

# *The Balanced Scorecard*

*A Strategic Management System*

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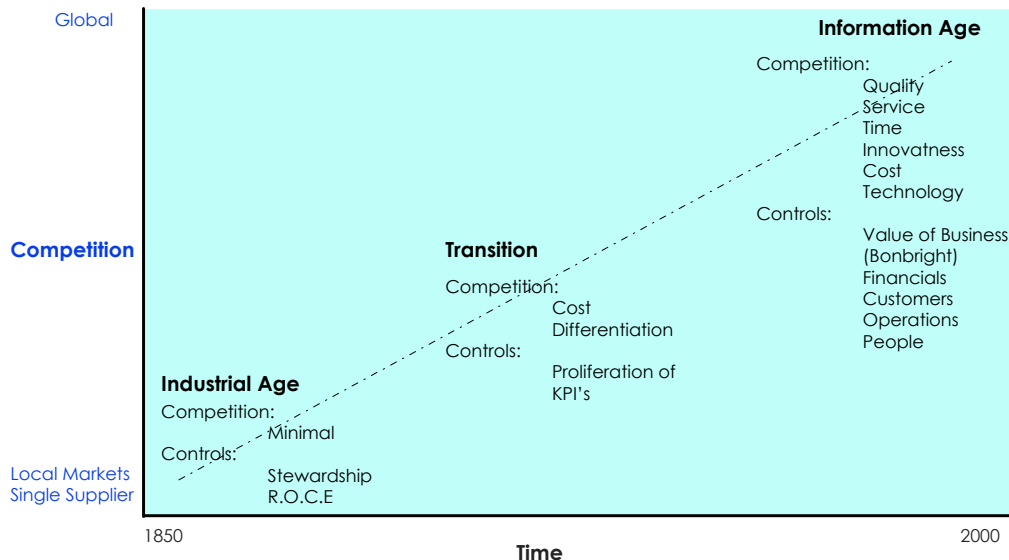
## Introduction

The Balanced Scorecard is a “Strategic Management System.” It translates an organisation’s mission and strategy into a comprehensive set of performance measures that provides the framework for a strategic measurement and management system. The BSC enables an organisation to understand the relationship between the business performance drivers and the associated financial outcomes, providing the crucial linkages between operational control and strategic intent.

Innovative companies are using the scorecard to manage their strategy over the long run. They are using the measurement focus of the scorecard to accomplish critical management processes, namely:

1. To Clarify and translate vision and strategy
2. To communicate and link strategic objectives and measures
3. To plan, set targets and align strategic initiatives
4. To enhance strategic feedback and learning

## Changing Needs of Management Control Systems



Firstly let's look at the changing requirements of management control systems as depicted through time with increasing levels of competition.

Companies are in the midst of a revolutionary transformation. Industrial Age competition is shifting to Information Age competition.

During the Industrial Age, from 1850 to 1975, companies succeeded by how well they could capture the benefits from economies of scale and scope. Success accrued to companies that could embed new technology into physical assets that offered efficient mass production of standard products. Financial control systems were developed to facilitate and monitor efficient allocations of financial and physical capital. A summary financial measure such as R.O.C.E. could ensure capital was allocated to its most productive use and monitor the efficiency by which managers used financial/physical capital to generate shareholder wealth.

The Information Era, however, has changed the rules of competition. The ability to efficiently allocate physical resources has been superseded by the ability to effectively exploit intangible assets. Intangible assets enable an organisation to:

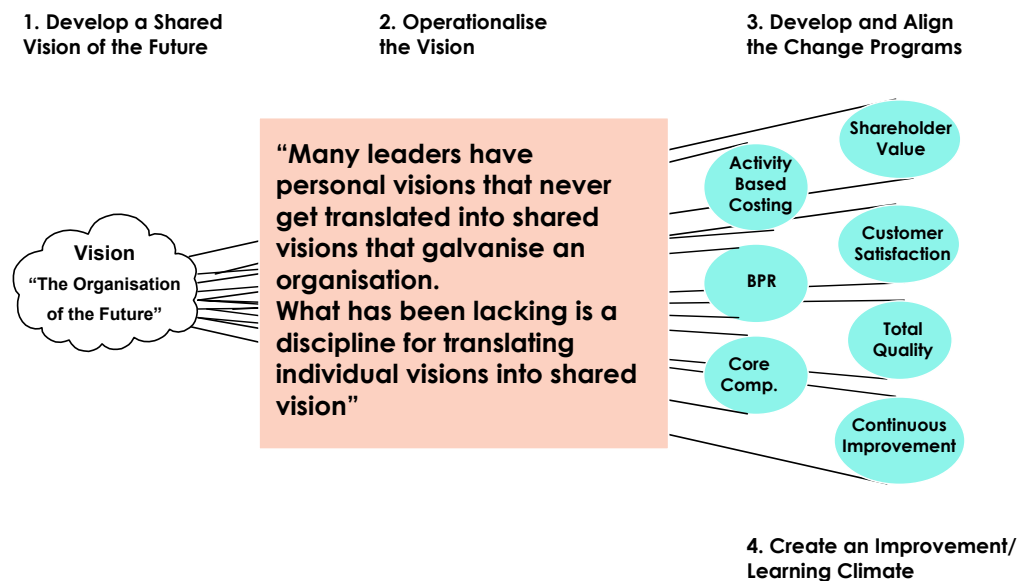
1. Develop customer relationships, enabling new customer segments and market areas to be served.
2. Introduce innovative products and services desired by targeted customer segments.
3. Produce customised high quality products and services at low cost and with short lead times.
4. Mobilise employee skills and motivation for continuous improvement in process capabilities, quality and response times.

Information Age organisations are built on a new set of operating assumptions:

1. Cross Functions - Integrated business processes.
2. Links to Customers and Suppliers.
3. Customer Segmentation vs “They can have it in any colour as long as it is black.”
4. Global Scale - International Markets.
5. Innovation - Shorter product life cycles.
6. Knowledge Workers - “People are problem solvers not variable costs.”

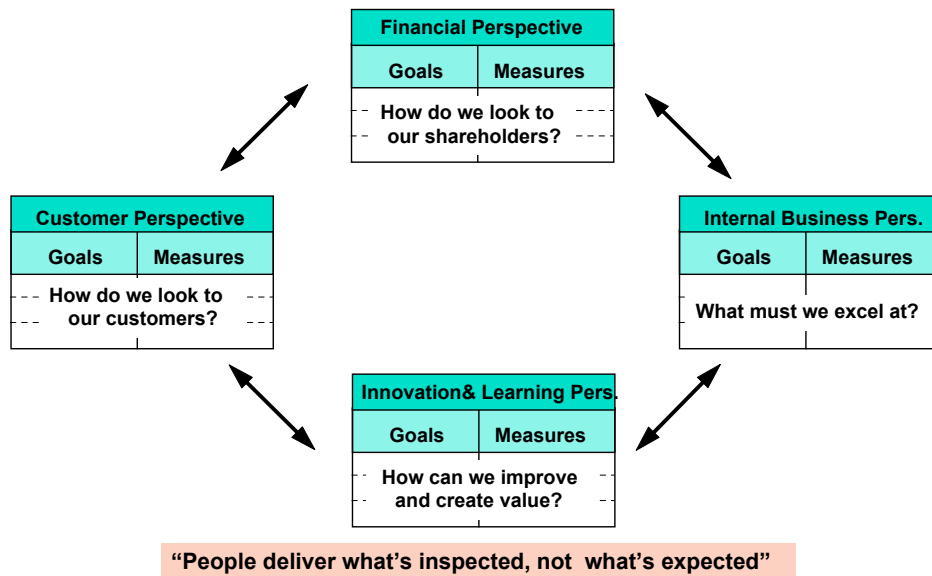
The dynamism of the Information Era has created a need for a more sophisticated and responsive management control system

## A New Role for Strategic Performance Measurement has Emerged



The Information Age organisation is faced with the task of integrating and mobilising its intangible assets in such a way to create sustainable competitive advantage. The challenge for managers is to find a way of creating a shared vision of the future, operationalising the implementation of that vision, integrating the initiatives which are designed to yield the step change in performance and creating an environment where the organisation can learn and grow.

