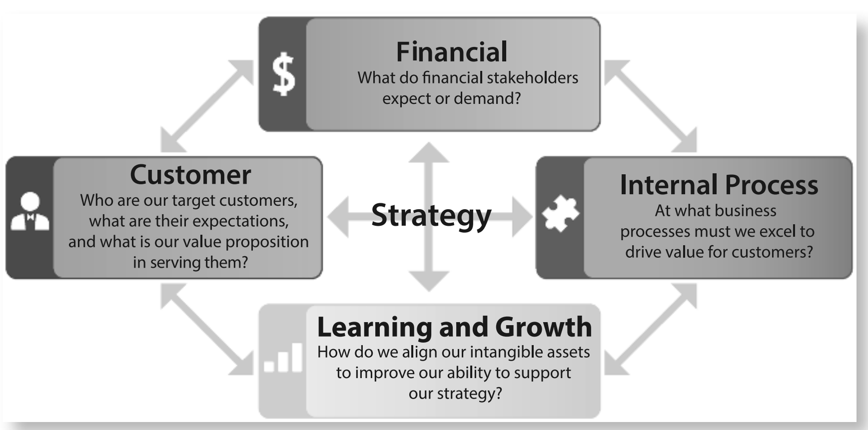

EXHIBIT 1.1 Balanced Scorecard Perspectives

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

help any organization effectively execute their strategy, is comprised of four unifying elements:

1. Objectives
2. Measures
3. Targets
4. Strategic initiatives

Objectives are housed on a dynamic communication device known as a strategy map, while measures, targets, and initiatives reside on the Balanced Scorecard. Let's look at each to discover how they combine to create a system whose whole is immensely greater than the sum of its parts.

Objectives and Strategy Maps

Objectives are concise statements of what the organization must do well in each of the four perspectives of financial, customer, internal process, and learning and growth in order to execute its unique strategy. Many early adopters of the Balanced Scorecard used it primarily as a measurement system, translating their strategy into measures that populated each of the four perspectives of the system. However, some of these pioneers struggled with identifying the best measures to track strategic success. To assist in selecting better indicators

they began prefacing the discussion of measures with "What they must do well" in each perspective. The answer to "What must we do well?" was known as an objective. For example, a customer-perspective objective could be "Provide differentiated solutions." Objectives always begin with verbs and are intended to bridge strategy and measures.

As time went on organizations began to pay increasing attention to objectives, realizing it was imperative to understand what must be done well to execute the strategy in order to create context for robust performance measures. Experimentation flourished and many companies began creating graphical representations of the objectives spanning the four perspectives. These diagrams became known as strategy maps and have proven to be a revolutionary advance in the field of strategy communication and execution. Today we can define a strategy map as: "A one-page graphical representation of what the organization must do well (in each of the four perspectives) in order to successfully execute their strategy." The strategy map, which is first and foremost a communication tool, translates your strategy into the vital objectives necessary to execute the plan. Whereas your strategic plan may be 50 to 100 pages or more (sadly, I've seen them with much more), the strategy map must be confined to one page in order to fulfill its chief responsibility of clearly communicating and articulating the strategy to employees and, if so desired, external stakeholders. Strategy maps almost always combine words (the objectives noting what we must do well) with images that are culturally resonant for the organization. This creative combination engages employees by bringing strategy, a subject considered by most to be dry and academic, to life by translating it into concrete actions and compelling images. The word *map* fits the document perfectly because, as we all know, a map guides us on a journey, providing the landmarks we must navigate to travel from our current location to our desired destination. In this context the current location is the un-executed strategy and the desired destination is the successful execution of that plan. We'll return to strategy maps in Chapter 5, where you'll discover how to create vibrant documents that translate your strategy with dazzling clarity and simplicity. An example strategy map is shown in Exhibit 1.2.

Performance Measures and Targets

A key principle to keep in mind as you learn about, and work with, the Balanced Scorecard is that of translation. Every component of the Scorecard is translated from the organization's strategy, because that is the system's raison d'etre—strategy execution. We begin by translating the strategy into objectives

