The Balanced Scorecard: Translating Strategy into Action
By Robert S. Kaplan and David P. Norton

Synopsis by R. Dimon

Executive Summary

This book is like a user/designer guide for HPM.
Allows you to see what's important to VITO.
Guides you through the identification of performance measures.
Provides excellent real-world design & implementation cases (not synopsized).

New Operating Environment

(p.4) Information age organizations are built on a new set of operating assumptions:

- Cross-Functions
- Links to Customers and Suppliers
- Customer Segmentation
- Global Scale
- Innovation
- Knowledge Workers

Competitive demands have increased the number of people performing analytic functions: engineering, marketing, management, and administration.

Improvement initiatives promise breakthrough (read: NOT incremental) performance and enhanced value creation:

- Total Quality Management (TQM)
- Just In Time (JIT) production and distribution systems
- Time-based competition
- Lean production/lean enterprise
- Building customer-focused organizations
- Activity-based cost management
- Employee empowerment
- Reengineering

Traditional Financial Accounting Model

(p.7) Ideally, a financial accounting model should be expanded to incorporate the valuation of a company's intangible and intellectual assets. However, there are difficulties in placing a reliable financial value on such assets as:

- The new product pipeline
- Process capabilities and Methodologies
- Employee skills

- ♦ Motivation and flexibility
- ♦ Customer loyalty
- ♦ Databases
- ♦ Systems

The Balanced Scorecard

"The collision between the irresistible force to build long-range competitive capabilities and the immovable object of the historical-cost financial accounting model has created a new synthesis: The Balanced Scorecard."

- ♦ Retains traditional financial measures
- ♦ Tells about future value creation rather than past events
- ♦ Derived from organizations vision and strategy
- ♦ Reveals drivers for superior long-term financial and competitive advantage/performance
- ♦ It's a management system
- ♦ Must be part of the information system for all levels of employees
- ♦ Measures are derived from a top-down process drive by the mission and strategy of the business unit.
- ♦ Translates mission and strategy into tangible objectives and measures.
- ♦ The measures represent a balance between external (shareholders and customers) and internal (innovation, learning, and growth) issues

(p.10) The scorecard (BSC) is a strategic management system used to accomplish critical management processes:

1. Clarify and translate vision and strategy
2. Communicate and link strategic objectives and measures
3. Plan, set targets, and align strategic initiatives
4. Enhance strategic feedback and learning

Why does Business Need a Balanced Scorecard?

(p. 21) "Measurement matters: If you can't measure it, you can't manage it. An organization's measurement system strong effects the behavior of people both inside and outside the organization."

The Balanced Scorecard retains financial measurement as a critical summary of managerial and business performance, but it highlights a more general and integrated set of measurements that link current customer, internal process, employee, and system performance to long-term financial success.

(p.24) Financial measures (alone) are inadequate for guiding and evaluating organizations' trajectories through competitive environments. They are lagging indicators that fail to capture much of the value that has been created or destroyed by managers.

(p.25) The Balanced Scorecard translates mission and strategy into objectives and measures, organized into four different perspectives:

1. **Financial**
2. **Customer**
3. **Internal business process**
4. **Learning and growth**

(p.31) A good BSC should have a mix of <u>outcome measures</u> and <u>performance drivers</u>.

A BSC can (and usually is) done for a strategic business unit (**SBU**). Multiple SBUs roll-up to form the entire organization

Why do organizations opt to implement BSC? What drives them? Top answers:

- (p. 275) Obtain clarity and consensus about strategy
- Achieve focus
- Leadership development
- Strategic intervention
- Educate the organization
- Set strategic targets
- Align programs and investments
- Build feedback system
- (Also see p. 299)

Measuring Business Strategy

(p. 43) The following generic measures show up in most BSCs:

Perspective	Generic Measure
Financial	Return on investment and economic value added (EVA)
Customer	Satisfaction, retention, market, and account share
Internal	Quality, response time, cost, and new product introductions
Learning and Growth	Employee satisfaction and information system availability

Linking Financial Objectives to Business unit strategy

(p.48) Three stages of a business's life cycle are identified. Financial objectives are distinct in each stage of the life cycle:

Growth

Early stage of life cycle.
Significant growth potential
Commit considerable resources to develop and enhance new products and services:

- Construct and expand production facilities
- Build operating capabilities
- Invest in systems, infrastructure, and distribution networks
- Nurture and develop customer relationships

<u>Financial objectives</u>: percentage growth rates in revenues and sales growth rates in targeted markets

Sustain

Majority of companies
Required to earn excellent returns on invested capital
Maintain existing market share and grow somewhat
Investing in expanding capacity and continuous improvement
<u>Financial objectives</u>: related to profitability (operating income, gross margin, return on investment, return on capital)

Harvest

Mature phase of life cycle
Harvest investments made in two earlier stages
Invest only enough to maintain equipment and capabilities
Investments must have short payback periods
Maximize cash flow back to the corporation
Overall <u>financial objectives</u>: operating cash flow (before depreciation) and reductions in working capital requirements.

(p.50) Therefore, the development of a BSC must start with an active dialogue between the CEO of the business unit and the CFO of the corporation about the specific financial category and objectives for the business unit.

The Financial Perspective

(p.51) For each of the three stages of growth, there are three financial themes that drive the business strategy:

1. Revenue and growth mix

   Sales growth rates, market share, new products, new applications, new customers and markets, new relationships, new product and service mix, new pricing strategy.

2. Cost reduction/productivity improvement

   Increase revenue productivity, reduce unit costs, improve channel mix, and reduce operating expenses.

3. Asset utilization/investment strategy

   Cash-to-cash cycle, improve asset utilization.

The Customer Perspective

(p. 67) Core Measures:

- ♦ Market share
- ♦ Customer retention
- ♦ Customer acquisition
- ♦ Customer satisfaction
- ♦ Customer profitability

(p. 73) Customer value propositions represent the attributes that supplying companies provide. The value proposition is the key concept for understanding the drovers of the core measurements: satisfaction, acquisition, retention, and market & account share.

There is a common set of attributes that organize the value proposition:

Product/Service attributes

(p.86) Functionality/Time
(p.88) Price
(p.87) Quality

Customer relationship attributes

Knowledgeable people
Convenient access
Responsiveness

Image and reputation attributes

Loyalty
Influence

The Internal business process Perspective

(p. 92) Most organizations' existing performance measurement systems focus on improving existing operating processes (controlling and improving existing responsibility centers). For the BSC, they recommend that mangers define a complete internal-process value-chain that starts with the innovation process.

The internal business value chain model

Customer Need Identified
- Innovation Process
  - Identify the Market
  - Create the Product/Service Offering
- Operations Process
  - Build the products/services
  - Deliver the products/services
- Postsale service processes
  - Service the Customer

Customer Need Satisfied

Performance Measures for each of the above processes

Innovation Process

- Number of entirely new products and services developed
- Success in developing specific products and services
- Market research on emerging and future customer preferences
- Percentage of sales from new products
- Percentage of sales from proprietary products
- New product introduction versus competitors, also vs. plan
- Manufacturing process capabilities
- Time to develop next generation of products
- Time to market
- Number of times design needs to be modified
- Gross margin from new products

Operations Process

- Yield
- Cycle Time
- Cost
- Quality
- Labor & Machine Efficiency
- Price variance
- Flexibility

(p.105) Post sale service processes

- ♦ Cycle time for problem resolution
- ♦ Costs of resources used
- ♦ First pass yields (# of customer requests handled with 1 call)
- ♦ Length of time between project completion and final cash payment by customer

The Learning and growth perspective

(p. 126) The objectives in this perspective enable the objectives in the other perspectives to be achieved.

There are 3 principal categories for this perspective:

1. Employee capabilities
   - ♦ (p.129) Employee satisfaction (measure = survey)
   - ♦ Employee retention (measure = turnover)
   - ♦ Employee productivity (measure = revenue per employee)

   Key Driver: Reskilling the work force

2. Information system capabilities
   - ♦ (p.136) Uptime/real-time quality
   - ♦ strategic information coverage ratio (how many employees can do a specific task)

3. Motivation, empowerment, and alignment
   - ♦ Measures of suggestions made and implemented
   - ♦ Measurements of improvement (quality, time, performance)
   - ♦ (p.140) Measures of individual and organizational alignment

     (% of top managers exposed to BSC
     % of staff exposed to BSC
     % of top managers with personal goals aligned to BSC, etc)

