

# Balanced Scorecard

## REPORT

THE STRATEGY EXECUTION SOURCE

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## What Is Your Strategy Management Philosophy?

By David P. Norton

**Every profession has its approaches, or “schools of thought.” The profession of strategy management is no exception, claims David Norton, who believes business leaders should do more to educate themselves about the different schools of thought—and select the one that is right for their organization. The Balanced Scorecard, in its evolution from performance measurement to performance and strategy management system, has become such a school of thought, with some considerable advantages over other leading schools.**

If you’ve ever seen a glacier up close, you’ve undoubtedly observed the action caused by the melting on the glacier’s face. Every day, numerous slabs “calve,” or break off and drop to the ground or water below. A glacier is so large that the impact of a single calf is minor. But collectively, the impact of this process is significant. Every guide invariably points out a landmark miles away, noting that “less than 15 years ago, the face of the glacier was over there.” So while the daily changes to the landscape are incremental and seemingly imperceptible, over a matter of 15 years, the cumulative change can be dramatic.

What does this have to do with strategy management? Well, it has been slightly more than 15 years since Bob Kaplan and I introduced the Balanced Scorecard. Through our research and writings, we have studied countless companies that have used the Balanced Scorecard approach to manage strategy execution. Frequently, the results have been powerful, even transformational, creating an impact analogous to that of the calving glacier. But it’s important for leaders to examine the steps they have taken to understand the real implications of the experience and the approach. It’s important to question how well your approach supports your underlying philosophy of value creation—and ultimately, your long-term performance.

With the publication of *The Execution Premium*, our fifth book on the Balanced Scorecard, I’d like to step back and examine the BSC’s evolution from measurement to management system—and how it compares with other economic models and performance management approaches. I’d also like to share some observations from our years of research about the requirements of a 21st-century performance management system.

Surveys confirm that business leaders recognize the primary importance of strategy execution. Yet we find a glaring lack of awareness about leading performance management systems—their capabilities and their shortcomings. At many organizations, management approaches have been adopted organically, rather than systematically, and often alongside other methodologies and programs—and not always in a top-down, integrated fashion. The management approach may not support the organization’s underlying performance management philosophy, if one exists at all. A consciously chosen philosophy and performance management approach is vital to a coherent strategy management system and to achieving

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#### Kaplan and Norton’s New Blog

Harvard Business Online and Palladium Group are pleased to announce the debut of Robert Kaplan and David Norton’s blog. The two take turns ruminating on today’s pressing performance management issues, provoking your thinking and soliciting your views and experiences.

Discover what’s on their mind—and join the conversation—at [www.executionpremium.org](http://www.executionpremium.org).

sustainable performance success. But not all philosophies or approaches are created equal.

## The Balanced Scorecard as Management System

The BSC was originally designed to solve a performance measurement problem.

Up until the 1990s, most organizations relied excessively, if not exclusively, on financial measures such as profitability and ROI to manage themselves. Because financial measures are lag indicators, these organizations tended to make short-term decisions to impact financials at the expense of long-term decisions that could create future value. The BSC represented a measurement framework that could balance the long-term factors that create value (lead indicators) with the short-term factors that record value (lag indicators). Today it has become the dominant framework for measuring organizational performance. Studies conducted between 2002 and 2006 showed that 50% of organizations used some kind of scorecarding system. Of that group, 62% used a Balanced Scorecard, while 13% used a Quality Management framework (encompassing a variety of methodologies such as Total Quality Management [TQM], Six Sigma, and Lean Manufacturing). Three percent used a Shareholder Value framework.<sup>1</sup>

Many people still believe the BSC is just a measurement technique. Our readers well know, however, that the term “Balanced Scorecard” means far more; it is a full-fledged performance management system. Even the latest primer on the BSC, *Balanced Scorecard Strategy for Dummies*, recognizes that, while measurement is a key aspect of the BSC, the system is really “a means to setting and achieving the strategic goals and objectives for your organization.”<sup>2</sup>