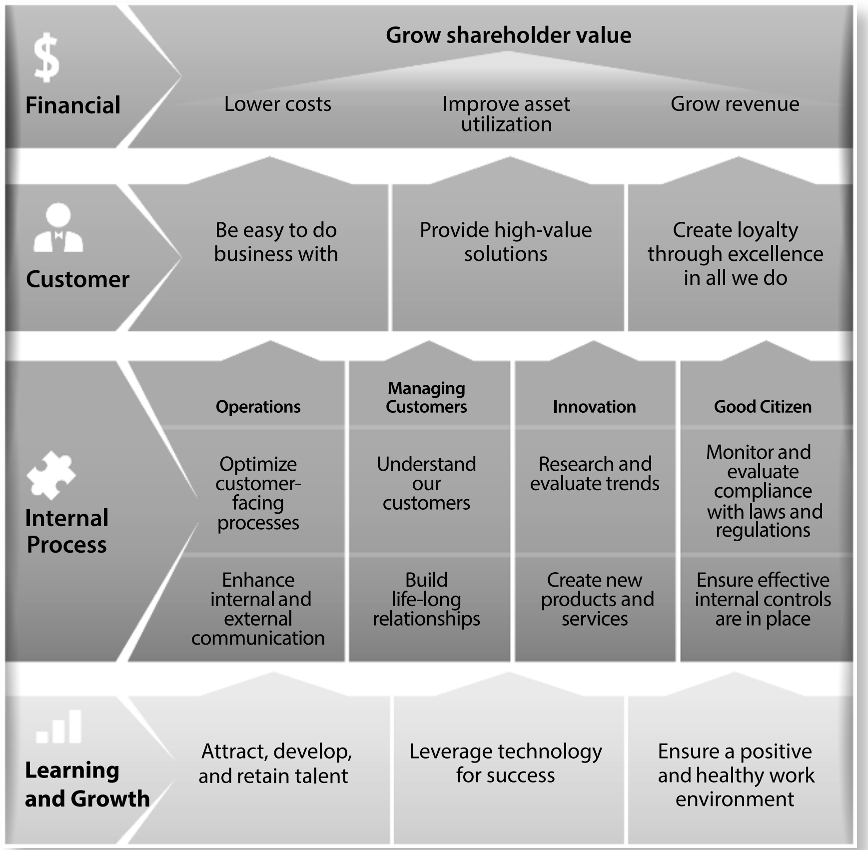

EXHIBIT 1.2 Example Strategy Map

on our strategy map, which communicates what we must do well in order to succeed. Strategy maps are outstanding devices for signaling to everyone in the organization what must be performed flawlessly in order to execute, but at the end of the day we need to know if we have in fact moved the needle on the objectives and progressed towards the execution of our strategy. Enter the performance measures: quantifiable standards used to evaluate and communicate performance against expected results. Those expected results take the form of targets that accompany each measure.

Do you remember that old song, *Love and Marriage?* Feel free to sing along: "Love and marriage, love and marriage, they go together like a horse and

carriage . . . you can't have one without the other." It's the same with these two vital links in the chain of strategic success—strategy maps and measures; one just won't do without the other. You may create the most inspirational and visually resplendent strategy map ever conceived in a corporate conference room, but without the accountability and focus afforded by accompanying performance measures, its value is specious at best. The map points to what you must do well, but unless you know whether you're actually doing well, whether you're winning or losing, it's just the product of yet another corporate exercise. On the flip side, while performance measures act as potent monitoring devices, without the benefit of a clear and compelling strategy map much of their contextual value is lost (this was the problem many early Scorecard adopters faced). We'll return to the vital concepts of measures and targets in Chapter 6.

Strategic Initiatives

To quickly recap, a fundamental aspiration of every organization, whether public, private, or nonprofit, is the execution of strategy to drive breakthrough performance. The Balanced Scorecard was conceived to ensure that strategy is translated into action through the interplay of objectives, measures, targets, and strategic initiatives. The objectives appear on a strategy map and are further translated into performance measures, which, in combination with targets, are used to gauge the achievement of those same objectives.

The last piece of the puzzle in using the Balanced Scorecard to execute your strategy is the development and prioritization of strategic initiatives that will help you achieve your targets. Strategic initiatives (often simply referred to as initiatives in the Scorecard vernacular) are the specific projects, activities, or programs you'll embark upon in order meet or exceed your performance targets. A strategic initiative could be anything from launching a career development program for employees to rolling out new financial software to creating an environmental plan. They are, of course, strategy specific, and the portfolio of strategic initiatives you assemble will depend entirely on the unique strategic path you pursue. You may ask, "I notice the examples you use all begin with verbs. Objectives are strategy specific and also start with verbs, so what's the difference between an objective and a strategic initiative?" The primary distinction between objectives and strategic initiatives is that the former are meant to be ongoing, while the latter have a clear beginning and end point. They are projects of a short-term (typically) duration that have been designed to assist an organization in correcting a performance deficit.

To illustrate the use of strategic initiatives, let's say you decide to pursue a customer-intimacy strategy and thus include the objective "Delight our customers" on the customer perspective of your strategy map. One of the accompanying measures you select may be customer loyalty. The reasoning is simple: if you are in fact delighting your customers, you would expect more of them to remain loyal to you. You establish a target and, with sky-high expectations, begin collecting data. After a couple of months the numbers are sobering; customer loyalty is flat and resting at a level far below the rate you anticipated. To close the gap in performance you may decide to establish a customer rewards program as a means to enhancing loyalty. The specific strategic initiative would be the "Development of a customer rewards program," and would entail the allocation of resources, the creation of a detailed plan including key milestones, and an analysis highlighting the anticipated results. While the objective "Delight our customers" will most likely remain on your strategy map until you decide to make a strategic course change, the development of the loyalty program will have a defined beginning and end.

We'll dive much deeper into the world of strategic initiatives in Chapter 6.

