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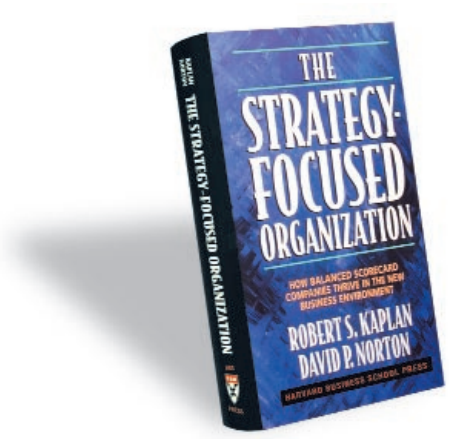


## How Balanced Scorecard Companies Thrive in the New Business Environment

# THE STRATEGY-FOCUSED ORGANIZATION

By Robert S. Kaplan and David P. Norton

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## THE SUMMARY IN BRIEF

In 1996, Robert Kaplan and David Norton introduced the Balanced Scorecard performance measurement method, which included not only traditional financial measures but also such qualitative measures as employee satisfaction, corporate mission and customer loyalty. In *The Strategy-Focused Organization,* they show how the following five principles transform the Balanced Scorecard from a tool for performance measurement to a tool for creating a strategy-driven performance management company:

**1. Translate the strategy into operational terms.** Use the Balanced Scorecard to describe and communicate strategy in consistent, insightful, operational terms.

**2. Align the organization to the strategy.** For organizational strategies to work, they must be linked and integrated across many functions — finance, manufacturing, sales, marketing and so forth. The Balanced Scorecard can link these disparate and dispersed functions.

**3. Make strategy everyone's everyday job.** Use the Balanced Scorecard to educate the organization about strategy, help employees develop personal objectives, then compensate them based on their adherence to and implementation of the business' strategies.

**4. Make strategy a continual process.** Use the Balanced Scorecard to link strategy to the budget process; review strategy regularly in management meetings; and develop a process for learning and adapting strategy.

**5. Mobilize change through executive leadership.** Through a method of mobilization, governance and strategic management, executives can embed new strategy and new culture into their management systems, creating a continual process to meet the strategic needs of today and tomorrow.

Formulating strategy is one endeavor. In this summary, you will learn how to make strategy work.

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# THE STRATEGY-FOCUSED ORGANIZATION

**by Robert S. Kaplan and David P. Norton**

## — THE *COMPLETE* SUMMARY

In today's business landscape, it has never been more important to implement solid strategies — the unique and sustainable ways by which organizations create value. Yet, research reveals that companies have an increasingly difficult time executing the strategies they need to remain competitive. One reason for this is clearly that while these strategies, and the business issues behind them, are changing constantly, the tools for measuring the effectiveness of these strategies have not kept pace.

Many corporations still use tools that measure success in terms of tangible assets — investments in inventory, property, equipment, etc., and the resulting returns. The decentralized nature of business that prevails today, however, values more intangibles (knowledge, capabilities, relationships). Constant changes in technology and the competitive environment dictate that all business units, support units and employees be linked to strategy — and that all have a common language to communicate strategy, as well as the processes and systems to implement it.

***Strategy-Focused Organizations have transformed the Balanced Scorecard from a performance management tool into a strategic tool.***

The Balanced Scorecard was initially conceived as an organizational performance measurement tool that included non-financial as well as financial measures. By ensuring that all of the objectives and measures inherent to it are derived from an organization's vision and its resulting strategy, Strategy-Focused Organizations have transformed the Balanced Scorecard from a performance management tool into a strategic tool. Com-panies like Mobil, CIGNA and Chemical (Chase) Retail Bank have used the Balanced Scorecard approach to focus their organizations on strategy by adhering to the five key principles that will be explained in detail in this summary:

1. **Translate the strategy into operational terms.**
2. **Align the organization to the strategy.**
3. **Make strategy everyone's everyday job.**
4. **Make strategy a continual process.**
5. **Mobilize change through executive leadership.** ■

# Principle 1: Translate Strategy into Operational Terms

In order to be a Strategy-Focused Organization, you must put strategy at the center of your organization's management process. Strategy cannot be executed if it cannot be understood; it cannot be understood if it cannot be described. In the past, however, there has been no generally accepted framework for describing strategy and the value created from intangible assets.

