

BALANCED SCORECARD: SUCCESS WITHOUT THE PITFALLS

Quick Points: An overview in 60 seconds

The Balanced Scorecard celebrates its twelve birthday this month and properly implemented and maintained it is a powerful performance management tool. Unlike financial measurement tools it looks at four dimensions – people, process, offerings and financial objectives - to holistically view the organisation's progress. But to ensure success you must avoid the pitfalls. The keys to success are:

- Key Point 1:** Work out your strategy. Without a clear strategic direction, the scorecard becomes a confusing and ambiguous tool.
- Key Point 2:** Do not use the scorecard process as a top down management control tool. Implement it not only in Head Office, but in all areas of the organisation.
- Key Point 3:** Ensure that local measures and objectives are developed to support your organisation's strategy.
- Key Point 4:** Sponsor action when significant scorecard variances are revealed.
- Key Point 5:** Remember that the Balanced Scorecard is *the* organisation's performance management system – not one of several.
- Key Point 6:** Embed the scorecard within your strategy process and ensure that the implications of any strategic change are worked through its four dimensions.
- Key Point 7:** Avoid *reification* – the scorecard is a window through which you see your world. Make sure it gives a clear and not distorted view.

This *Critical Update* provides research-based guidance for new and established users alike. Please read on to learn more.

Introduction

The Balanced Scorecard celebrates its twelfth birthday this month. It is now twelve years since Robert Kaplan and David Norton published their revolutionary views on how performance measurement systems must change to embrace the demands of a future environment in the *Harvard Business Review* (see "References and Suggested Reading" at the end of this briefing). The Balanced Scorecard is now accepted by many organisations as a tool that has reinvented the way that information is gathered, decisions are made and strategy is implemented. It is reported that over 50% of Fortune 1000 firms now use the scorecard concept. I have helped to implement the Balanced Scorecard and found that it has acted as a catalyst to assist staff at all levels in an organisation to see their jobs and the outside world from a totally new and more dynamic perspective. Above all, the Balanced Scorecard concept provides an excellent foundation for organisations to design their management information systems.

But like any business process or application, it has its problems. The advantages of the Balanced Scorecard are well publicised, so in this briefing I would like to concentrate upon two topics:

- § Implementation. What are the problems and potential pitfalls when building a Balanced Scorecard for the first time?
- § Sustaining success. What are the downsides that long-term users of the Balanced Scorecard must avoid? This area in particular has received little attention and warrants investigation.

I will start by providing a brief refresher of the Balanced Scorecard concept itself and then look more closely at the above two questions.

The Balanced Scorecard Concept

The concept was borne out of the observation that traditional performance measurement systems – that were largely based upon financial performance indicators – would be inadequate to steer organisations of the future. Traditional, financially based performance measurement approaches have a number of serious drawbacks. These include:

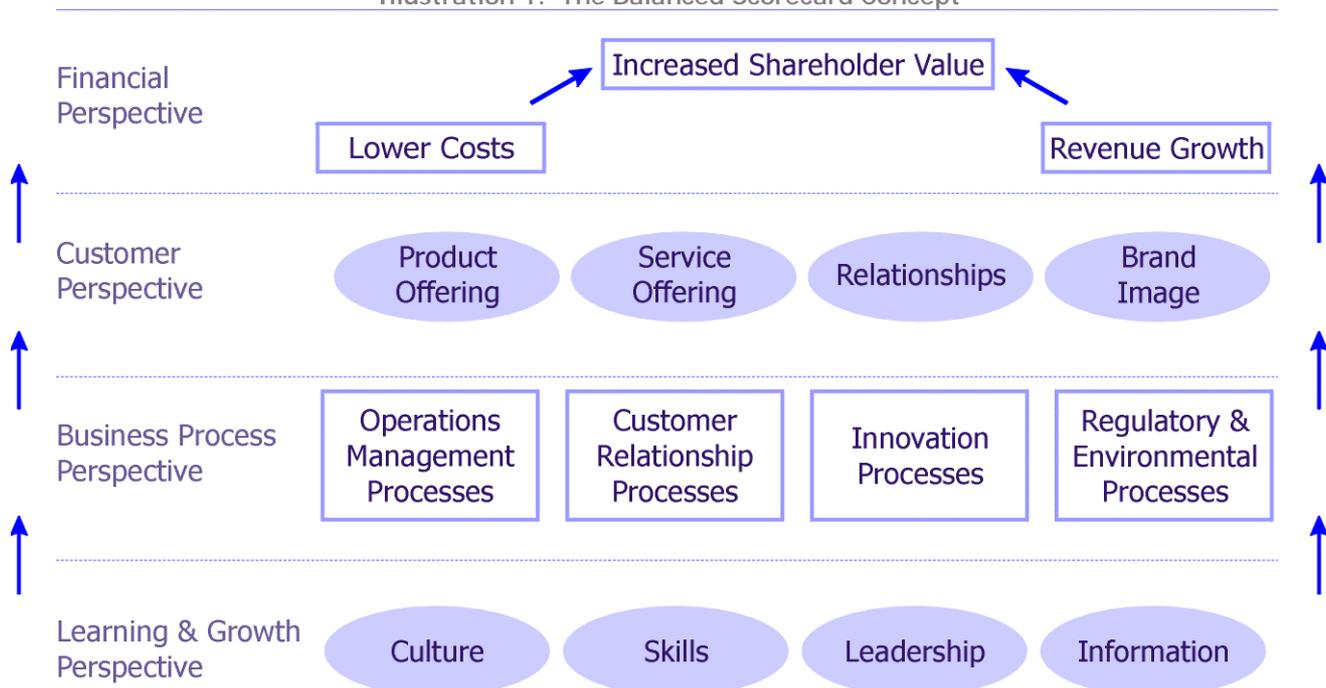
1. *Outcome focus.* Established financial indicators such as turnover and profit before tax are *outcome* indicators. They only alert us when things have gone wrong and the effect is being felt in the balance sheet. Such indicators and measures don't provide us with an indication of when things may go right or wrong in the future. In short, these measures are lagging not leading indicators - they do not provide us with an early warning system.
2. *The drivers of business success.* Financial measures alone do not assess and measure the parts of the organisation that create the customer value that in turn delivers profit. A more holistic approach is needed that helps managers – like physicians – to examine the state of health of the entire body corporate.
3. *Strategy into action.* I have raised this failing in earlier briefings. Many business plans paint favourable future financial returns but don't explain explicitly what must be done to achieve the planned returns. A well-managed scorecard project will identify and measure the key activities needed to deliver planned performance.
4. *Strategic communication, involvement and ownership.* Traditional, financially based plans are difficult to communicate across the organisation. I always remember, when I was a manager, giving a presentation looking at the future objectives of my company and at the end someone put their hand up and said "Excuse me, but what does the word ROCE mean?" I had forgotten that ROCE (return on capital employed) was a technical term used by very few people in the company. The fact is that most business strategies are not communicated in ways everyone can understand. A well constructed scorecard is an effective communication vehicle.

The Balanced Scorecard is based on the simple premise that we must understand and measure the true drivers of financial success. To do this, we must define what are the component parts of the organisation (again using a medical analogy, components such as the nervous and digestive systems of the human body) that deliver financial performance. The Balanced Scorecard identifies three broad areas called "perspectives" of the corporate body that must be examined:

- § Learning and Growth Perspective
- § Internal Business Processes Perspective
- § The Customer Perspective

These are illustrated overleaf.

Illustration 1: The Balanced Scorecard Concept



Source: Adapted from Kaplan and Norton (2004)

Attainment of financial objectives – growth, lower costs and above all increases in shareholder value is driven by other dimensions or perspectives in the organisation. It all starts at the bottom in the “Learning and Growth” perspective. Skills, culture, leaders and management information that are aligned to the organisation's strategy will create effective and efficient business processes – as shown in the “Business Process” perspective. Effective and efficient product delivery, customer relationship, innovation, regulatory and environmental processes in turn make sure that the organisation's offerings meet and exceed the needs of customers. The components of the organisation's offerings to its customers (products, services relationships and brand) are shown in the Customer perspective. Satisfied customers and efficient business processes combine to produce growth, lower costs and better use of the organisation's capital – the result being increase in shareholder value. So, if we create objectives and measurements in each of the four dimensions or perspectives that are aligned to our strategy we have a performance measurement and assessment system. And that, at its simplest, is the Balanced Scorecard concept, a concept that is:

- § Holistic – all critical areas in the organisation that produce financial outcomes are assessed. In addition to the financial dimension, we have the three key parts of the organisation that inter-lock to deliver shareholder value.
- § Forward looking – failure to meet say, skill acquisition targets, is a leading indicator of future failure in processes, customer satisfaction and ultimately, profits.
- § Easy to communicate - strategy can be easily explained and communicated. The illustration above is the basis for a *strategy map* – a series of initiatives that must be completed to achieve the objectives in the organisation's business plan. A simple and visual way of communicating what the organisation plans to do to meet its financial objectives.
- § Based on measuring four key dimensions – *Learning and Growth* (people, skills, culture, leadership and information), *Business Processes* (embracing four processes – product delivery, customer relationships, innovation and adherence to regulatory and broader environmental needs), *Customer Offerings and Relationships* and finally *Financial* embracing key financial objectives.

The key to the success of the Balanced Scorecard is its simplicity – essentially seeing an organisation from four key perspectives – one driving another. Financial results are driven first by people. People with the right skills, motivation and information create effective and efficient processes, which in turn deliver products, relationships and services that create value for the customer. Customer value in turn delivers profit to meet the organisation's financial objectives.

This linkage is summarised in Illustration 2:

Illustration 2: The Four Interlinking Perspectives That Drive Shareholder Value Creation



Source: Adapted from Kaplan and Norton (2004)

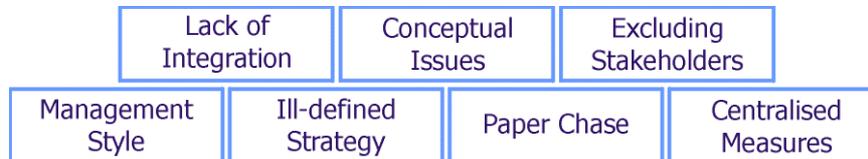
So if it's that simple, why not just go ahead and implement it? Whilst the management press is full of success stories, there are issues to bear in mind both if you are considering implementing the concept and if you are already a user. I would like to devote the rest of this briefing to answering two questions:

1. "What are the implementation pitfalls that I should avoid?"
2. "Are there issues for established users?"

"What are the implementation pitfalls that I should avoid?"

My own experience in implementing the Balanced Scorecard and research - for example Heinz Ahn (2001), Zoe Radnor and Bill Lovell (2003), David Dinesh and Elaine Palmer (1998) – identify a number of potential pitfalls when introducing and maintaining the Balanced Scorecard. In terms of implementation issues these are introduced in Illustration 3:

Illustration 3: Implementation Pitfalls



- § *Work out your strategy.* The success of any scorecard project is determined by how well your organisation has worked through and defined its strategy. Broadly, an *ill-defined strategy* produces a vacuous and confusing scorecard. You must either have worked through the strategy process (as summarised in my briefing *Its Strategy Time Again 2* - www.drstrategy.co.uk/brief_5.htm) or you must incorporate a strategy building element right at the beginning of your Balanced Scorecard project. Failure to define and articulate a clear strategy will lead to an ambiguous and confused scorecard – and importantly one that lacks the thread of strategic consistency as the scorecard process is rolled out across all areas and functions in the organisation.
- § *Management style.* Some readers may remember another process for guiding the organisation to strategic success – *Management by Objectives* (MBO). MBO was consigned to the recycle bin of failed management panaceas over 25 years ago. The major reason for its failure was an issue of management style. Remember that the Balanced Scorecard is not (i) a tool for imposing a strategy created at the top of the organisation or (ii) a stick to beat people with. It is actually a tool to allow people to both participate in the strategy process and create objectives and measures that reflect their business area's efforts to support the broader corporate strategy. MBO failed due to a highly centralised top-down style.
- § *The paper chase.* Remember that the Balanced Scorecard will create a need for information that cannot be sourced from existing financial information systems. This is both a strength and a weakness. It is a strength, as it is part of a process for building a more holistic performance management system that includes new areas such as the People and Learning dimension. It is a weakness, as a laborious paper based system can be created. The extra time needed to build a paper-based scorecard can demotivate staff. My answer is twofold. Firstly, make it as simple as possible for staff to build the scorecard and secondly, make it easy for staff to drill down and see the true causes of adverse or positive performance revealed by the scorecard measures. I usually start by helping a business unit to build an Excel model that produces the scorecard with minimal user intervention, by drawing in data in Excel format from disparate systems across the organisation. The model also allows users to quickly drill down and see where the real issues are. Far from being a paper chase it is a hands-on problem solving tool. And being a problem solving tool helps gain acceptance.
- § *Centralised measures.* One of the major benefits of the Balanced Scorecard is that it helps staff understand, develop and apply strategy within their business units. Do give staff the freedom to develop their own objectives and measures in addition to common, centrally defined objectives and measures. Do make sure that all areas in your organisation are involved.
- § *Lack of integration.* The Balanced Scorecard isn't another stand-alone project or system. It is *the* performance management and monitoring system, integrating typically a range of disparate systems, measures and monitoring approaches.