This section began by noting the Balanced Scorecard constitutes a system: "A regularly interacting or interdependent group of items forming a unified whole." I'll talk more about terminology later in the chapter, but for now it's important to recognize that when you hear the term Balanced Scorecard, it is a collective noun that encompasses objectives on a strategy map, and measures, targets, and strategic initiatives on a Scorecard. What all the elements of the Scorecard system have in common, what unites and unifies them, is the fact that all are derived from the organization's strategy.

The system that is the Balanced Scorecard serves three primary purposes (see Exhibit 1.3):

1. **Communication:** strategy maps are designed to translate the organization's strategy into action via objectives stitched together through the four perspectives. Just as a map helps guide you through unfamiliar territory by highlighting landmarks on your journey, strategy maps communicate the organization's chosen direction in a simple and powerful manner, allowing all employees, and other stakeholders, to quickly grasp the organization's story of success.
2. **Measurement:** The Scorecard was originally created to alleviate three measurement challenges plaguing modern companies: how to competently gauge the role of intangible assets, balance financial and nonfinancial indicators, and ultimately execute strategy. While strategy maps

EXHIBIT 1.3 The Balanced Scorecard System

communicate the strategic destination, Scorecard measures (and associated targets) monitor the course, ensuring we stay on track.

3. **Strategic Management:** In this capacity, the Balanced Scorecard can be used as the centerpiece of a broader management system, which links it to such crucial management processes as: budgeting (strategic resource allocation), compensation, board governance, and risk management. In the preface I wrote, "As these new management frameworks have proliferated, they have frequently crowded out, and overshadowed the Balanced Scorecard. These complex conceptual structures promise many benefits that practitioners are of course eager to reap. However, most organizations possess limited resources and thus spread those available means thinly across the entire spectrum of activities, failing to devote the effort necessary to create a robust Balanced Scorecard. The unfortunate product of this diffuse effort is a Scorecard that is unable to fulfill its responsibility as a vital tool in the execution of strategy." In this book I focus on ensuring you build a Balanced Scorecard that will serve as a ready foundation should you choose to instill a broader management framework with it as the instrumental hub.

TELLING THE STORY OF YOUR STRATEGY THROUGH CAUSE AND EFFECT

We know the Balanced Scorecard is designed to execute strategy through translation into objectives, measures, targets, and strategic initiatives, but what is a strategy? That's an enormous and evolving question, well beyond the scope of this book; however, at its core we know strategy represents a hypothesis developed by its creators. Organizations carefully examine their operating environments, consider their unique place in that competitive arena, and look for areas of defensible advantage that form the core of their strategy. Hence the strategy is a hypothesis—a best guess and set of assumptions as to the appropriate course of action given their knowledge of information concerning the environment, resident competencies, competitive positions, and so on. What is needed is a method to document and test the assumptions inherent in the strategy, and the Balanced Scorecard does just that.

By translating the strategy through objectives appearing on the strategy map and measures chosen for the Scorecard, the Balanced Scorecard provides the necessary means to document and test strategic assumptions. Ideally, the objectives and measures chosen should link together in a chain of cause and effect relationships from the performance drivers in the learning and growth perspective all the way through to improved financial performance as reflected in the financial perspective. We are attempting to document the strategy through measurement, making the relationships between the measures explicit so they may be monitored, managed, and validated.

Here is a typical example of cause and effect: Your organization is pursuing a growth strategy. Your objective is "Grow revenue," and therefore you measure revenue growth in the financial perspective of the Scorecard. You hypothesize that loyal customers providing repeat business will result in greater revenues, so you measure customer loyalty in the customer perspective. How will you achieve superior levels of customer loyalty? Now you ask yourself: At what internal processes must the organization excel in order to drive customer loyalty and ultimately increased revenue? You believe customer loyalty is driven by your ability to continuously innovate and bring new products to the market, and therefore decide to measure new product development cycle times in the internal process perspective. Finally, you're challenged to determine how you will improve cycle times. Investing in employee training on new product initiatives may eventually lower development cycle time and

is thus measured under the learning and growth perspective of the Balanced Scorecard. This linkage of measures throughout the Balanced Scorecard is constructed with a series of if-then statements: if we increase training, then cycle times will lower. If cycle times lower, then loyalty will increase. If loyalty increases, then revenue will increase. When considering the linkage between measures, we should also attempt to document the timing and extent of the correlations. For example, do we expect customer loyalty to double in the first year as a result of our focus on lowering new product development cycle times? Explicitly stating the assumptions in our measurement architecture makes the Balanced Scorecard a formidable tool for strategic learning (see Exhibit 1.4).

Cause and Effect Linkages in Practice

There is little doubt that weaving cause and effect linkages through your strategy map and Scorecard will yield dividends in the form of enhanced strategic insight. However, perhaps surprisingly, relatively few organizations implement this practice with rigor. In one revealing study of performance measurement practices published in 2003, the authors discovered that of 157 companies surveyed, only 23 percent consistently built and verified causal models.[7] This despite the fact that return on assets were 2.95 percent higher and return on equity 5.14 percent higher in those organizations using causal models.