## Balanced Scorecard-a methodology



The Balanced Scorecard methodology has been founded on the principles of goal congruency, integration, learning and strategic control.

The concept is predicated on the question of which measures would one use to value a business. If for example we were to buy a company, how would we evaluate its performance and therefore its worth? Well we would wish to know:

1. Details of its market personality. Brand strength, market share and customer loyalty.
2. How efficient and effective are the internal business processes.
3. The calibre of the employees. Whether they could grow the business for tomorrow.
4. Finally, the financial performance.

If these are the areas of interest in assessing a company's worth then these are the areas we should manage.

The BSC requires the organisation to look at itself from four different perspectives and to answer four basic questions:

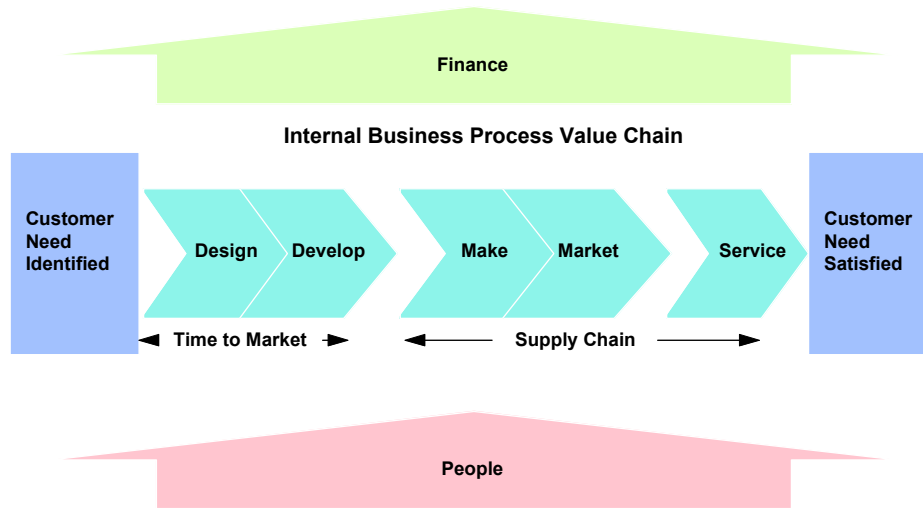
1. Customer - What do existing and new customers value from us?
2. Internal - What processes must we excel at to achieve our financial and customer objectives?
3. Innovation & learning - Can we continue to improve and create future value?
4. Financial - How can we create value for our shareholders?

The answers are established by talking to stakeholder groups outside the company, not by board discussions.

Having understood what is important for the business, strategic goals are determined, performance targets established and performance measures set up to monitor progress.

The balanced scorecard then becomes the primary monthly report for managing the business.

## Business Model-holistic perspective



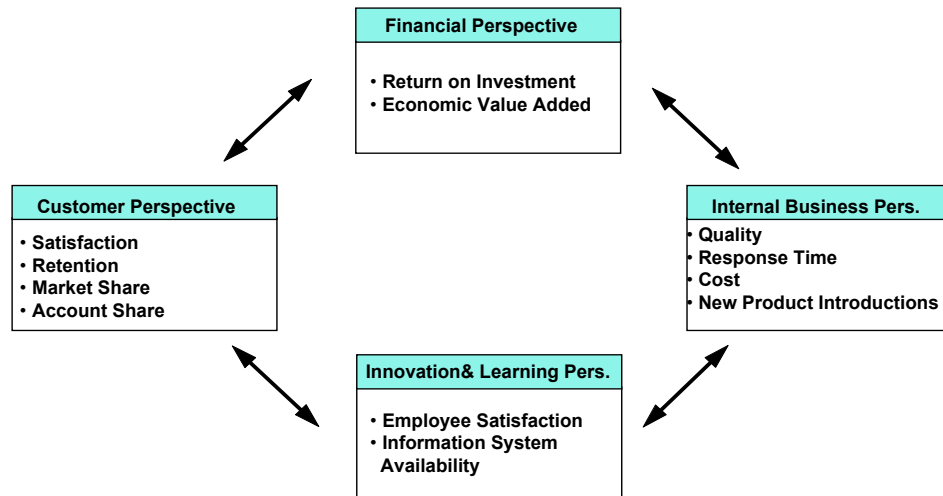
The four perspectives cover the complete organisational business model. In value chain terms: from assessing customer needs, designing and developing appropriate products or services, making and marketing those products/services to ensuring the delivery of service and thereby satisfying customer requirements. In managerial and human resource terms and in terms of financial outcomes.

Although simple in concept, the BSC challenges managers to think about the business from a holistic perspective rather than a functional viewpoint. To hypothesise on the cause/effect relationships in the service delivery value chain. To build business processes which are integrative and add value. To test assumptions and learn how to improve the business mix.

## Balanced Scorecard-generic measures

The four perspectives of the scorecard permit a balance between short and long term objectives, between outcomes desired and the performance drivers of those outcomes, and between hard objective measures and softer more subjective measures.

Managing a company has been described as being like flying an aircraft. The cockpit has dials and indicators for airspeed, altitude, direction, position, destination, fuel and so on. All these are needed for a successful arrival and relying on any combination of individual instruments would be potentially fatal. No single performance measure can provide a clear target for sustained competitive advantage in any organisation.



**“People deliver what’s inspected, not what’s expected”**

Traditional financial measures, such as return on capital and earnings per share can give rise to short term decisions which are harmful to competitiveness, continuous improvement and innovation. They might encourage companies to achieve short-term financial results at the expense of long term viability.

The scorecard has been designed to balance decision-making by focusing on the interrelationship between the differing competitive pressures facing the organisation and stimulating continuous improvement.

### Customer Perspective

In the customer perspective of the BSC, managers identify the customer and market segments in which the business will compete and the measures of the business performance in these targeted segments. This perspective typically includes several core or generic measures of the successful outcomes from a well-formulated and implemented strategy. The core outcome measures include customer satisfaction, customer retention, new customer acquisition, customer profitability, and market share in targeted segments. But the customer perspective should also include specific measures of the value propositions that the company will deliver to customers in targeted market segments. The segment-specific drivers of core customer outcomes represent those factors that are critical for customers to switch to or remain loyal to their suppliers e.g short lead times, on-time delivery etc.

### Internal Business Processes

In the internal business process perspective, managers identify the critical internal processes in which the organisation must excel. These processes enable the business to:

1. Deliver the value proposition that will attract and retain customers in targeted market segments, and
2. Satisfy shareholder expectations of excellent financial returns.