The Balanced Scorecard links the intangible and tangible assets in value-creating activities. Using strategy maps of cause-and-effect linkages, it describes how intangibles are mobilized and combined with other assets to create value-creating customer value propositions.

Specifically, strategy maps illustrate the processes for transforming intangible assets into tangible customer and financial outcomes, providing executives with a framework for describing and managing strategy in a knowledge economy. The example illustrated on the following page (of a fashion retailer specializing in women's clothing) shows the key components of the strategy map.

### *Four Perspectives*

The strategy map and Balanced Scorecard provide a framework to look at a value-creation strategy from four different perspectives:

1. **Financial —** the strategy for growth, profitability and risk, viewed from the perspective of the shareholder.
2. **Customer —** the strategy for creating value and differentiation from the perspective of the customer.
3. **Internal business processes —** the strategic priori-

***(continued on page 3)***

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## Principle 1: Translate Strategy into Operational Terms

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ties for various business processes, creating customer and shareholder satisfaction.

4. **Learning and growth** — the priorities to create a climate that supports organizational change, innovation and growth.

The arrows in the strategy map show the cause-and-effect relationships between elements in each perspective, clearly displaying how such intangible assets as strategic awareness feed into themes that eventually yield tangible results.

Within each of the strategic themes, a second strategy map and Balanced Scorecard [on the right] breaks down into detail how the theme affects the customer objectives that result from the theme. In this example, we see how **sourcing and distribution** affect customer objectives of product quality and product availability that, in turn, drive customer retention and revenue growth, as well as the internal processes (factory management and line programming) that contribute to those objectives.

In Balanced Scorecards, value-creating processes and critical roles for intangible assets are clearly portrayed, in the correct context of how those intangibles create value, providing the measurement and management framework for knowledge-based strategies. ■

# Principle 2: Align the Organization to the Strategy

The Balanced Scorecard provides a powerful framework for business units to describe and implement their strategies. A Strategy-Focused Organization, however, requires more than just having each business unit use its own Balanced Scorecard to manage a great strategy; the strategies and scorecards for all such units should be aligned and linked with one another. Synergies can then

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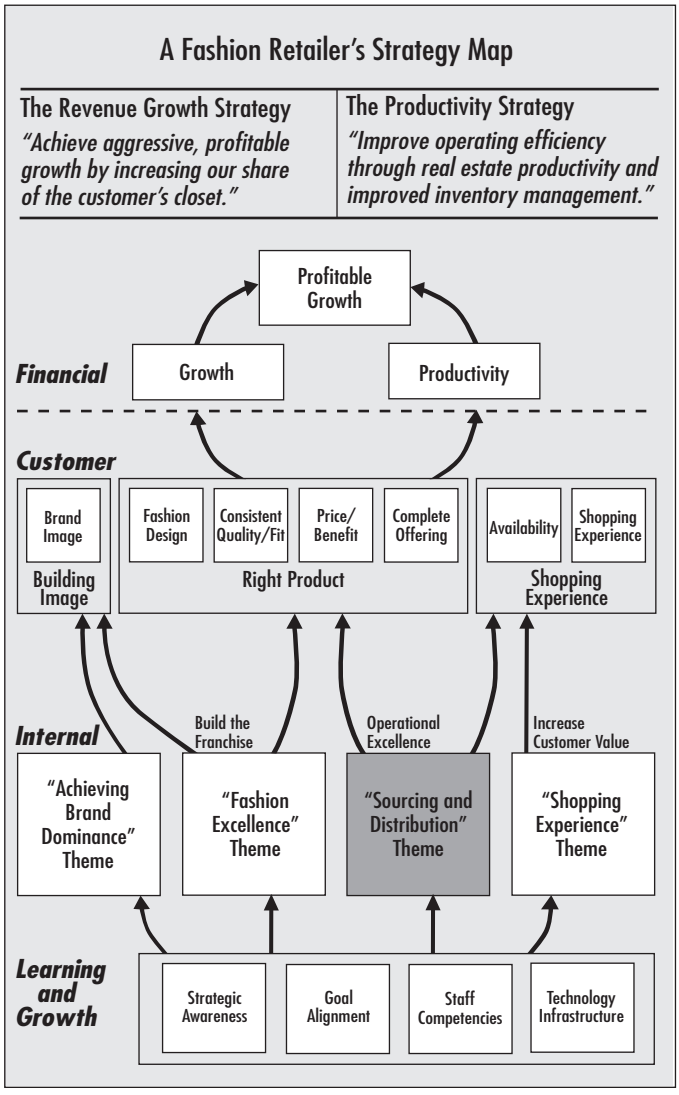