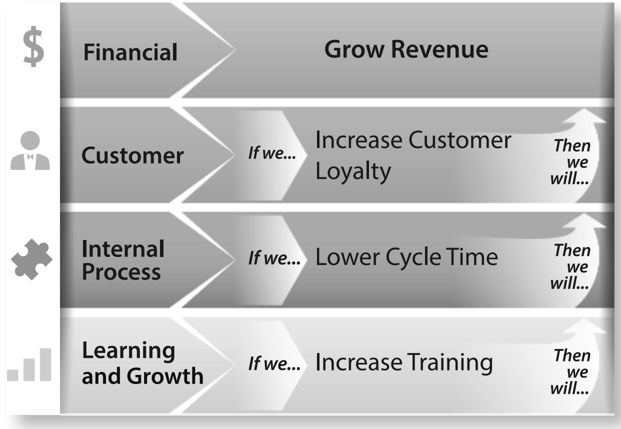

EXHIBIT 1.4 Cause and Effect

As noted, the study referenced above was published in 2003, so in the intervening 10 years, have more organizations availed themselves of the benefits of cause and effect modeling? Columbia Business School finance professor Michael Mauboussin says the answer is no, and has proposed a method for increasing the percentages who do.[8] He argues that two basic questions must be answered before deciding upon which measures to monitor:

1. What is your overarching objective? In business, quite frequently, it's the desire to increase shareholder value.
2. What factors or activities will help you achieve your objective?

With those simple questions answered you're now on the hunt for measures that reliably demonstrate cause and effect, and Mauboussin offers a four-step program for doing so. Step one is clear enough: define your governing objective, which for most profit-seeking enterprises will be the maximization of shareholder value. In step two you develop a theory of cause and effect to assess presumed drivers of that objective. Let's use a bank as an example. They may assume that customer satisfaction drives the use of bank services, and the more services used, the greater the economic value derived by the bank. The bank now measures the correlation between customer satisfaction, usage, and value to determine if the theory of cause and effect is correct. Step three entails the identification of activities that employees can engage in to help achieve the governing objective. Finally, in step four the organization regularly evaluates the statistics to ensure the presumed drivers of value are in fact contributing as theorized.

In my opinion, it is step two that causes most organizations to eschew cause and effect modeling, and therefore fail to benefit from the insights and value it promises. In that step the organization chooses measures and statistically examines correlations. Of course it takes time (and effort) to perform correlation analyses, and many organizations are more interested in using the Scorecard from day one to determine whether they are winning or losing instead of to execute their strategy. It's certainly not controversial to suggest we live in an instant gratification world, and performance measurement is not immune to this phenomenon. Modeling cause and effect linkages exacts the most precious resource companies have: time. Having said that, the growth of analytics software (and the associated knowledge of employees specializing in this field), is making these modeling efforts less demanding, and as a result I expect more organizations will take advantage of the power of cause and effect linkages within their Balanced Scorecards.

Always Strive to Tell Your Strategic Story

Robert McKee is a man who knows a thing or two about telling a story. While you may not recognize his name I'm certain you'll know some of the works produced by his students: *Forrest Gump, The Color Purple*, *Toy Story*, and *Erin Brokovich*, just to name a few. McKee is arguably the world's greatest screenwriting coach, and the 18 Academy Awards, 109 Emmys, and 19 Writers Guild Awards won by his protégés are very solid testimony to that assertion. McKee understands the necessity of introducing the art of storytelling in a business context. As he puts it, "A big part of a CEO's job is to motivate people to reach certain goals. To do that he or she must engage their emotions, and the key to their hearts is a story . . . if you can harness imagination and the principles of a well-told story, then you get people rising to their feet amid thunderous applause instead of yawning and ignoring you."[9]

The objectives and measures appearing on your strategy map and Scorecard should tell your strategic story. All of the elements you need to create a compelling and dramatic story are present: customers, processes, people, and finances. Your job is to creatively link the objectives and measures in a manner that both tells a spellbinding story and allows you to garner additional insights about your business. While statistically based cause and effect modeling can be a valuable tool in maximizing the benefits of the Balanced Scorecard, it's not absolutely necessary to derive results from the system. You simply need the creativity and acumen to craft a story that works on two levels: entertainment and business logic.

Consider for a moment two possible scenarios for presenting corporate strategy to your employee base. In the first case, your CEO goes to the front of the room, directs the audience's attention to a series of PowerPoint slides and dutifully walks them through a series of charts with exacting precision and detail. My eyes are rolling back in my head as I write that. Contrast that with your CEO telling the story of your company; the strategic destination of financial success, the customer outcomes that will fuel that success, the key processes driving results for customers, and the enabling infrastructure of people, technology, and culture setting the foundation for it all. The linkages among the perspectives bring the story to life, demonstrating that your business is not a patchwork of disparate elements but actually a powerful and cohesive system that, if working seamlessly, is geared for success. Over the years, I've been present at many corporate gatherings during which I can literally see the "Aha" moments as employees, often for the first time, have the curtain pulled back on the mystery that is strategy, and leave the room filled with the liberating knowledge of where the company is going, and how they fit into that direction.