The internal business process measures focus on the internal processes that will have the greatest impact on customer satisfaction and achieving the organisations financial objectives, a reflection of the organisation’s core skills and the critical technology involved in adding customer value.

Consideration should be given to both the short and long term approaches to delivering customer value, along with the integrating processes which ensure customer needs are anticipated:

The short wave of value creation focuses on the processes which deliver today's products and services to today's customers. The operations cycle begins with the receipt of an order from an existing customer for an existing product/service and ends with the delivery of the product/service to the customer.

In contrast, the long wave of value creation focuses on the process which creates entirely new products and services that will meet the emerging needs of current and future customers. This innovation cycle begins with the identification of customer needs, and ends with the design and development of products/services to meet those needs. For many companies, their ability to manage successfully a multi-year product-development process or to develop a capability to reach entirely new categories of customers may be more critical for future economic performance than managing existing operations efficiently, consistently, and responsively.

### Learning and Growth Perspective

The learning and growth perspective identifies the infrastructure that the organisation must build to create long term growth and improvement. A company's ability to innovate, improve, and learn ties directly to the company's value. That is, only through the ability to launch new products, create more value for customers, and improve operating efficiencies continually can a company penetrate new markets and increase revenues and margins - in short, grow and thereby increase shareholder value.

Organisational learning and growth come from three principle sources: people, systems and organisational procedures. The financial, customer, and internal business process objectives on the balanced scorecard typically will reveal large gaps between the existing capabilities of people, systems, and procedures and what will be required to achieve breakthrough performance. To close these gaps, businesses will have to invest in re-skilling employees, enhancing information technology and systems, and aligning organisational procedures. These objectives are articulated in the learning and growth perspective of the BSC.

Employee based measures include a mixture of generic outcome measures - employee satisfaction, retention, training, and skills - along with specific drivers of these generic measures, such as detailed, business-specific indexes of the particular skills required for the new competitive environment.

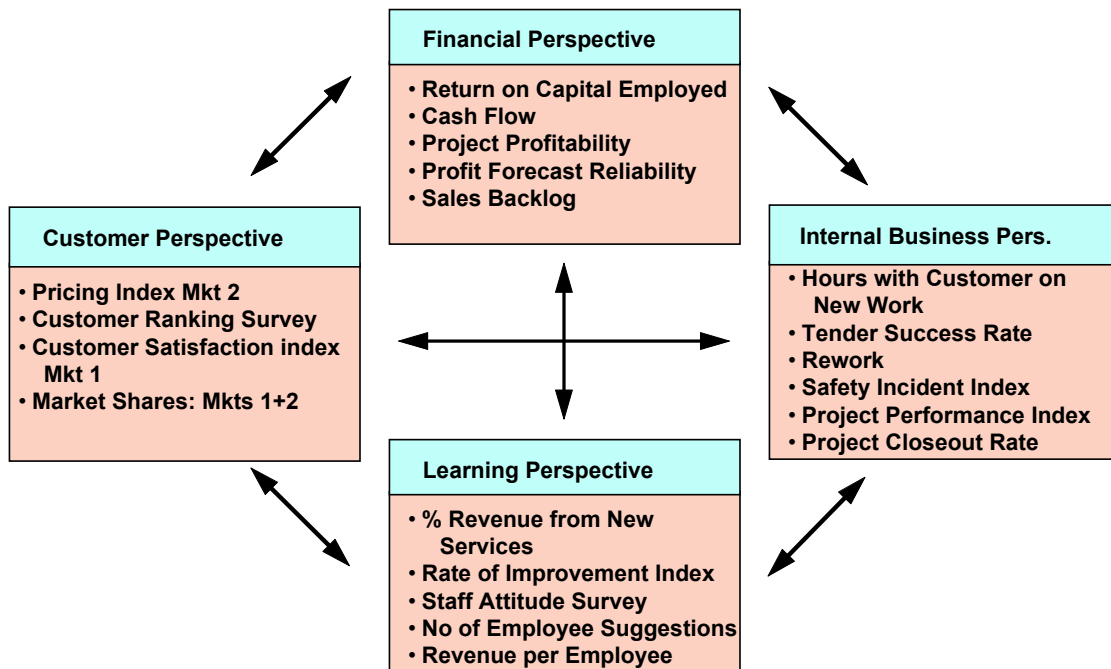
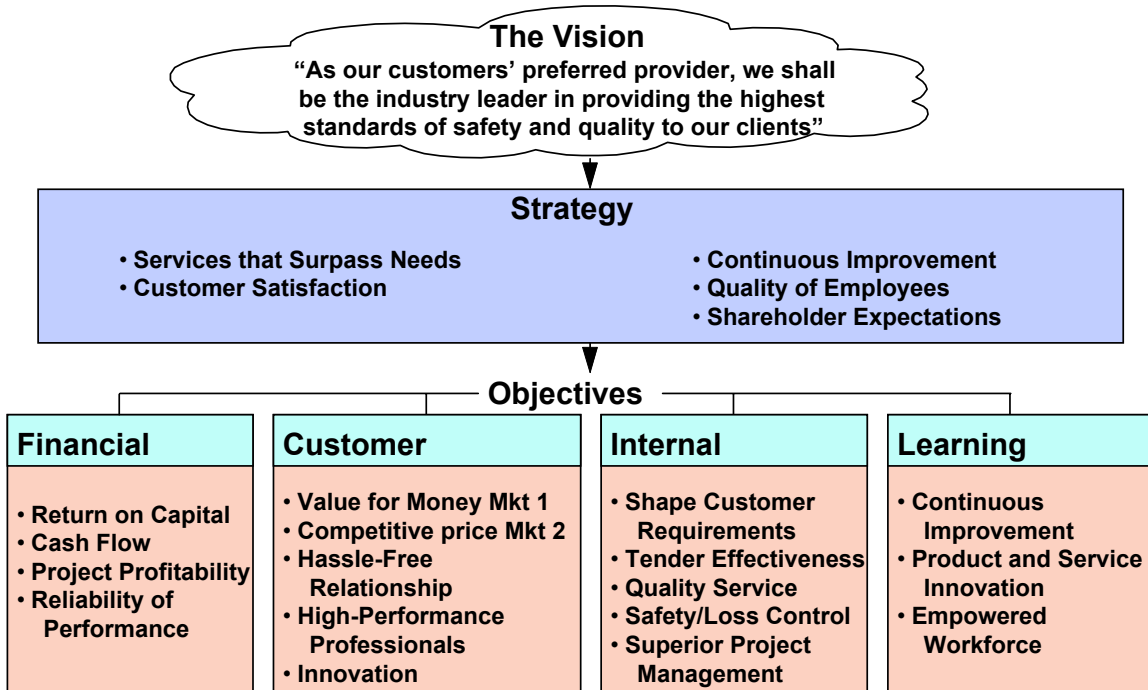
Information systems capabilities can be measured by real-time availability of accurate, critical customer and internal process information to employees.

Organisational procedures can examine alignment of employees incentives with overall organisational success factors, and measured rates of improvement in critical customer-based and internal processes.

### Financial perspective

The BSC retains the financial perspective since financial measures are valuable in summarising the readily measurable economic consequences of actions already taken. Financial performance measures indicate whether a company's strategy, implementation, and execution are contributing to bottom-line improvement. Financial objectives typically relate to profitability - measured, for example, by operating income, return-on-capital-employed, or more recently, economic value-added. Alternative financial objectives can be rapid sales growth or generation of cash flow.