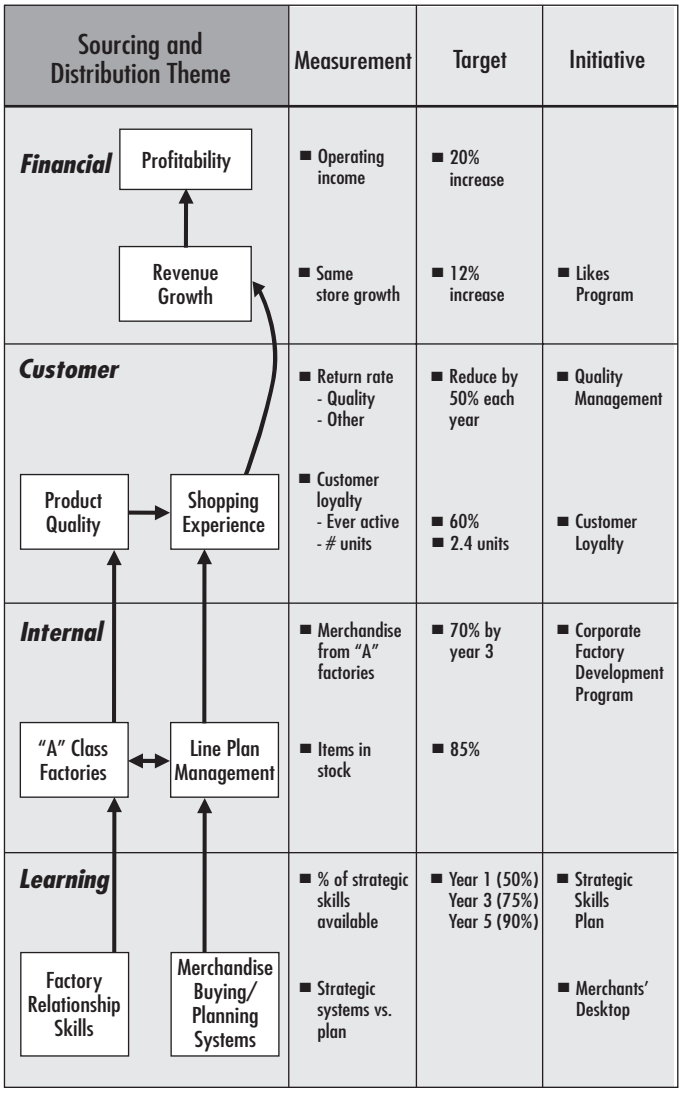

## Principle 2: Align the Organization to the Strategy

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develop from efficient interactions between those units — interactions which must be explicitly recognized in the strategies and scorecards of each unit.

Many organizations share common business processes and require a corporate role to ensure their most effective use; others share common technologies and knowledge. A corporate scorecard should articulate the rationale behind keeping different business units operating within a corporate structure rather than spinning them off into individual, independent entities.

A corporate scorecard can clarify two elements of a corporate-level strategy:

- **Corporate themes —** values, beliefs and ideas that reflect the corporation's identity and must thus be shared by all business units.
- **Corporate role —** the actions mandated at the corporate level that create synergies at the business unit level.

### *Shared Services Units*

Organizations can also create synergies by aligning the internal units that provide shared services. These shared service units are created at a corporate or division level because of economies of scale and the advantages of specialization and differentiation that these units can create — for example, purchasing, manufacturing, distribution, real estate, etc.