Cause and effect modeling takes many forms, with some organizations drawing links between practically every objective and measure appearing on their strategy map and Scorecard. I call these graphical nightmares *spaghetti diagrams* because they are virtually indecipherable, and thus of no value in communicating and executing strategy. At the other end of the spectrum are maps and Scorecards with virtually no cause and effect relationships whatsoever. For those of you thinking you'll probably come down in the middle on this debate and create fairly simple cause and effect models, emphasizing the relationships among the perspectives, take heart. Simple modeling certainly does not preclude you from enjoying great success with the Balanced Scorecard. Many leading Scorecard adopters exhibit very limited cause and effect among objectives and measures while still garnering tremendous focus, alignment, and improved resource-allocation decisions from their work. The key linkages you should articulate on the Map and in the Scorecard are between the internal process and customer perspectives. In many ways the objectives appearing in the learning and growth perspective are considered the enablers of everything you're attempting to achieve and thus may not warrant one-to-one connections with other sections of the map. However, the link between processes and customers is key, as it is here we signal two major transitions: from internal (employees, climate, processes) to external (customers); and from intangible (skills and knowledge, and so on) to tangible (customer outcomes and financial rewards). Customer outcomes signal the *what* of strategic execution, and internal processes supply the *how*. Every organization should make an effort to explicitly document this equation, articulating how they expect to transform their unique capabilities and infrastructure into revenue-producing results.

KEY BALANCED SCORECARD QUESTIONS AND ANSWERS

We'll conclude the chapter with some fundamental questions surrounding the Balanced Scorecard, all of which are vital to your understanding and use of the system.

What Is the Difference between a Balanced Scorecard and a Dashboard?

As you begin to socialize the Scorecard concept among your team and throughout your organization, it is very likely that at least a few people will say something like, "Oh, so we're building a dashboard." Any tacit agreement

to this fundamental misunderstanding will immediately begin to derail your implementation because, although the Balanced Scorecard and dashboards have some elements in common, at their core they serve distinctly different purposes.

The Balanced Scorecard facilitates strategy execution through the translation of strategy into a carefully chosen set of objectives on a strategy map, and then performance measures, targets, and strategic initiatives on a Scorecard. Strategy execution and strategic decision making are aided using the insights gleaned from the Balanced Scorecard. A dashboard on the other hand, focuses on tactical decision making by monitoring the vital *operational* signs of a business that yield immediate understanding into a critical process. While both systems use measures to track progress (often called key performance indicators when used with a dashboard), they are substantially different, as the Scorecard focuses on achieving longer-term strategic goals, while dashboards monitor operations in real time. The following table illustrates key differences between a Balanced Scorecard and a dashboard.

Element	Balanced Scorecard	Dashboard
Purpose	Strategy execution.	Operational efficiency and effectiveness.
Expertise Required	Knowledge of strategy to develop appropriate objectives and measures; ability to interpret trends from the data to glean strategic insights.	Comprehension of esoteric operational processes to drive operational improvement.
Number of measures	Small number, limited to those that serve as translations of the organization's strategy.	Large number, analyzing a process from multiple points of view.
Timing	Long-term: While measure frequencies vary, most companies review Scorecard results monthly to assess progress on strategy execution.	Short-term: Depending on the indicator, dashboards can provide up-to-the-minute information on essential operational processes, and thus may be reviewed in real time in order to make necessary interventions.

Depending on the organizational context and goals, dashboards can fulfill a useful function. However, they are not designed for, or solely capable of, producing the knowledge necessary to drive strategy execution.

Does Balance Mean an Equal Number of Objectives and Measures in Each Perspective of the Balanced Scorecard?

No. There is a misconception that when constructing a Balanced Scorecard you must populate the perspectives with an equal number of objectives and measures, thereby honoring the principle of balance. In practice, the number of objectives and measures appearing in each perspective will depend on your unique strategy and what is necessary for you to execute it at this particular juncture in your history. Having seen thousands of strategy maps and Balanced Scorecards over the past 20 years, I know that while there are no concrete rules prescribing actual figures, it is common to see a roughly similar number of objectives and measures in the financial, customer, and learning and growth perspectives, while the largest number will reside in the internal process perspective. This results from the fact that even small organizations must choose among dozens of potential processes in order to isolate those that contribute directly to the company's chosen value proposition and strategy. Creating the appropriate value chain of processes frequently leads to several strategically vital objectives and measures.

Balance in the Balanced Scorecard reflects three things:

1. A balance between financial and nonfinancial objectives and measures.
2. A balance between leading (predictive; performance drivers) and lagging (end of period) measures.
3. A balance between short-term and long-term success. While some metrics will produce impact immediately, others (innovation and learning, for example) will require a longer period to bear strategic fruit.