# Balanced Scorecard-a construction company



## Lead and Lag Indicators-a bank

A good Balanced Scorecard should have a mix of outcome measures and performance drivers. Outcome measures without performance drivers do not communicate how the outcomes are to be achieved. They also do not provide an early indication about whether the strategy is being implemented successfully. Conversely, performance drivers - such as cycle times and part-per-million defect rates - without outcome measures may enable the business to achieve short-term operational improvements, but fail to reveal whether the operational improvements have been translated into expanded business with existing and new customers, and, eventually, to enhanced financial performance.

	Strategic Objectives	Strategic Measures	
		Lag Indicators	Lead Indicators
Finance	<ul style="list-style-type: none"> <li>• Improve returns</li> <li>• Broaden revenue Mix</li> <li>• Reduce Cost Structure</li> </ul>	<ul style="list-style-type: none"> <li>• Return-on-Investment</li> <li>• Revenue Growth</li> <li>• Service Cost Change</li> </ul>	<ul style="list-style-type: none"> <li>• Revenue Mix</li> </ul>
Customer	<ul style="list-style-type: none"> <li>• Increase Customer Satisfaction with Products and People</li> <li>• Increase Satisfaction "After the Sale"</li> </ul>	<ul style="list-style-type: none"> <li>• Share of Segment</li> <li>• Customer Retention</li> </ul>	<ul style="list-style-type: none"> <li>• Depth of Relationship</li> <li>• Customer Satisfaction Survey</li> </ul>
Internal	<ul style="list-style-type: none"> <li>• Understand Our Customers</li> <li>• Create Innovative Products</li> <li>• Cross Sell Products</li> <li>• Shift Cust. to Lo Cost Channel</li> <li>• Minimise Operational Issues</li> <li>• Responsive Service</li> </ul>	<ul style="list-style-type: none"> <li>• Revenue from new Products</li> <li>• Cross-Sell ratio</li> <li>• Channel Mix Change</li> <li>• Service Error Rate</li> <li>• Request Fulfilment Time</li> </ul>	<ul style="list-style-type: none"> <li>• Product development Cycle</li> <li>• Hours with Customers</li> </ul>
Learning	<ul style="list-style-type: none"> <li>• Build Strategic Information</li> <li>• Develop Strategic Skills</li> <li>• Focus resources</li> <li>• Employee Effectiveness</li> </ul>	<ul style="list-style-type: none"> <li>• Revenue Per Employee</li> <li>• Employee Satisfaction</li> </ul>	<ul style="list-style-type: none"> <li>• Strategic Info Availability</li> <li>• Strategic Job Coverage</li> <li>• Personal Goals Alignment</li> </ul>

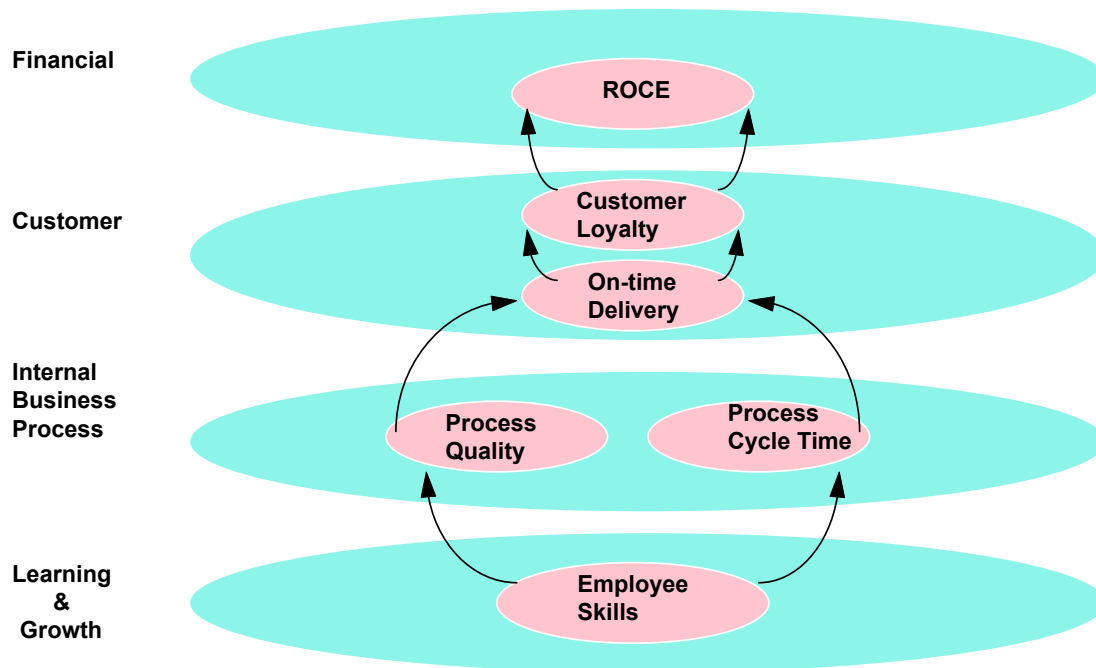
A good Balanced Scorecard should have an appropriate mix of outcome (lagging indicators) and performance drivers (leading indicators) of the organisation's strategy - a linked set of measures that define the long term objectives and the mechanisms for achievement.

## Business Drivers-cause/effect hypothesis

A strategy is a set of hypotheses about cause and effect. The measurement system should make the relationships (hypotheses) among objectives (and measures) in the various perspectives explicit so that they can be managed and validated. The chain of cause and effect should pervade all four perspectives of a Balanced Scorecard. For example, return-on-capital-employed may be a scorecard measure in the financial perspective. The driver of this measure could be repeat and expanded sales from existing customers, the result of a high degree of loyalty among those customers. So, customer loyalty is included on the scorecard (in the customer perspective) because it is expected to have a strong influence on ROCE. But how