## The Balanced Scorecard as School of Thought

Virtually every profession has its schools of thought—groups of people who share a point of view about its ideals and how to accomplish them. In architecture, Walter Gropius led the Bauhaus School of design; Frank Lloyd Wright created the Prairie School. Each school has its design *philosophy* to help the architect make design choices (for example, the “form follows function” philosophy of the Prairie School), as well as a design *approach*, which encompasses the different methodologies supporting that philosophy.<sup>3</sup>

Likewise, performance management has its own schools of thought. TQM,<sup>4</sup> one of today’s leading approaches, is “centered on quality, based on the participation of all [an organization’s] members, and aiming at long-term success through customer satisfaction and benefits to all members of the organization and to society.”<sup>5</sup> Shareholder Value is based on the philosophy that shareholders’ money should be used to earn a higher return than shareholders could earn by investing in other assets having the same amount of risk.<sup>6</sup> We define the Balanced Scorecard as a framework for implementing strategy that translates an organization’s strategy into a set of objectives and measures and aligns the organization to them through its planning and control processes.

As shown in *Figure 1*, each performance management school of thought has three building blocks (tiers). First is an *economic model* on which the approach is built. TQM’s economic model views the role of quality in improving customer satisfaction as the source of value creation. Shareholder Value emphasizes the return on investments relative to

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**Figure 1. A Performance Management System Is Built Upon a Foundation of Economic Assumptions and a Management Philosophy**

PERFORMANCE MANAGEMENT SCHOOLS OF THOUGHT				
		Total Quality Management	Shareholder Value	Balanced Scorecard
BUILDING BLOCKS	I. An Economic Model of Value Creation	Improved quality improves customer satisfaction, which in turn benefits all organization members	Make only investments that exceed the investors' equivalent risk-adjusted rate of return	Value is created by developing the intangible assets that improve business processes and that satisfy customer needs—which in turn create shareholder value
	II. A Philosophy of Management	A bottom-up process where all individuals are responsible for improving quality in their own sphere of influence	Value is created through control of investments	A top-down process led by senior executives that clarifies and communicates the strategy and requires each part of the organization and each person to align to the strategy
	III. An Integrated Management System	Quality circles using statistical tools are empowered to challenge the status quo of operational performance	Capital allocation and initiative portfolio management tools monitor the implementation of projects	The governance process is redefined so that planning, resource allocation, and performance reviews are linked to the strategy, using BSC tools

*The three leading performance management schools of thought shown here are based on dramatically different models of value creation and philosophies. Their management systems, likewise, differ significantly in such areas as direction (top-down, bottom-up), scope, and degree of prescriptiveness.*

the cost of capital. The BSC uses a strategy map to define value drivers. Second, each school has a unique *philosophy* of management—or a set of values by which the organization should be managed. TQM follows a bottom-up process in which all individuals are responsible for improving quality in their sphere of influence. Shareholder Value views the capital allocation process as the management framework. And the BSC relies on a top-down cascading process to ensure organization alignment. Finally, the philosophy and the economic model are embedded into a *management system* that allows the performance approach to be executed. TQM uses approaches like quality circles, supported by methodologies like Pareto charts, to improve performance. Shareholder Value taps into the organization's finance system for capital allocation and initiative portfolio management. The BSC restructures the traditional double-loop planning and control process with a link to strategy as its framework for creating alignment.

Each performance management school of thought has a comprehensive and cohesive body of knowledge that is internally con-

sistent. This knowledge provides the language, methodologies, and processes needed to educate professionals, identify best practices, and implement improvements (whether in the strategy itself, or in processes or methodologies). Let's compare the leading schools of thought within this three-tier framework.

#### **Tier I: An Economic Model (Model of Value Creation)**

Whether it's investments whose return exceeds the cost of capital (as with Shareholder Value) or quality improvement initiatives that increase customer satisfaction (TQM), the economic model defines what is meant by performance and provides the focal point of the management system. As shown in *Figure 2* (next page), the BSC economic model has two distinctive components: a *descriptive* framework—the strategy map<sup>7</sup>—establishes the organization's vision and stakeholder objectives and depicts the causal relationships among business processes, human capital, and information technology (IT), showing how these can be harnessed to satisfy customer needs to create shareholder value. A *measurement* framework, the

Balanced Scorecard,<sup>8</sup> balances four performance dimensions or perspectives—financial, customer, process, and learning and growth—that are linked by the cause-and-effect logic of the strategy map. First, organizations define objectives within each perspective; then they create supporting measures; next, they identify targets and performance gaps. These gaps are closed by executing strategic initiatives, thus creating value. These two components provide a framework to describe how value is created through an organization's strategy.