As for how technically balanced a Balanced Scorecard should be, it must be modified to meet the unique needs of each organization. Keep in mind that at its core, the Scorecard is a tool for executing strategy, and organizations will pursue different strategies to secure market dominance and financial success. The Scorecard should reflect their strategic priorities. Consider consulting firms. They rely heavily on intangible assets such as the knowledge of their consultants, the ability to share that knowledge, and the opportunity to build on it in future engagements. Therefore, we would expect to see a heavily populated learning and growth perspective. However, the other perspectives of performance are still vital. In the consulting company case, we would expect investments made in people and enabling technology in the learning and growth perspective to drive results in their internal process perspective—perhaps the

ability to generate new solutions for clients and do so faster and more efficiently, thereby reducing costs. This in turn should improve outcomes in the customer perspective—client satisfaction being an obvious metric. Finally, everything touched on above should eventually manifest itself in improved financial returns to demonstrate the strategy is, in fact, effective.

What Version or Generation of the Balanced Scorecard Does This Book Cover?

One of the many reasons the Balanced Scorecard is relied upon by thousands of organizations is the fact that it has evolved substantially since its formation in the early 1990s. It was the combined efforts of practitioners, researchers, consultants, and academics alike that propelled the Scorecard's ascendance from humble beginnings as an improved measurement system to the centerpiece of modern strategic management systems. While Scorecard creators Kaplan and Norton have not applied a naming or numbering protocol to the successive versions of the Scorecard, each boasting new functionality, others have filled that void with their own lexicon. Again, no standard naming system exists to chronicle the history of the Balanced Scorecard, but the following classifications have been widely shared in research papers and on the Internet:[10]

First generation: Utilized almost exclusively to capture and analyze financial and nonfinancial measures across the four perspectives.

Second generation: This iteration saw the inclusion of strategic objectives, which created context for the selection of measures, leading ultimately to the invention of strategy maps. Enhanced cause and effect modeling also appeared during this generation.

Third generation: The chief enhancement touted by proponents of third-generation Balanced Scorecards is that of the destination statement:

> A description, ideally including quantitative detail, of what the organization (or part of organization managed by the Balanced Scorecard users) is likely to look like at an agreed future date. Typically the destination statement is subdivided into descriptive categories that serve a similar purpose (but may have different labels) to the "perspectives" in first- and second-generation Balanced Scorecards.[11]

The destination statement serves to clarify and align the management team around a common definition of strategic success, which facilitates the creation of the Balanced Scorecard. I have no quarrel with the concept of

destination statements, except to note they really aren't an evolution, because they sound virtually identical to what I described as a vision statement in my earliest book on this subject. In 2002 I wrote: "A vision statement provides a word picture of what the organization intends to become—which may be 5, 10, or 15 years in the future. This statement should not be abstract—it should contain as concrete a picture of the desired state as possible and also provide the basis for formulating strategies and objectives."[12]

The parade of versions marches on and by the time you read these words even more generations may be offered by enthusiastic writers and practitioners. All innovation is positive, and all fresh thinking expands the frontier of knowledge outward, which is admirable and productive. However, my experience in this field tells me that many organizations still struggle with the core elements necessary to derive utility from the Balanced Scorecard: selecting strategic objectives, designing robust measures, and, most importantly, using the Balanced Scorecard to learn more about and execute strategy. My focus in these pages is not on advocating for a specific version of the methodology or promoting an arcane name. Rather, my commitment is to provide you with the tools and techniques you'll need to construct a future-ready Balanced Scorecard.

Does the Balanced Scorecard Change?

It may appear odd to be addressing this now, considering you've yet to construct your Scorecard system, but experience tells me that the question is probably on your mind. During Scorecard training sessions and early in implementations, the question of how rigid or permanent a Scorecard should be is always a popular topic, as some people fear that once they commit to a certain element of performance they're obligated to keep the objective and measure as long as the Scorecard is in existence. That is definitely not the case.

The Balanced Scorecard is designed to be a dynamic tool, flexible and capable of change as conditions warrant. Over time you can expect a number of changes to take place within the realm of your map and measures. In the most extreme case you may abandon a strategy you've pursued, based on Scorecard results that prove much of your hypothesis was invalid. In that case you would likely develop a new strategy for your organization and select updated objectives and measures that act as direct translations of the new strategy.

Recently I've been speaking with a company that adopted the Balanced Scorecard more than 10 years ago, and have been using it faithfully ever since. The organization turned to the tool in an effort to assist them in executing a

new customer-driven strategy, one that required substantial changes to their processes, investments in new technologies, and, of course, updated skill sets in their employee base. Like thousands of other organizations they found the Scorecard to be invaluable for successfully unlocking the value of their strategy; as noted above, they've been devoted advocates since that time.

Fast-forward 10 years and the world is a different place, replete with changes that have impacted companies around the globe, including this one. Somewhere along the line their customer-focused strategy gave way to a new commitment to cost leadership, an economic reality in a market that was moving quickly towards commoditization. What they neglected to do was substantially change the Scorecard's core elements to be consistent with their new direction. So, while they've remained committed to the Scorecard, its benefits have waned over the past few years, and managers are openly voicing their doubts about the tool's ongoing efficacy.