### Shell Services International

The Shell Services International (SSI) division of the Royal Dutch/Shell Group of Companies provided nonroutine services in consultancy, IT, business services and human resources to Shell's business units. SSI used the Balanced Scorecard to develop multiple levels of service, in accordance with the needs of the business units it served. This multi-level system was achieved largely due to the enhanced measuring capabilities that the Balanced Scorecard provided, including cost figures and performance measures related to the following:

- **Customer satisfaction.**
- **Quality/speed of support.**
- **Customized technical measurements.**
- **Business alignment/ease of doing business.**

These measurements and resulting service-level agreements changed the mindset of the business units from focus on cost-related factors to quality and service-centric concerns.

For example, the Limited (an apparel retailer with eight retail divisions, each with its own target audience and retail chain) has a real estate division, which acquires and manages retail properties. The real estate division is a single organization that can be deployed to the benefit of all eight retail divisions.

The Limited also has one division that manages the relationships with factories that supply products for the eight retail divisions. The company has found that it is more cost-effective to concentrate such expertise in a single shared services division, rather than have each of the retail divisions manage its own capabilities in those critical areas.

The challenge is for the centrally supplied service to be responsive to the strategies and needs of the business units it serves. These units should be aligned through the creation of a Balanced Scorecard for the shared service unit that adds value and responsiveness to the strategies of the business units. In an ideal world, there would exist a top-down strategic architecture that defines the corporate role and how shared service units contribute to the corporate strategy; often, however, this architecture does not exist. In the absence of that architecture, shared service units can use the Balanced Scorecard in a somewhat different manner, using one of two models: the strategic partner model and the business-in-a-business model.

The *strategic partner* model allows for the shared service unit to be a partner in the process of the business units' development of Balanced Scorecards. Successful Balanced Scorecard companies typically first develop scorecards for business units that sell products and services to external customers, then develop shared service unit scorecards. The linkage between business unit and shared service unit scorecards requires four components:

1. **A service agreement between the business units and shared service unit that defines expectations about services and costs.**
2. **The shared service unit scorecard, which reflects its strategy to support the service agreement with the business units.**
3. **A linkage scorecard, in which the shared service unit accepts accountability for improving selected measures on the business unit scorecards.**
4. **Customer feedback from the business units on the performance of the shared service unit.**

The *business-in-a-business* model can be employed when business units do not have Balanced Scorecards; in such situations, the shared service unit must view itself as a business and the business units as its customers. The shared service scorecard defines the relationship. This

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### Principle 2: Align the Organization to the Strategy

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approach works best in such functional organizations as human resources, IT, finance, marketing and R&D. The scorecard enables executives of these functional units to build a management approach that motivates their organizations to be customer-focused and competitive. ■

## Principle 3: Make Strategy Everyone's Everyday Job

In the past, aligning all employees to a strategy was not critical. In the age of sequenced, repetitive, task-based manufacturing jobs, employees did not have to understand or implement strategy; they simply had to perform the narrow tasks management assigned them and trained them to do.

Today, this type of work is virtually obsolete, replaced by knowledge-based work. Employees must be aligned to the strategy in order to create value. Indeed, there are several critical factors that require intense alignment of employees to organizational objectives:

- While many companies focus on employee satisfaction by bulking up compensation and benefits packages, this satisfaction does not imply commitment from the employee to the goals of the company.
- Companies might claim that employees are their most valuable asset, but the frequency with which they check employee attitudes and skills reveals a different story.
- Not all employees are equally important to their employers; those who directly affect customer experiences and relationships are not always the ones who are given the most compensation and training.
- Some companies are implementing programs to involve customers more directly in the hiring, training, and rewarding of key employees.

Strategy-Focused Organizations understand that, ultimately, employees are tasked with implementing strategy, and are often the ones who come up with the innovative ideas that make strategies work. These organizations use the Balanced Scorecard in three distinct processes to align their employees to the strategy: creating strategic awareness, defining personal and team objectives, and linking incentives and compensation to the Balanced Scorecard.

### *Creating Strategic Awareness*

Employees must learn about and understand the strategy before they can help implement it. Executives must use communication processes at the launch of their new strategy, starting with education and followed by 1) testing to ensure that employees understood the message; 2) checking that employees believe the strategy is being followed; and, 3) determining how many are teaching others about it. Think of a product launch. You wouldn't put a new product on the shelves without telling customers about it; don't expect the strategy to generate much excitement or buy-in if you haven't evangelized it to your employees.