#### **Tier II: A Philosophy of Management**

The performance management approach will ultimately become a system of plans and activities to govern organizational action. Should the process be top-down or bottom-up? Should it work within or across functional silos? Should it be transparent or known only to top management? Collectively, the answers to these and many other such questions embody the philosophy of the approach.

The management philosophy of the BSC (*Figure 2*, Tier II),

described in *The Strategy Focused Organization* (SFO)<sup>9</sup> consists of five principles Bob Kaplan and I identified: *Mobilize* Change Through Executive Leadership, *Translate* the Strategy into Operational Terms, *Align* the Organization to the Strategy, *Motivate* to Make Strategy Everyone’s Job, and *Govern* to Make Strategy a Continual Process. These principles define a set of beliefs and values that guide the design of the many details of the management system. For example, we believe that “strategy is everyone’s job.” In organizations dominated by knowledge workers who interface directly with customers, suppliers, and partners, low-ranking employees are best positioned to execute the strategy. This statement of philosophy means that the management system must make the strategy transparent, ensuring that everyone understands it, personalizes it, and is incentivized to execute it.

**Tier III: An Integrated Management System**

The values provided by the SFO principles must be translated into management processes that help govern the organization. To

“Motivate,” Public Service Electric and Gas (a BSC Hall of Fame winner) introduced an incentive compensation program tied to the BSC for its thousands of union employees. To help “Govern,” life sciences company Millipore converted its budget to a BSC-driven quarterly rolling forecast. But this translation isn’t always easy. Even leaders who have embraced these principles and successfully executed strategy have generally been unable to sustain their breakthrough performance. Why? Because they lacked a *formal* governance process.

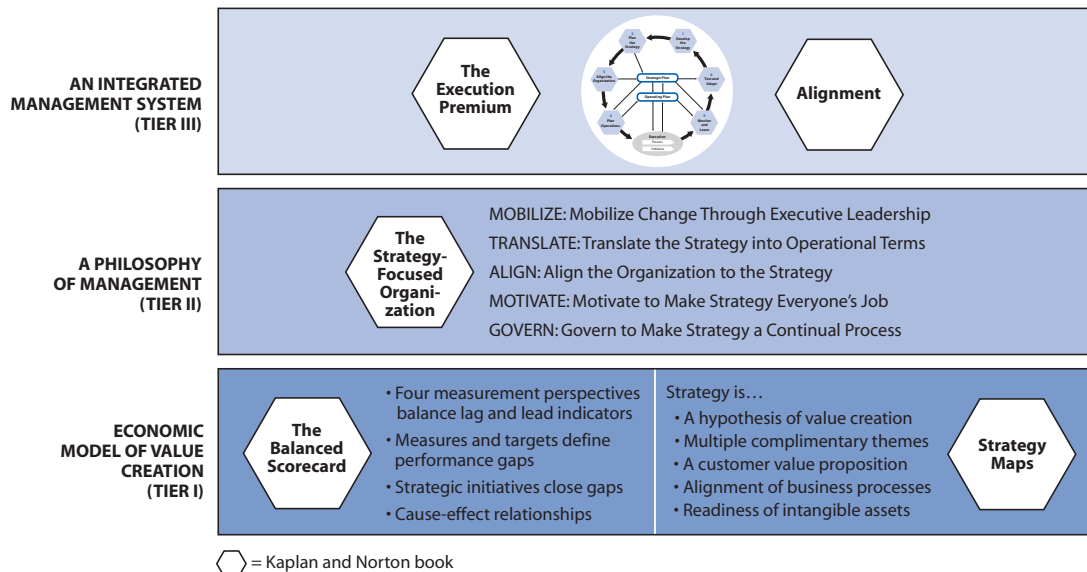
Thus, the economic model and the philosophy must be translated into an integrated management system—a set of processes, such as planning, budgeting, and strategy reviews, that are understood and adhered to by all members of the organization. As we argue in *Alignment*,<sup>10</sup> the fundamental source of value added an organization achieves is proportional to the degree of alignment between the organization’s parts and its strategic priorities. In short, alignment is a process that should be formalized and managed. In *The Execution Premium*,<sup>11</sup> we recommend adopting a six-stage,