This is a company that clearly needs to unfreeze. The Scorecard they instituted years ago is no longer a proper representation of the organization's strategy, and there is little wonder that managers, hungry for every strategic advantage good information provides, have lost faith in the tool. To continue benefiting from the framework, they'll have to carefully reconsider how it fits with their new strategy and how its core elements must be updated in order to reflect current realities. This, of course, may be painful because it will undoubtedly mean selecting new objectives, measures, targets, and initiatives, and in an even more painful step, possibly unhinging mature links between the Scorecard and vital organizational processes such as budgeting, compensation, and employee reviews. However, if the Scorecard is to continue producing benefits, this has to be done.

Of course, you don't need to wait 10 years to update your Scorecard, and may in fact be forced to make changes due to circumstances beyond your control. That was the case for another client of mine, a public sector organization in New Jersey. They had just adopted the Balanced Scorecard and were about to begin using it when Hurricane Sandy battered the state in October 2012. In the aftermath priorities shifted and many of the objectives and measures they had chosen, while important in normal operating circumstances, were no longer appropriate in such an emergency situation. As they put it, "We had to turn out the lights on a number of our measures." Once the worst was over, Governor Christie challenged his teams to have even the most damaged areas open for business by Memorial Day, just a few months later. After discussing the situation, I advised my client to ask: What are the key challenges you're facing right now in light of the governor's goal, and what Scorecard objectives and measures will you enlist to meet the challenge? Based on that, I recommended they shrink their strategy

map and Scorecard to the vital few objectives and measures necessary to guide them through those extraordinarily challenging times.

It shouldn't take a natural disaster, however, to cause a thoughtful review of your Balanced Scorecard. Your Scorecard elements should be reviewed at least annually in conjunction with your planning events (strategic planning, business planning, budgeting, and so on). Objectives and measures should be evaluated to ensure they are still valid in light of current and anticipated business conditions, and are able to remain as key chapters in your strategic story.

Many organizations tend to make subtle changes to objectives and measures as they gain experience with the Balanced Scorecard system. With measures, the method of calculation may change to better capture the true essence of the event under investigation, or the measure's description may be enhanced to improve employee understanding of its operational and strategic significance. You may also change the frequency with which you collect performance data. For example, you may have attempted to track employee satisfaction monthly, but the logistics of gathering the data simply proved too challenging. In that case you wouldn't forsake this important indicator, you would simply change the reporting period to something more amenable to measurement. Changing your performance measures is yet another way to tap into the collective knowledge of your organization. Be sure to advertise the fact that you're about to consider measure changes for the coming fiscal year, and give the entire employee base the opportunity to provide feedback regarding beneficial adjustments.

The caveat regarding such changes is this: Don't alter your objectives or measures simply because you don't like the current crop, or the results aren't what you expected. The Balanced Scorecard is about learning. Learning about your strategy, learning about the assumptions you've made to win in your marketplace, and learning about the value proposition you've put forth. Sometimes you won't necessarily enjoy what your results are telling you, but don't simply treat these alterations from plan as defects, instead use them to question and learn about your business.

How Important Is Terminology in a Balanced Scorecard Implementation?

Very! In his 1832 book *On War*, Carl von Clausewitz declared, "The first task of any theory is to clarify terms and concepts that are confused. . . . Only after agreement has been reached regarding terms and concepts can we hope to consider the issues easily and clearly, and expect others to share the same viewpoint . . ."[13] Reaching agreement on terms and concepts is not

as easy as it sounds, especially when you consider there are over 14,000 meanings for the 500 most common words in the English language. And of course anyone who has endured a corporate wordsmithing exercise can attest to how quickly it can devolve into a *Dilbert*-esque tableau, leading to frustration and cynicism.

Confusing our words can lead to the transmission of mixed signals to employees and result in less-than-desirable outcomes for the organization. Thus it's imperative we use consistent definitions for key Balanced Scorecard terms and concepts. You probably won't be surprised to learn that I recommend you use the definitions below as you communicate and implement the Scorecard. However, in the end it really doesn't matter what you call the concepts—remember Shakespeare's admonition: "What's in a name? That which we call a rose by any other name would smell as sweet." The key is using your chosen terms with unwavering consistency throughout the organization to ensure there is true consensus on the point, and the term is communicated clearly to all stakeholders. Everyone must be speaking the same language if you expect the Balanced Scorecard, or any change initiative, to be understood, accepted, and able to produce results.

Key Balanced Scorecard Terms and Concepts

Balanced Scorecard—An integrated system for describing and translating strategy through the use of linked performance objectives, measures, targets, and strategic initiatives in four, balanced perspectives—customer, internal process, financial, and learning and growth. The Balanced Scorecard acts as a measurement system, strategic management system, and communication tool.

Initiatives—Strategic initiatives (often simply referred to as initiatives in the Scorecard vernacular) are the specific projects, activities, or programs you'll embark upon in order meet or exceed your performance targets.