Certain core outcome measures appear repeatedly on scorecards (they're popular): *(p. 306)*

Core Financial Measures

- ♦ Return on investment/ EVA
- ♦ Profitability
- ♦ Revenue Growth/Mix
- ♦ Cost reduction productivity

Core Customer Measures

- Market share
- Customer acquisition
- Customer retention
- Customer profitability
- Customer satisfaction

Core Learning and Growth Measures

- Employee satisfaction
- Employee retention

Employee productivity

Linking Balanced Scorecard Measures to your Strategy

(p. 147) Why it is important to build a BSC that communicates a business unit strategy:

- Creates shared understanding by communicating strategy to all levels of the org.
- Creates a holistic model that shows each person how they contribute to the overall success of the org.
- It focuses change efforts

Three principals to link BSC to strategy:

1. Cause-and-effect relationships
2. Performance drivers
3. Linkage to financials

Term definition: Outcome measures are lag indicators. Performance drivers are lead indicators.

See p. 155 & 157 for excellent summary examples

(p. 165) BSCs need to be a mixture of 15 to 25 financial and non-financial measures grouped across the 4 main perspectives.

Managing Business Strategy

Barriers causing the disconnect between strategy formulation and execution:

1. Visions and strategies that are not actionable
2. Strategies that are not linked to departmental, team, and individual goals
3. Strategies that are not linked to long- and short-term resource allocation
4. Feedback that is tactical, not strategic

(p. 200) Interrelated Mechanisms to translate strategies into local objectives and measures:

1. Communication and education programs
2. Goal-setting programs
3. Reward system linkage

Targets, Resource Allocation, Initiatives, and Budgets

(p. 226) Set stretch targets
Identify strategic initiatives
Continuous improvement programs linked to rate-of-change metrics
Strategic Initiatives directed to radical improvement of performance drivers
(p. 244) Identify critical cross-business and corporate initiatives
Link to annual resource allocation and budgets

Feedback and the strategic learning process

- (p. 251) Strategies are incremental and emerge over time
- Intended strategies can be superseded
- Strategy formulation and implementation are intertwined
- Strategic ideas can arise throughout the organization
- **A strategy is a process**

Implementing a Balanced Scorecard Program

- (p. 272) It's really a management system, not merely a measurement system.
- The strategy is the reference point for the entire management process.
- The shared vision is the foundation for strategic learning.
- Most companies introduce the scorecard to drive single pieces of the management process.
- (p. 276) Because of its scope, complexity, and impact, a new management system must be phased in over time.
- (p. 286) BSC should not be created by emulating the best measures used by the best companies.

General BSC implementation timeframe

(p. 278/9)

Month	Action
0-3	Clarify the vision
4-6	Communicate to middle managers
6	Develop Business Unit Scorecard
6	Eliminate non-strategic investments
6	Launch corporate change program
9	Review business unit scorecards

12	Refine the vision
12	Communicate the balanced scorecard
13	Establish individual performance objectives
15	Update long-range plan and budget
18	Conduct monthly and quarterly reviews
25	Conduct annual strategy review
25	Link everyone's performance to the balanced scorecard

Building the BSC

1. (p. 295) Establish objectives for the BSC
2. Obtain clarity and consensus about strategy
3. Achieve focus
4. Decentralization and leadership development
5. Strategic intervention

The Players

The architect is the project leader. Typically this is a VP of finance and/or strategy. Architect owns and maintains the framework, philosophy, and methodology for designing and developing the BSC.
The architect guides the process, oversees the scheduling of meetings and interviews, ensures adequate documentation, and makes sure info is available to BSC team. Keeps project on track.

The Process

Compare this to Saplings Methodology: "The Scoring Approach"
Define the measurement Architecture (p. 300)

Task 1: Select the appropriate organizational unit
Task 2: Identify Strategic Business Unit (SBU)/corporate linkages

Build consensus around strategic objectives

Task 3: Conduct first round of interviews
Task 4: Synthesis session (digesting interviews)
Task 5: Executive workshop, 1st round

Select and Design Measures

Task 6: Subgroup meetings
Task 7: Executive Workshop, 2nd round

Build the implementation Plan

Task 8: Develop the implementation plan
Task 9: Executive workshop, 3rd round
Task 10: Finalize the implementation plan