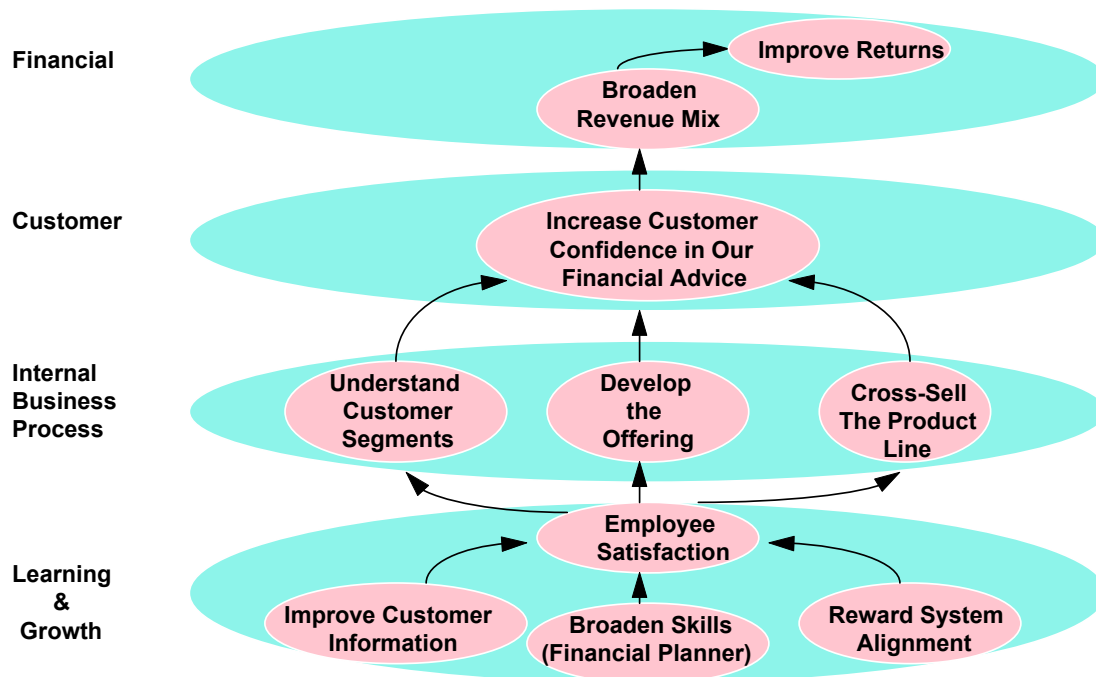
will the organisation achieve customer loyalty? Analysis of customer preferences may reveal that on-time delivery of orders is highly valued by customers. Thus, improved on-time-delivery is expected to lead to higher customer loyalty, which, in turn, is expected to lead to higher financial performance. So both customer loyalty and OTD are incorporated into the customer perspective of the scorecard.

The process continues by asking what internal processes must the company excel at to achieve exceptional on-time-delivery. To achieve improved OTD, the business may need to achieve short cycle times in operating processes and high-quality internal processes, both factors that could be scorecard measures in the internal perspective. And how do organisations improve the quality and reduce the cycle times of their internal processes? By training and improving the skills of their operating employees, an objective that would be a candidate for the learning and growth perspective. We can now see how an entire chain of cause-and-effect relationships can be established as a vertical vector through the four BSC perspectives.

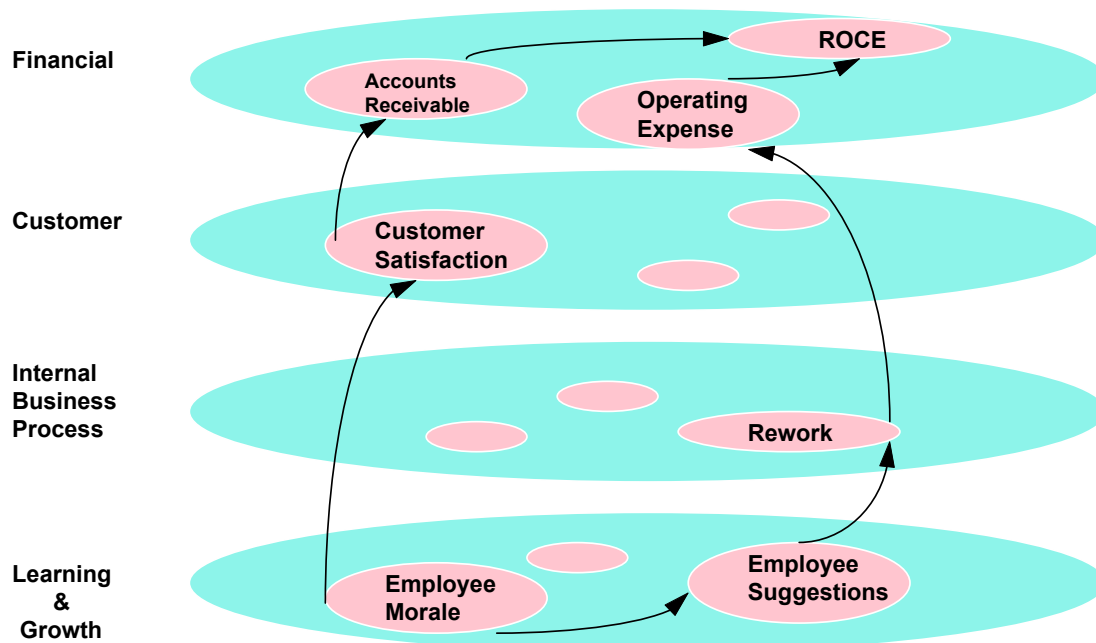


Thus, a properly constructed Balanced Scorecard should tell the story of the business strategy. It should identify and make explicit the sequence of hypotheses about the cause-and-effect relationships between outcome measures and the performance drivers of those outcomes. Every measure selected for a BSC should be an element in a chain of cause-and-effect relationships that communicates the meaning of the business strategy to the organisation.

## Business Drivers-a financial services organisation



## Business Drivers-an engineering company

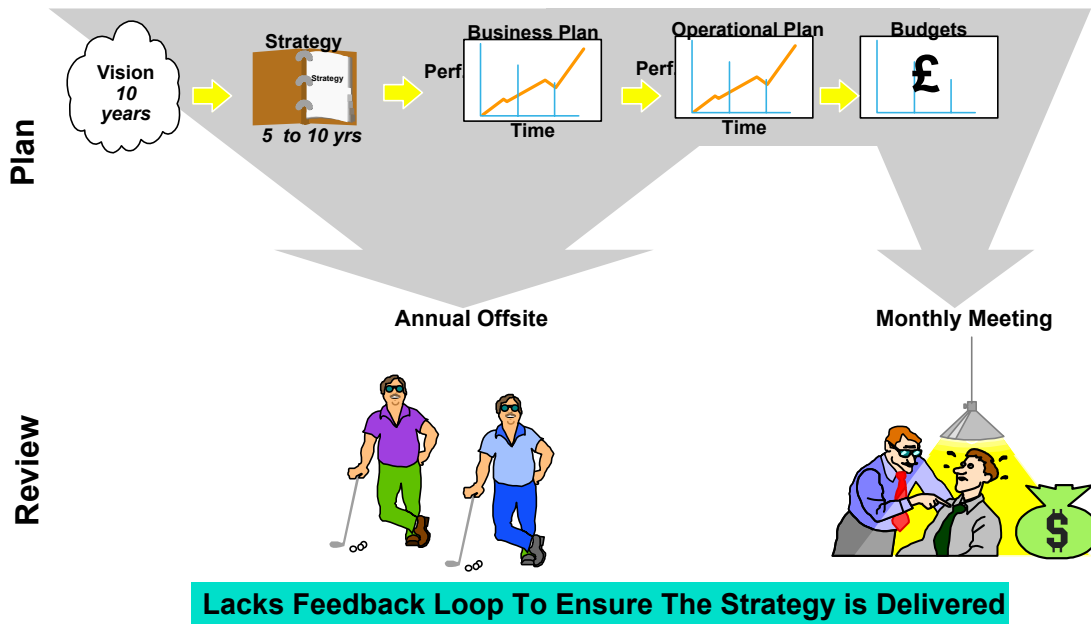


## Strategic Planning/Review Process-traditionalist

The traditional approach to business planning and control has involved:

1. The top team articulating a vision for the direction of the business, which gives rise to a series of high level business objectives.
2. The objectives give rise to a business strategy which in turn spawns a series of functional strategies. Namely: marketing, manufacturing, logistics, purchasing and support.
3. These strategies give rise to shorter term operational plans, typically a one year detailed version supported by a less detailed outlook for a two to three year time frame.
4. The operational plan is then translated into a series of detailed budgets.