Your communications program should have the following objectives:

1. **Develop an understanding of the strategy throughout the organization.**
2. **Develop buy-in to support the strategy.**
3. **Educate the organization about the Balanced Scorecard measurement and management system for implementing the strategy.**
4. **Provide feedback, via the Balanced Scorecard, about the strategy.**

### *Defining Personal and Team Objectives*

Employees must understand how they can influence the successful implementation of the strategy. Homogeneous organizations whose outcomes are easy to measure — sales organizations, for example — can focus on a few primary metrics. More complex organiz-

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## Sears' Strategic Learning Maps

Sears, Roebuck and Co. uses visual representations of strategy, or learning maps, to help employees understand the changes that are occurring and how they can contribute to successful implementation of change initiatives. These maps consist of images and pathways designed to create employee discussions of a strategic theme.

One such learning map helped Sears develop a vision of its future in retail sales. The map showed a winding street that started with pictures of the retail environment in the 1950s, and progressed through successive decades until the street showed the environment of the 1990s: Wal-Mart, J.C. Penney, The Limited, etc. The maps were accompanied by tables and charts that defined the context for employees to respond to three strategic themes about the company: that it was a compelling place to shop, work and to invest. Employees had to answer the question, "What are the implications of these themes on our business and our team?"

Through use of the map and a series of town hall meetings, Sears communicated its vision and enabled employee involvement in the day-to-day efforts required to make that vision reality.

### Principle 3: Make Strategy Everyone's Everyday Job

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tions must share the outcomes and strategy they are trying to achieve. They will allow individuals and teams to define personal objectives that can influence and will have an impact on the organizational objectives.

The city of Charlotte, N.C.'s Department of Transportation (CDOT) linked the department's Balanced Scorecard measures to the department's high-priority programs and assigned individual work teams to each of those programs, including measurements of accountability and performance. Each of the 41 programs had a one-page report that included their objectives, the action steps required to implement the program, the desired outcomes, responsible managers, critical factors and program-specific performance measures. This method and its inherent accountability factors enhanced the motivation of frontline teams by mapping their day-to-day activities up to high-level business unit and corporate objectives.

#### *Linking Compensation to the Balanced Scorecard*

Employees should feel that their organization's successes result in shared rewards for those who brought about those successes — namely, the employees. Conversely, when the organization experiences shortfalls, employees should feel some pain. Incentive and reward systems provide the link between organizational performance and individual rewards.

Citicorp (now Citigroup, Inc.) linked the three tiers of its Balanced Scorecard (corporate, business unit and personal performance) to levels of compensation. The performance of the business unit, for example, was based on six dimensions: financial performance; customer/franchise performance; strategy implementation; risk and control; people; and community standards. Each component of the business unit's performance scorecard was scored either below par, at par, or above par with bonuses at branch management level tied to those scores. This scheme provided strong incentives for managers not to under-perform on any of the six performance dimensions. ■

## National Bank OFS: Using the Scorecard as a Budget Filter

National Bank Online Financial Services (OFS) used its Balanced Scorecard to develop a process to screen and rank budget initiatives. Management first sorted initiatives into two categories — "strategic" and "business as usual" — by grading each initiative on a set of three criteria:

**1. Helps OFS achieve a strategic objective (defined by the strategic themes on the Balanced Scorecard).**

**2. Builds competitive advantage.**

**3. Builds sustainable points of differentiation.**

The second screen focused on the initiatives that drew upon the resources from several functional units and required significant costs and time to implement. The effect of these screens was to separate operational budgeting tasks from strategic budgeting tasks. Senior management only wanted to consider strategic projects that could create new capabilities for supporting strategic objectives. And it worked — the two screens filtered hundreds of initiatives down to about a dozen, which were then ranked and considered for the budget based on the strategic themes from the Balanced Scorecard.