- § *Ignoring conceptual issues.* Don't try to get one generic scorecard to fit the entire organisation. Each organisation's scorecard will be different. Key differences include industry, strategy and organisational structure. Ensure that staff really do understand how the scorecard works and how it will benefit them.
- § *Excluding stakeholders.* Don't implement the concept in one or two Head Office areas only for example. To work, you must build a hierarchy of scorecards, reflecting the structure of your organisation and how it adds value to the customer. Remember that over a decade has passed since the scorecard concept was first developed. Outsourcing and offshoring are now commonplace – ensure that these value generating operations are included too.

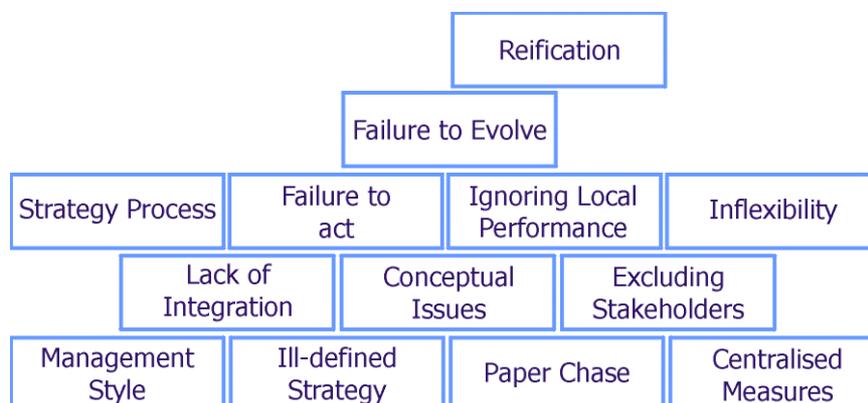
So, these are some of the key issues to consider when implementing a Balanced Scorecard project for the first time, but what of the issues for established users?

Are there issues for established users?

Yes. Obviously, the issues raised above also apply, but there are several problems that are unique to established scorecard systems. These are shown together with the implementation issues already discussed in Illustration 4 on the next page.