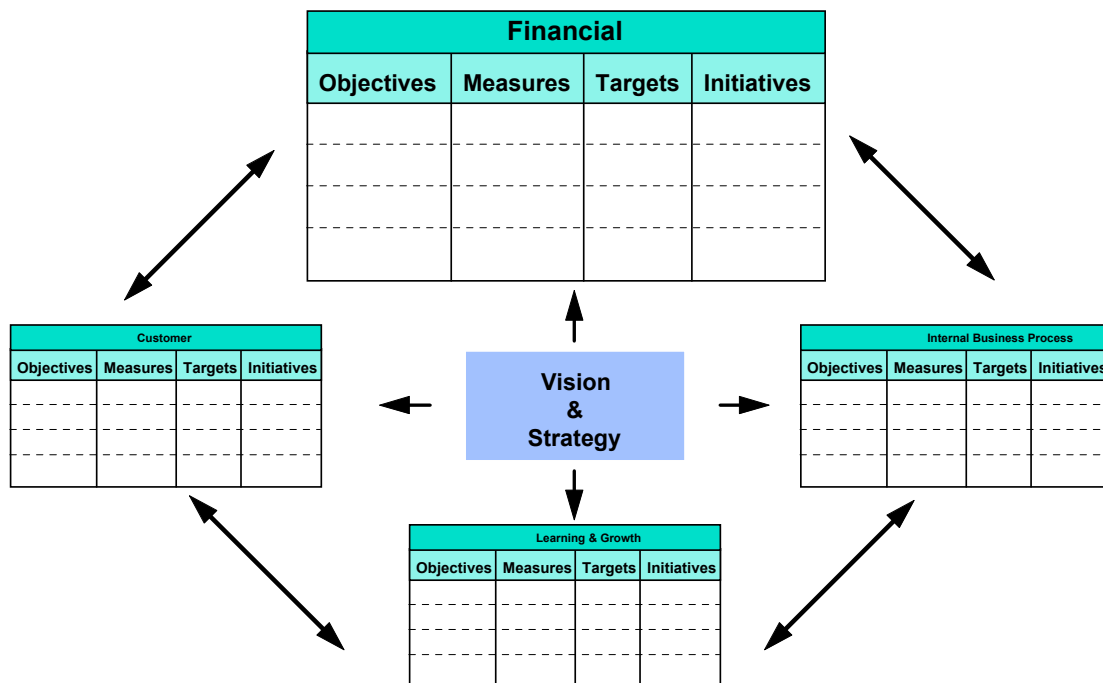
The control process then involves a detailed week to week and/or month to month review of financial results versus budget. The business plan and strategy is reviewed infrequently - often annually.



The above process is typical of most companies. Most companies' operational and management control systems are built around financial measures and targets, which bear little relation to the company's progress in achieving long-term strategic objectives. Thus the emphasis most companies place on short-term financial measures leaves a gap between the development of a strategy and its implementation.

## Balanced Scorecard- linking strategy to activity

The very exercise of creating a balanced scorecard forces companies to integrate their strategic planning and budgeting processes and therefore helps to ensure that their budgets support their strategies. Scorecard users select measures of progress from all four scorecard perspectives and set targets for each of them. Then they determine which actions will drive them toward their targets, identify the measures they will apply to those drivers from the four perspectives, and establish the short term milestones that will mark their progress along the strategic paths they have selected. Building a scorecard thus enables a company to link its financial budgets with its strategic goals.



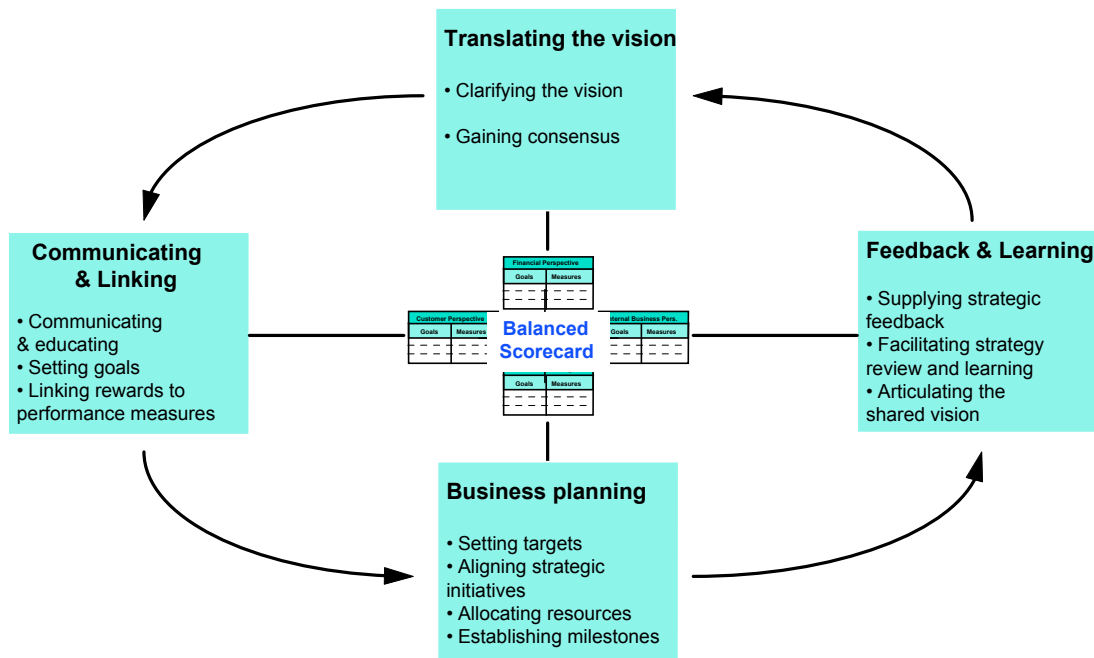
Use of the Balanced Scorecard as the primary management review tool on a regular basis - i.e. monthly at the director level - ensures performance is compared against strategic intent.

## Balanced Scorecard-Strategic Planning/Review

Managers using the Balanced Scorecard do not have to rely on short-term financial measures as the sole indicators of the company's performance. The scorecard lets them introduce four new management processes that, separately and in combination, contribute to linking long-term strategic objectives with short-term actions.

The first process - *translating the vision* - helps managers build a consensus around the organisation's vision and strategy. Despite the best intentions of those at the top, lofty statements about becoming "best in class," "the number one supplier," or an "empowered organisation" don't translate easily into operational terms that provide useful guides to action

at the local level. For people to act on the words in vision and strategy statements, those statements must be expressed as an integrated set of objectives and measures, agreed upon by all senior executives, that describe the long-term drivers of success.