Lagging Indicator—Performance measures that represent the consequences of actions previously taken are referred to as lag indicators. They frequently focus on results at the end of a time period and characterize historical performance. Employee satisfaction may be considered a lag indicator. A good Balanced Scorecard must contain a mix of lag and lead indicators.

Leading Indicator—These measures are considered the drivers of lagging indicators. There is an assumed relationship between the two, which suggests that improved performance in a leading indicator will

drive better performance in the lagging indicator. For example, lowering absenteeism (a leading indicator) is hypothesized to drive improvements in employee satisfaction (a lagging indicator).

Measure—A standard used to evaluate and communicate performance against expected results. Measures are normally quantitative in nature capturing numbers, dollars, percentages, and so on. Reporting and monitoring measures helps an organization gauge progress toward effective implementation of strategy.

Mission Statement—A mission statement defines the core purpose of the organization—why it exists. The mission examines the raison d'être for the organization and reflects employees' motivations for engaging in the organization's work. Effective missions are inspiring, long term in nature, and easily understood and communicated.

Objective—Objectives are concise statements of what the organization must do well in each of the four perspectives of financial, customer, internal process, and learning and growth in order to execute its unique strategy. Objectives begin with verbs such as increase, reduce, improve achieve, and so on. Strategy maps are comprised entirely of objectives.

Perspective—In Balanced Scorecard vernacular, perspective refers to a category of performance objectives or measures. Most organizations choose the standard four perspectives (financial, customer, internal process, and learning and growth), however, the Balanced Scorecard represents a dynamic framework, and additional perspectives may be added as necessary to adequately translate and describe an organization's strategy.

Strategic Management System—Describes the use of the Balanced Scorecard in aligning an organization's short-term actions with strategy. Often accomplished by cascading the Balanced Scorecard to all levels of the organization, aligning budgets and business plans to strategy, and using the Scorecard as a feedback and learning mechanism.

Strategic Resource Allocation—The process of aligning budgets with strategy by using the Balanced Scorecard to make resource allocation decisions. Using this method, budgets are based on the initiatives necessary to achieve Balanced Scorecard targets.

Strategy—Represents the broad priorities adopted by an organization in recognition of its operating environment and in pursuit of its mission. Situated at the center of the Balanced Scorecard system, all performance objectives and measures should align with the organization's strategy.

Strategy remains one of the most widely discussed and debated topics in the world of modern organizations.

Strategy Map—A one-page, graphical representation of what must be done well in order to execute strategy. Strategy maps are composed of performance objectives spanning the four perspectives and linking together to tell the organization's strategic story.

Target—Represents the desired result of a performance measure. Targets provide organizations with feedback regarding performance, and imbue the results derived from measurement with meaning.

Value Proposition—Describes how an organization will differentiate itself to customers, and what particular set of values it will deliver. To develop a customer value proposition many organizations will choose one of three disciplines articulated by Treacy and Wiersema in *The Discipline of Market Leaders*: operational excellence, product leadership, or customer intimacy.

Vision—"A vision statement provides a word picture of what the organization intends to become—which may be 5, 10, or 15 years in the future. This statement should not be abstract—it should contain as concrete a picture of the desired state as possible and also provide the basis for formulating strategies and objectives."

NOTES

1. Robert S. Kaplan and David P. Norton, "The Balanced Scorecard—Measures that Drive Performance," *Harvard Business Review* (January–February 1992): 71–79.
2. Nolan Norton Institute, "Measuring Performance in the Organization of the Future: A Research Study" (1991).
3. See, for example, Bain Management Tools 2011, www.bain.com/images/bain_management_tools_2011.pdf.
4. Michael J. Gelb, *How to Think Like Leonardo da Vinci* (New York: Random House, 2004).
5. Michael Treacy and Fred Wiersema, *The Discipline of Market Leaders* (Reading, MA: Perseus Books, 1995).
6. Robert S. Kaplan and David P. Norton, *Strategy Maps: Converting Intangible Assets Into Tangible Outcomes* (Boston: Harvard Business School Press, 2004).
7. Christopher D. Ittner and David F. Larcker, "Coming Up Short on Nonfinancial Performance Measurement," *Harvard Business Review* (November 2003): 88–95.

8. Michael J. Mauboussin, "The True Measures of Success," *Harvard Business Review* (October 2012): 46–56.
9. Robert McKee, "Storytelling That Moves People," *Harvard Business Review* (June 2003): 51–55.
10. See, for example, Gavin Lawrie and Ian Cobbold, "Development of the 3rd Generation Balanced Scorecard." Accessed at http://2gc.eu/files/resources/2GC-WP-Dev3rdGenBSC-090311.pdf.
11. Ibid., 12.
12. Paul R. Niven, *Balanced Scorecard Step by Step: Maximizing Performance and Maintaining Results* (New York: John Wiley & Sons, 2002), 83.
13. Carl von Clasewitz, Michael Eliot Howard (Translator), Peter Paret (Translator). *On War* (Princeton: Princeton University Press, Reprint Edition, 2008).