closed-loop management system that codifies a perpetual process for strategy development, strategic planning, alignment, linking to operations, performance reviews, strategy testing, and adapting. This system is based on our research, which indicates that 70% of organizations with a formal management system for strategy execution outperform their peers.<sup>12</sup> The creation of a formal, integrated management system (Figure 2, Tier III) is the final step in this journey toward a new way of managing.

**The Balanced Scorecard as Integrating Platform**

Strategy is holistic; organizations are siloed. This contradiction creates the fundamental barrier to building an effective strategy management system. Shareholder Value, while clearly based on an economic model and a philosophy, does not provide a holistic methodology for managing strategy. TQM is a bottom-up framework. Some TQM programs exist discretely within a functional area or department (e.g., manufacturing), while others are organization-wide but focus on specific processes such as supply chains.

**Figure 2. The Balanced Scorecard Performance Management School of Thought**



The BSC creates a common, holistic framework that applies throughout the six stages of management. The concepts defining its economic model, philosophy of management, and integrated management system are described in Kaplan and Norton’s five books, published from 1996 (The Balanced Scorecard) to 2008 (The Execution Premium).

Despite its proven capabilities and the dramatic breakthroughs many organizations have achieved with TQM, it does not provide a blueprint for enterprisewide strategy management. The BSC, a top-down approach linking all performance perspectives causally is, we contend, the only true integrative performance management system.

To illustrate, let's look at the challenges faced by an organization implementing a new customer relationship management (CRM) program. The program will require a new technology (the IT plan), new training and incentives for users (the HR plan), new approaches to customer acquisition and account development (the sales plan), additional capital investment (the finance plan), and so on. To successfully implement this strategic program, the work of many departments must be integrated and synchronized. The typical planning and control system is designed to support organizational hierarchies and is fragmented into functional silos, not to provide the necessary integration.

The BSC provides a solution. Its economic model, built around strategy maps and strategic themes, creates a common, holistic framework that applies throughout the six stages of management. The strategic themes, introduced during strategy development, provide a mechanism for cross-functional management, which is essential for keeping strategy holistic. The CRM implementation, for example, might fall within two themes: one for new customer acquisition and one for account growth. Quantitative targets and gaps would be established for each. In the strategic planning process, each strategic theme is translated into a set of discrete objectives and measures. A portfolio of strategic initiatives, drawn from across the organization, along with its investment budget (strategic expenditures, or "StratEx")

creates a cross-organizational plan that can be managed outside silo boundaries.

This top-down approach provides the basis for aligning the organization. Strategic themes provide a way to keep the strategy holistic, and as the strategy is cascaded from the top, each department or area is asked to define how it will fulfill (or affect) the strategic themes. In the CRM example, all employees are asked how they will help acquire new customers or grow existing accounts. This is not an activity confined to one silo, such as sales. The strategic themes and plans provide the logic of the cross-functional strategy.

The strategy map and BSC help create a common architecture that integrates the various functional systems without the need to destroy them or reconfigure the organizational structure. The BSC becomes a platform for integrating the diverse functional management systems, just as an operating system does to integrate diverse software applications. Within this top-down organizing framework, many other approaches and methodologies can be used in concert. LG.Philips (now LG.Display) integrated a blue ocean strategy<sup>13</sup> program into the customer perspective of its strategy map, Bank of Tokyo-Mitsubishi integrated a major risk management program into the process layer of its strategy map, and Thai Carbon Black created a strategic theme for its sophisticated Six Sigma program. In many organizations, these programs would function independently in different parts of the organization. Though valuable, their effectiveness would be diminished because they were not focused on the strategic priorities or linked to the

strategy management system.