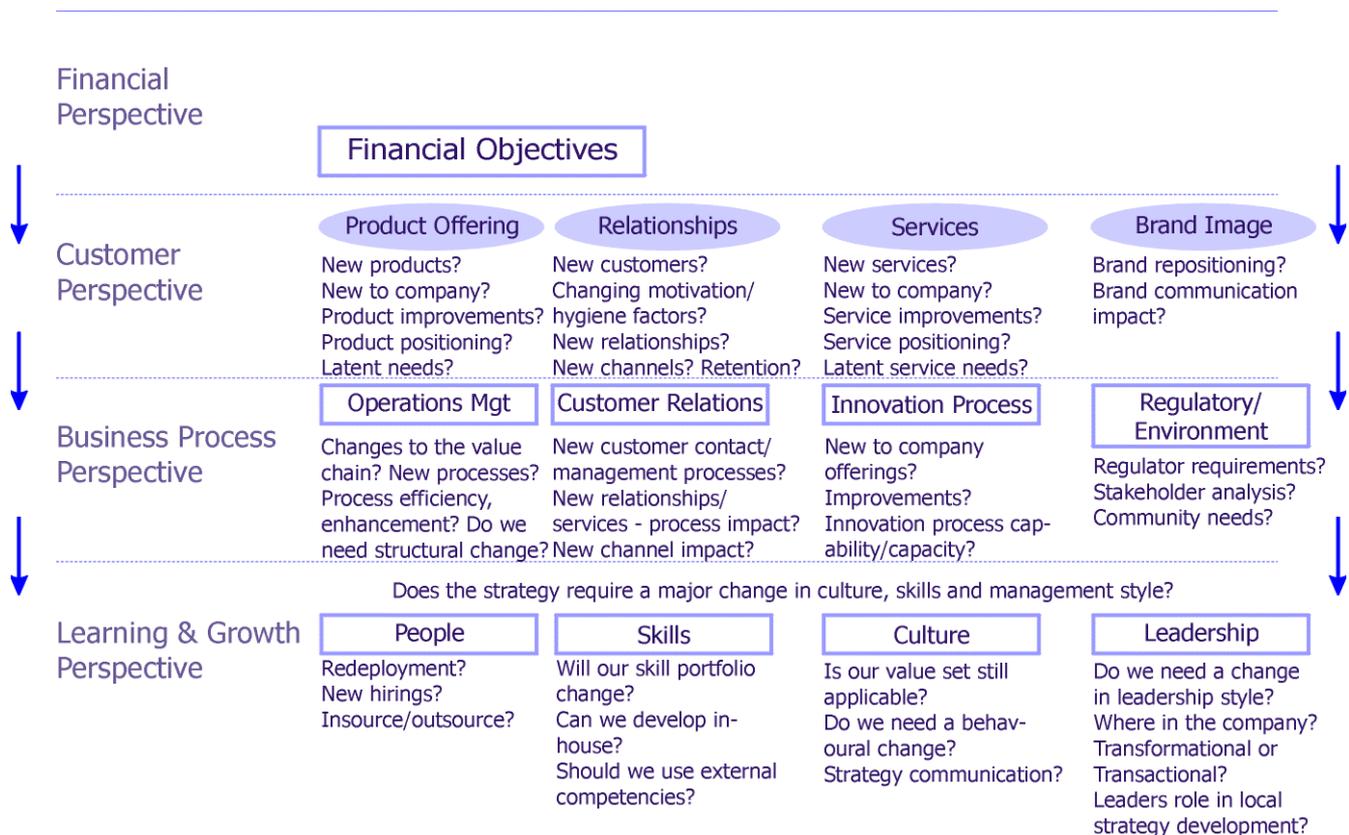
Looking at this illustration, you can see that I have added another three layers of brickwork to foundation layers that we have just discussed. I will now turn to review each of the new bricks.

Illustration 4: Bricks in the Boundary Wall to Success



- § *Strategy process.* I am now going to repeat myself. The scorecard is not a stand-alone process. It must feed into and be driven by your strategy process. And this is not just an after thought. Updating you scorecards is not just an issue of slotting in new financial targets to match this year's budget or taking an arbitrary 5% off the staff turnover rate. Every organisation's strategy changes to a degree each year and so should each element of the scorecard. Illustration 5 overleaf gives examples of some of the questions you should be asking when going through the annual strategy process. Notice this time how the action moves *downwards* from the financial plan. Answering these questions will help you identify actions, objectives and new measures in each of the scorecard dimensions. The output is a series of actions need to reach the financial plan objectives. This is called a *strategy map*. This questioning must be part of your business planning cycle. **Omission is a common failing.** Have you answered these questions and created a strategy map of actions?
- § *Failure to act.* The organisation must act when the scorecard shows either positive or negative deviations from objectives. Failure to act, or more importantly, failure of top management to encourage and sponsor action will dent the credibility of the entire process.
- § *Ignoring local performance.* Good scorecards, as we have already observed, should encourage business areas to develop their own initiatives and measures. But frequently top management ignore local measures and just rely on centrally devised corporate objectives to assess local performance. Don't do this – look at locally devised measures when assessing business area performance. If you don't – especially when looking at compensation – you will undermine the credibility of the process.