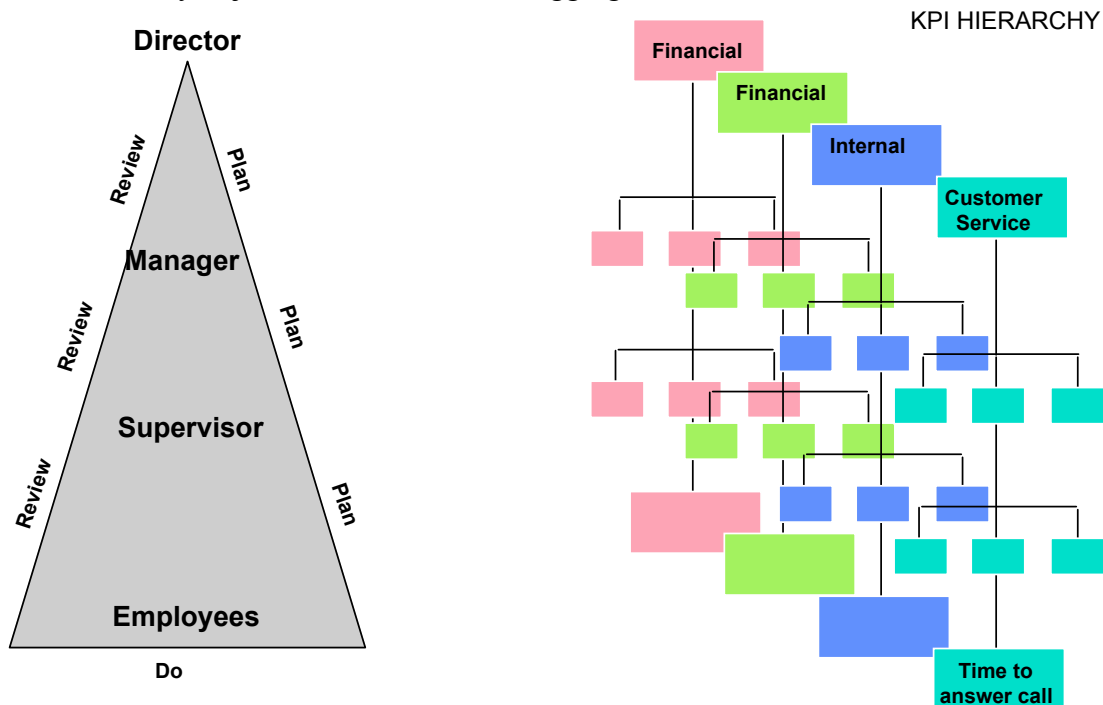
The second process - *communicating and linking* - lets managers communicate their strategy up and down the organisation and link it to departmental and individual objectives. Traditionally, departments are evaluated by their financial performance, and individual incentives are tied to short-term financial goals. The scorecard gives managers a way of ensuring that all levels of the organisation understand the long-term strategy and that both departmental and individual objectives are aligned with it.

The third process - *business planning* - enables companies to integrate their business and financial plans. Almost all organisations today are implementing a variety of change programs, each with its own champions, gurus, and consultants, and each competing for senior executives' time, energy, and resources. Managers find it difficult to integrate those diverse initiatives to achieve their strategic goals - a situation that leads to frequent disappointments with the programs' results. But when managers use the ambitious goals set for balanced scorecard measures as the basis for allocating resources and setting priorities, they can undertake and co-ordinate only those initiatives that move them toward their long term strategic objectives.

The fourth process - *feedback and learning* - gives companies the capacity for strategic learning. Existing feedback and review processes focus on whether the company, its departments, or its individual employees have met their budgeted financial goals. With the Balanced Scorecard at the centre of its management systems, a company can monitor short-term results from the three additional perspectives - customers, internal business processes, and learning and growth - and evaluate strategy in the light of recent performance. The scorecard thus enables companies to modify strategies to reflect real-time learning.

# Linking Business & Individual Targets

A good balanced scorecard will reflect the vertical cause and effect relationships for a given objective and summary measure, in the same way the causal relationships were reflected horizontally across the business value chain by the four perspectives. In other words, having delineated the causal relationship between the Learning/Innovative perspective, the Internal Business Process Perspective, the Customer Perspective and the Financial Perspective we take each summary objective/measure and disaggregate same to determine causation.



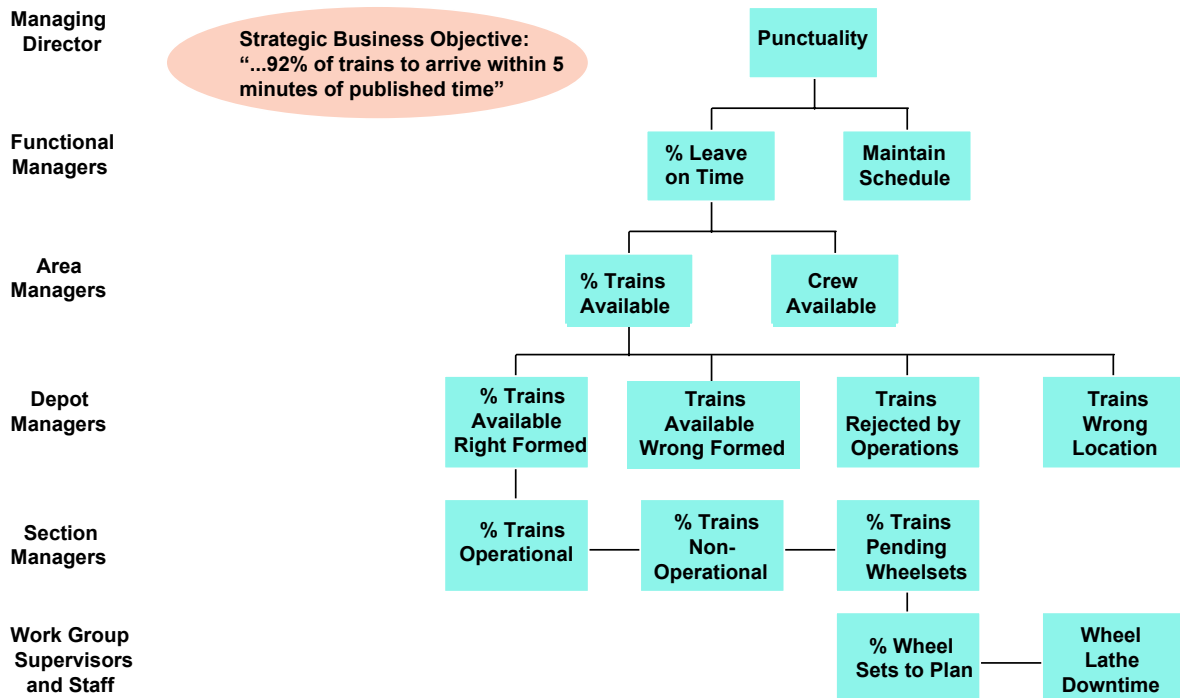
The objective is to devolve responsibility for achieving the disaggregated objective with its associated measure to the appropriate level within the organisation. Operationalising the strategy and measuring achievement depends on allocating responsibility for the various processes to the point where the activity is undertaken.

This kind of hierarchical cascade allows people at all levels to understand how they can contribute most effectively to an organisation's performance. It also taps into people's intrinsic motivation in two important ways. First, it enables effective delegation. Most organisations now accept the motivational benefits of devolving accountability lower in the organisation; but delegating accountability for performance in this way is best done alongside a framework of performance measures against which to align targets and focus delivery. Secondly, it encourages individuals to exercise initiative without waiting for instruction from above, because they can work-out for themselves what will be in line with the organisation's overall strategic direction. The freedom to develop the means to achieve jointly agreed ends is a powerful human motivator.

This disaggregation of the measures should be undertaken without regard for the organisational structure, but with respect to logical process flows. It is often the case that the structure needs to be amended to support the process flow - since structures often evolve in isolation from logical processes.