## Principle 4: Make Strategy a Continual Process

One reason so many organizations have difficulties in implementing strategy is that these companies have at least one (sometimes many) disconnects between how they manage strategy and how they manage operations. These companies use their budget as a planning and control system, creating a loop that defines resources allocated to operations (inputs) and the performance targets required to hit their budgetary goals (outputs).

Strategy-Focused Organizations use a "double-loop" process, integrating the management of budgets and operations with the management of strategy. The Balanced Scorecard creates a reporting system that allows the progress against the strategy to be monitored and corrective actions to be taken as required. The scorecard also serves as a link between the operations control process and the learning and control process for managing strategy.

This management system enables you to do three essential things:

- **Link strategy and budget.** Stretch targets and strategic initiatives on the Balanced Scorecard link the rhetoric of strategy with the rigor of budgets.
- **Close the strategy loop.** The Balanced Scorecard links with feedback systems to provide a new framework for reporting and a new strategy-centered focus for management meetings.
- **Test, learn and adapt.** The Balanced Scorecard explicitly states the hypothesis of the strategy, allowing it to evolve in real time as new ideas and directions emerge from the organization.

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## Principle 4: Make Strategy A Continual Process

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### *Two Processes*

Strategy-Focused Organizations must view their budgets for financial numbers and resource allocation as arising from two different processes: operational budgeting and strategic budgeting.

*Operational budgets* consist of a forecast of the revenues expected from sales of goods and services and the expenses expected to be incurred, under efficient operations, for the goods and services to be produced and delivered to customers. Spending decisions can be determined by first estimating the production and sales volumes for the next period, then forecasting the demand for activities, calculating the resource demands, and determining the actual resource supply.

Operational budgets reflect expenses expected to be incurred to support recurring operations; this aspect of budgeting is informed by the Balanced Scorecard because of its connection to the business model for growth in existing businesses. Operational budgeting does not, however, represent the most significant opportunity for the scorecard to redirect and align the organization to its growth strategy, particularly if the strategy represents a distinct departure from the past.

*Strategic budgeting* authorizes the initiatives required to close the planning gap between desired breakthrough performance and that performance that is achievable by continuous improvement and business as usual. It authorizes spending initiatives that enable an organization to develop new products and services, new capabilities, new customer relationships and expanded capacity for future growth. The Balanced Scorecard helps organizations determine the quantity and mix of spending in their strategic budget. ■

# Principle 5: Mobilize Change Through Executive Leadership

Implementing new strategies requires large-scale change; the term transformation has emerged to differentiate the scale of change required by business strategy from the continuous improvement that organizations routinely perform. The leaders of Strategy-Focused Organizations lead transformations, not small-scale changes.

Getting transformations started, however, is often a challenge commensurate with the scale of the change. Some companies engage in strategic transformations out of a "burning platform" motivation — their organizations were failing, and drastic measures were in order. Some examples include:

✓ Bob McCool, of Mobil North American Marketing and Refining (NAM&R), who implemented strategy-based organizational changes after his company's expenses and capital had doubled, its margins had flattened, and its volumes were trending downward.

✓ Gerry Isom, of CIGNA, who used the Balanced Scorecard to turn around the Property and Casualty division of the company when its ratio of outgoing expenses to incoming premium revenues far exceeded the industry average.

✓ Bill Catucci, of AT&T Canada, who came to the company when it was close to bankruptcy, losing $1 million every day.

In other cases, the companies were successful; rather than resting on their laurels, however, their leaders created stretch targets to eliminate complacency and drive creative efforts. Some examples include:

✓ Jack Welch, who, shortly after becoming CEO of General Electric, energized the company by declaring that every division should become Number One or Number Two in every market they served. The change transformed his company from a lumbering giant to a giant with the speed and agility of a small enterprise.

✓ Douglas Newell, who, as head of the Internet banking division of National Bank OFS, set a goal to become the Number One Internet banking company in the world. Newell used the Balanced Scorecard to set stretch targets that kept the division ahead of the pack in the fast-moving world of the Internet.

These and other leaders set remarkable goals, goals that fell far outside their organizations' comfort zones, goals that required total organizational commitment to achieve them. They also recognized the benefits of using measurement to lead their change efforts. Executives that create Balanced Scorecards for their strategic initiatives help build their strategy, the team to implement that strategy and the commitment from the team that is required for success.