Illustration 5: Scorecard – Strategy Implementation Questions



- § **Inflexibility.** "I can't do this – it's not in the scorecard" is a statement you want to avoid. In earlier briefings I have made the point that it is impossible to precisely plan what will happen over say the next 12 months. Organisations need the capacity to respond innovatively to unforeseen opportunities as they arise. At least build a process to amend scorecards to incorporate such opportunities. Or include measures for spontaneous innovation. Don't allow rigid scorecards to lock your organisation out.
- § **Failure to evolve.** Some say that over the twelve years since the Balanced Scorecard concept was first introduced it has gone through two major evolutions. It should evolve as well in your organisation. If you're using the same structure and measurements three years in a row there might be something wrong...
- § **Reification.** An interesting word. I use it to mean "looking at a picture that doesn't reflect reality." A Balanced Scorecard is like a window or should I say two windows – one looking at the outside world and one looking at the inside world. What happens if there are distortions in the window glass or the view is too narrow? It means that as a manager you could be looking at, analysing and making decisions based on a false reality. Make sure that the measures you use really do measure what you want to assess. Reification – the false view of the real world - is a major problem in the Learning and Growth dimension. Many organisations use short questionnaires to assess culture for example. But repeated use of the same questions can lead to cynicism and inaccurate results. The answer? Reassess objectives and measures at least annually as part of the strategy process. But most importantly, don't just rely upon the scorecard to keep you in touch with employees and customers – *talk to them*. Remember that reification is the biggest potential danger in using a management tool such as the Balanced Scorecard

Concluding Guidelines

The management press is full of Balanced Scorecard success stories. Yes, in my experience it does work. It is particularly effective at:

- § Developing a clear understanding of how strategy is operationalised.
- § Communicating and more importantly developing a competitive strategy across the organisation.
- § Encouraging staff locally to develop initiatives to support your organisation's strategic direction.
- § Building an holistic view of the organisation and importantly, an early warning system of when things are going right and wrong.
- § Developing a performance measuring system that spans all levels in the organisation.

But go into the process with your eyes open and above all ensure that:

1. The concept is embedded in the strategy process.
2. It is *the* performance measurement system – not one of several.
3. Each unit and function has a scorecard with locally developed actions and measures.
4. It is acted upon.
5. You don't fall into the reification trap and find yourself looking at an artificial world.

References and Suggested Reading

- Ahn H (2001) Applying the Balanced Scorecard Concept: An Experience Report. *Long Range Planning* 34: 441-461
- Beer M and Eisenstat R A (2004) How to Have an Honest Conversation About Your Business Strategy. *Harvard Business Review* February: 82-89
- Dinesh D and Palmer E (1998) Management by Objectives and the Balanced Scorecard – will Rome fall again? *Management Decision* 36,6: 363-369
- Kaplan R S and Norton D P (1992) The Balanced Scorecard – Measures that Drive Performance *Harvard Business Review* February-March: 71-79
- Kaplan R S and Norton D P (2004) *Strategy Maps: Converting Intangible Assets Into Tangible Outcomes* (Harvard Business School Press: Boston)
- Radnor Z and Lovell B (2003) Defining, justifying and implementing the Balanced Scorecard in the National Health Service. *International Journal of Medical Marketing* 3,3: 174-188

Finally

I hope that you have enjoyed this Critical Update. You can find more on the website or e-mail me using the link below. I enjoy personally helping businesses - some of the work I undertake includes:

- | | |
|--|---|
| § Market research to identify the product performance and service needs of B2B customers | § Competency definition, development and assessment |
| § Facilitating board level strategic reviews, with a particular emphasis upon the definition of tomorrow's competitive environment | § Product portfolio assessment. Helping the business to define the optimal product portfolio – balancing future competitive conditions with the probability of achieving future planned performance |
| § Design and implementation of Balanced Scorecard performance measurement systems | § Communication programmes |
| § Research to help identify what potential capital providers will look for in your business plan | § Organisational audits – assessing the innovative capability of your organisation |

Best regards,

Robert Davies