# KPI Hierarchy-a train company

The need to derive Key Performance Indicators from the fundamental drivers of organisational performance underpins the idea of KPI trees. The process is illustrated by a KPI tree developed for a British Rail Network. It shows how a cascade of indicators linked to root causes connects shop-floor efforts to reduce wheel lathe downtime with the critical top-level issue of train punctuality. Imagine indicators and targets being “shaken down,” top to bottom, through the branches of this and other KPI trees so that eventually everyone in the organisation is connected to one or more of the top-level objectives.



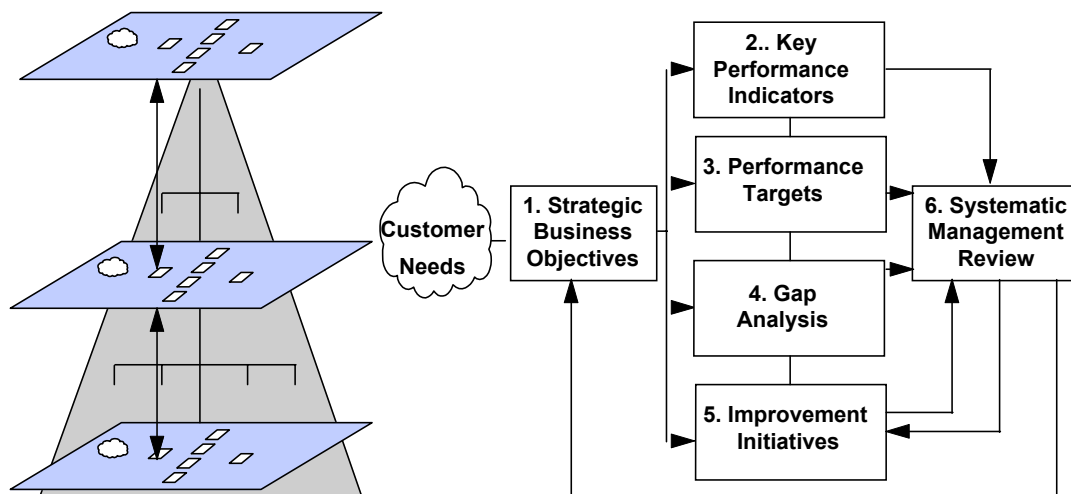
# Performance Management

An effective performance management process consists of:

1. A framework of explicit strategic objectives derives from customer and shareholder needs.
2. A balanced set of performance measures reflecting cause and effect relationships.
3. Agreed performance targets.
4. Gaps in performance or capability addressed by prioritised and properly managed improvement initiatives.
5. Systematic managerial review feeding back both into action and strategy.

The final link in the argument is the review process, it is crucial to the achievement of organisational objectives for the following reasons:

1. Rationally, by making achievement visible, systematic review builds people's confidence not just in the use of the BSC but in their ability to deliver against increasingly bold objectives. It causes people to think about how their business operates and so come to understand it better through the iterative process of action and reflection.
2. Emotionally, through structured review, people learn how to connect performance measures with decision making and action - and hence see the results of that action. Emotional value comes from the sense of accomplishment and purpose this creates. Unless the BSC drives action it achieves nothing.
3. Politically, it is the way managers at every level signal the importance they attach to effective performance management.



The review process should be undertaken on a systematic and regular basis, at the various levels within the organisation as determined by the operational process flows. The review frequency should cascade upwards - ie daily on the shop floor, weekly at supervisor level, fortnightly at manager level and monthly at director level - to reflect the aggregation of the performance data under review.

# The Learning Organisation

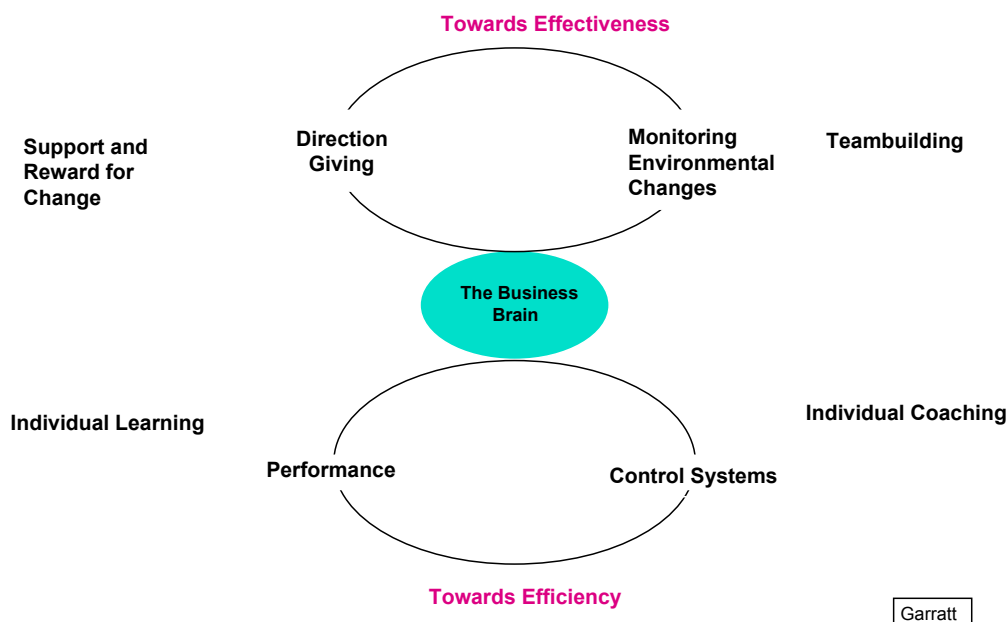
“Competition is now a *War of Movement* in which success depends on anticipation of market trends and quick response to changing customer needs. Successful competitors move quickly in and out of products, markets, and sometimes even entire businesses - a process more akin to an interactive video game than to chess. In such an environment, the essence of strategy is not the structure of a company’s products and markets, but the dynamics of its behaviour.”  
 Stalk, Evans & Shulman - “Competing on Capabilities: The New Rules of Corporate Strategy” - Harvard Business Review

“Forget your old, tired ideas about leadership,” Fortune magazine advised its readers. “The most successful corporation of the 1990’s will be something called a learning organisation.”  
 The organisations that excel will be those that discover how to tap their people’s commitment and capacity to learn at every level in the company.

Garratt refers to the learning organisation in terms of double loop learning.

The first learning cycle looks at the efficiency issues associated with the current operations. How can we improve that which we are currently doing? A plan-do- review approach to management, where the review is conducted in a coaching style rather than control mode, utilising appropriate internally focused metrics of performance will facilitate individual learning and concomitant performance improvements.

The second learning loop looks at the effectiveness issues associated with strategy. Are we doing the right things? A regular review of the organisation’s position in the market-place, conducted in a team environment, where individuals are supported and rewarded for their ability to change, utilising appropriate externally focused metrics of performance will facilitate team/organisational learning and concomitant performance improvements.



The Balanced Scorecard methodology provides the appropriate internally and externally focused metrics and associated management processes to support the creation of a learning organisation

# Business Management Imperative

Innovative companies are using the scorecard to manage their strategy over the long run. They are using the measurement focus of the scorecard to accomplish critical management processes, namely:

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2. To communicate and link strategic objectives and measures
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4. To enhance strategic feedback and learning