The BSC provides a platform that allows these programs to be routinely integrated into the holistic strategy framework, where their effectiveness is actually enhanced.

**The strategy map and BSC help create a common architecture that integrates the various functional systems without the need to destroy them or reconfigure the organizational structure.**

### **New Structures, a New Imperative**

Like the discipline of TQM, strategy management through the Balanced Scorecard approach has emerged as a professional discipline with a unique body of knowledge, set of organizational requirements, and set of specialists who can execute the approach. Its body of knowledge is characterized not so much by the complexity of its analytics, but by the complexity of its organizational scope. Strategy is holistic, requiring a cross-functional management system. Yet historically, there has been no natural home for cross-functional management in organizations. New organizational structures have emerged to fill this gap:

- *The Office of Strategy Management (OSM)*: the team (virtual or actual) responsible for designing, maintaining, and operating the strategy management process
- *The Chief Strategy Officer (CSO)*: the leader of the OSM, who is also a member of the senior management team
- *The Strategy Council*: a subset of the senior management team, which is responsible for overseeing strategy development and execution

- *Theme Teams*: groups of managers based on strategic themes who are responsible for extending strategy execution cross-functionally throughout the operational levels of the organization

Each of these structures allows the organization to deal with cross-functional issues raised by strategy that fall beyond the purview of the conventional silos. The OSM, which Bob Kaplan and I introduced in 2004, has been adopted by hundreds of organizations to build and run their closed-loop strategy management system.<sup>14</sup> It is also charged with integrating strategy into traditional siloed processes such as budgeting, HR planning, IT planning, and sales planning. Most important, the OSM is responsible for providing leadership for the new performance management process; in particular, educating senior management about this “new way” of managing. Already OSMs have had a dramatic impact on performance, helping accelerate successful strategy execution—and make strategy management a sustainable competitive advantage.

### Does Your System Produce Results?

Ultimately, the mark of a performance management approach is the degree to which it produces results. Various surveys report that only 10% to 15% of organizations successfully execute their strategies, a total that includes users of performance management systems. It takes time for any organization to introduce a new way of managing, as well as to introduce the changes required by the strategy. But the results are clear. The Balanced Scorecard strategy management system has helped create successful strategy-focused organizations. More than 100 organizations from every industry and every corner of the world

have been inducted into the Balanced Scorecard Hall of Fame. This distinction requires more than the world-class application of the BSC management system; each winner must prove that it has successfully executed its strategy over a sustained period—and has achieved breakthrough results. Infosys, the Indian outsourcer and 2007 BSC Hall of Fame winner, competes in the same markets as IBM and Accenture. Over a four-year period, it tripled revenue and earnings per share. Such financial results are common among Hall of Fame organizations. But these organizations also experience breakthrough results across all areas of performance: in process improvements and efficiencies, customer satisfaction, employee motivation—these and other areas garner these organizations recognition as “best company to work for” and “best managed” in their market. The BSC’s top-down view—and more important, its uniquely holistic, integrative ability—enables successful users to achieve dramatic, sustainable results *and* an execution premium.

When asked to describe his experience with the BSC, Peter Aldridge, CEO of Hall of Fame winner HSBC Rail, replied, “We came looking for measures and found a new way to manage.”<sup>15</sup> Performance management has arguably never been more important. Strategies are more complex and intangible. Competitive pressures have intensified, driven by an increasingly global marketplace and compressed business cycles. It takes more than just a philosophy or methodology to manage performance; it takes a holistic system—something most organizations lack. So in taking the first step on your strategy management journey, I ask you, “What is your philosophy of strategy management?” The answer to that question might

help you, as it helped the 100 Hall of Fame winners and the hundreds of other high-performing BSC organizations, to achieve your execution premium. ■

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15. Peter Aldridge, speaking at Palladium Group’s Balanced Scorecard European Summit, London, June 2008.

### TO LEARN MORE

*The stories of how BSC Hall of Fame winners achieved across-the-board breakthrough results with a holistic performance management system appear in our BSC Hall of Fame Report, which has been published annually since 2004. Visit [www.executionpremium.org](http://www.executionpremium.org) and search “Hall of Fame Report.”*

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