It's easy to build a business plan that addresses and meets specific growth objectives; the hard part is identifying how that growth will be achieved. The Balanced Scorecard helps organizations specify in detail the critical elements for their growth strategies:

- **targeted customers where profitable growth will occur;**
- **value propositions that lead customers to do more business and at higher margins with the company;**
- **innovations in products, services and processes;**
- **investments in people and systems to enhance processes and deliver differentiated value propositions for growth.**

*(continued on page 8)*

### Principle 5: Mobilize Change Through Executive Leadership

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Without clear specifics on these elements, employees cannot reinforce one another's efforts to implement strategy.

Ultimately, however, the ability to create a Strategy-Focused Organization depends less on structural and design issues and more on the leadership of the organization's senior executive. The leaders listed above created a climate for change, and provided the vision for what that change could accomplish, as well as the governance process that promoted communications, interactive discussions and learning about their strategies.

Indeed, most of these strategy-focused leaders found that their most important challenge was communication of their strategy to those whose job it was to implement it. They had to gain the hearts and minds of all their middle managers, technologists, sales forces, frontline employees and back-office staff. They developed their visions of what success would look like and the outcomes they wanted to achieve, then let their employees help find innovative ways to accomplish the strategic mission. In so doing, they found it more effective to communicate vision and strategy, rather than to try to control the actions of their subordinates; they used the Balanced Scorecard as a communications tool, not a control tool. ■

## What Are the Pitfalls of Implementation?

Although many companies enjoy the benefits from their Balanced Scorecard management systems, implementation failures do occur. More often than not, these disappointing results are self-inflicted, owing to factors internal to the business rather than attributable to external events. These pitfalls tend to fall into two categories: design failures and process failures.

### *Design Failures*

Some failures occur when companies build poor Balanced Scorecards. They may use too few measures in their perspectives, failing to obtain a balance between the outcomes they are trying to achieve and the performance drivers of those outcomes. Others include too many measures and never identify the critical few.

Failures also occur when units within the company are not aligned with an overall strategy. If each unit follows its own path in developing a Balanced Scorecard, organizations will not have a common strategic vocabulary — they will instead have a "Scorecard Babel." The management system collapses when each unit approaches its scorecard differently, with no overall link to group or corporate strategies. Senior leadership is then unable to mobilize at any level, local or organization-wide.

### *Process Failures*

The most common causes of implementation failures, however, are due to poor organizational processes, which tend to fall into at least one of seven common categories:

- **Lack of senior management commitment.** Senior management must articulate the organization's strategy and bring about consensus if consensus about the strategy is difficult to achieve. They must also be emotionally committed to the strategy, investing time and resources to see the strategy through.
- **Too few individuals involved**. Commitment must come from the appropriate decision-makers in an organization to keep business practices in line with strategic goals. The excuse that individuals (particularly key senior managers) "already attend too many meetings" is not a valid one.
- **Keeping the scorecard at the top.** The opposite error of not involving senior executives is to involve only senior executives. For the scorecard to be effective, it must be shared with everyone in the organization.
- **An over-long development process** (the Balanced Scorecard as a one-time measurement project). Some teams believe they only have one chance to launch the scorecard, so they want to produce the perfect scorecard, spending months refining it — so long, in fact, that it never gets implemented. The most successful implementations, however, start with missing measurements; the organizations simply learn by doing.
- **Treating the Balanced Scorecard as a systems project.** Sometimes, the Balanced Scorecard is implemented by consultants that specialize in installing large systems. These consultants spend months and millions of dollars automating and facilitating access to thousands and millions of data observations collected by the company. This has little to do with the engaging strategy that should be at the center of the Balanced Scorecard management system.
- **Hiring inexperienced consultants.** Using inexperienced consultants or consultants who deliver their favorite methodology under the rubric of the Balanced Scorecard is a recipe for failure.
- **Introducing the Balanced Scorecard for compensation only.** Linking strategy to compensation is a powerful lever to gain the attention and commitment of individuals to strategy. Some companies, however, forget that they must translate the strategy into terms each of their employees can understand and use in their everyday activities — a key component of implementation. ■