BALANCED SCORECARD STEP-BY-STEP

Maximizing Performance and Maintaining Results

Paul R. Niven

John Wiley & Sons, Inc.

BALANCED SCORECARD
STEP-BY-STEP

BALANCED SCORECARD STEP-BY-STEP

Maximizing Performance and Maintaining Results

Paul R. Niven

John Wiley & Sons, Inc.

This title is also available in print as ISBN 0-471-07872-7. Some content that appears in the print version of this book may not be available in this electronic edition.

For more information about Wiley products, visit our web site at www.Wiley.com

For my parents, Bev and Jean Niven

Foreword

Dave Norton and I initially proposed the Balanced Scorecard 10 years ago.[1] Since that time, the concept has been adopted by all types of organizations—manufacturing and service, for-profit and not-for-profit, private and public—in virtually every developed and developing nation in the world. During these 10 years, the Balanced Scorecard has evolved from its initial purpose of an improved performance measurement system to become the basis of a new management system, one that aligns and focuses the entire organization on implementing and improving its strategy.

Norton and I documented this evolution and enhancement of the Balanced Scorecard concept through additional *Harvard Business Review* articles and two books.[2] But because of the rapid changes that have occurred in the past ten years, few practitioners beyond our small circle of consultants and project leaders have gained much experience with implementations that are at the current state-of-the-art. Paul Niven, through his experience as project leader at the excellent and highly successful implementation at Nova Scotia Power, and subsequently as a Balanced Scorecard consultant, is one of the few who can talk and write knowledgeably about how to make the scorecard happen in an organization. *Balanced Scorecard Step By Step* guides readers through the processes required for a successful Balanced Scorecard project. In addition, he shows how to become a strategy-focused organization by imbedding the Balanced Scorecard into critical organizational processes. The book provides an excellent complement to the two Kaplan-Norton books by explicating the details and processes that project leaders can follow to implement the Balanced Scorecard measurement and management system in their organizations. We are pleased to welcome this new book to the Balanced Scorecard literature. Niven's contribution will enable

[1] R. S. Kaplan and D. P. Norton, "The Balanced Scorecard: Measures That Drive Performance," *Harvard Business Review,* January–February 1992, 71–79.

[2] Kaplan and Norton, *The Balanced Scorecard: Translating Strategy into Action* (Boston: HBS Press, 1996); ________ *The Strategy-Focused Organization* (Boston: HBS Press, 2001).

many more organizations to achieve successful Balanced Scorecard implementations.

Robert S. Kaplan
Marvin Bower
Professor of Leadership Development, Harvard Business School
and
Chairman, Balanced Scorecard Collaborative

Acknowledgments

A friend and colleague once told me the best way for adults to learn is by speaking with other adults. This book represents years of conversations I have had with colleagues, clients, family members, friends, and innumerable other associates. And yes, I have learned and benefited greatly from each and every exchange of ideas.

This book would not have been possible, literally, if not for my editor at John Wiley & Sons, Tim Burgard, who approached me with the initial idea and has skillfully guided me through the entire process. I would also like to thank all of the clients it has been my pleasure to work with over the years, and those individuals kind enough to share their Scorecard journey with me, particularly Chuck Wehrwein and Valerie Mercer of the National Equity Fund, Andreas Schroeter of Westdeutsche Landesbank, Steve Mann at the County of San Diego, Ed Berkman of McCord Travel Management, Frank Vito at the Texas State Auditor's Office, and Henry Johnson from Scripps Health in San Diego.

Many past and present colleagues have helped shape this book as well. From KPMG Consulting I would like to thank Faisal Yousuf, Chris Kingsley, and Beckie Voss. From CSC Consulting, Mike Contino, Sue Gafner, Chris Reichner, and especially Bill Chandon with whom I've enjoyed many spirited discussions. A big thank you to former collegues Jason Griffith and Wes Schaffer as well. My Scorecard initiation took place at Nova Scotia Power, and there I was very fortunate to be surrounded by amazing and talented people like Tina Whynot, Todd Bethune, Wanda Boutilier, and Bob Cyr. But most of all, I thank Nova Scotia Power's former CFO Jay Forbes—a great mentor and even better friend.

Finally, and most importantly, I would like to thank my wife Lois. While I wrote this book, she simultaneously acted as first line editor of the manuscript, chief supporter, dedicated community volunteer, and through it all, a constant source of encouragement and love.

Preface

Organizations in today's change-filled, highly competitive environment must devote significant time, energy, and human and financial resources to measuring their performance in achieving strategic goals. Most do just that, but despite the substantial effort and related costs, a recent survey found that only 35 percent of respondents rated their performance measurement systems as effective or very effective.[1] That, of course, means almost 7 out of every 10 organizations are feeling dissatisfied with their measurement efforts. Increasingly, organizations are reaching the conclusion that while measurement is more crucial than ever, their systems for capturing, monitoring, and sharing performance information are critically flawed. Today's systems in many ways bear a remarkable resemblance to their reporting ancestors. While the methods of modern business have transformed dramatically over the past decades, our systems of measurement have remained firmly mired in the past. At the root of our measurement misery is an almost exclusive reliance on financial measures of performance. While these systems were perfectly suited to the machine-like, physical asset-based nature of early industrial endeavors, they are ill-equipped to capture the value creating mechanisms of today's modern business organization. Intangible assets such as employee knowledge, customer and supplier relationships, and innovative cultures are the key to producing value in today's economy. Additionally, the role of strategy is more important today than it has ever been. Whether you're a high-tech newcomer or an established manufacturing veteran, the necessity of effectively executing strategy is crucial in an era of globalization, customer knowledge, and rapid change. But the sobering fact is that about 9 out of 10 organizations fail to implement their strategies. What is needed is a measurement system that balances the historical accuracy and integrity of financial numbers with today's drivers of economic success, and in so doing allows the organization to beat the odds of executing strategy.

The Balanced Scorecard has emerged as a proven and effective tool in our quest to capture, describe, and translate intangible assets into real value

[1]Performance Measurement Survey by the American Institute of Certified Public Accountants and Lawrence S. Maisel, 2001.

for all of an organization's stakeholders, and in the process allow organizations to successfully implement differentiating strategies. Developed by Robert Kaplan and David Norton, this deceptively simple methodology translates an organization's strategy into performance objectives, measures, targets, and initiatives in four balanced perspectives: Financial, Customer, Internal Processes, and Employee Learning and Growth (often simply referred to as Learning and Growth). While many organizations have used a combination of financial and non-financial measures in the past, what sets the Balanced Scorecard apart is the concept of cause and effect linkages. A well-constructed Scorecard will tell the story of an organization's strategy through a series of linked performance measures weaving through the four perspectives. The hypothesis reflecting strategy comes to life through the interplay and interdependencies among the financial and nonfinancial measures. Organizations around the globe have rapidly embraced the Balanced Scorecard and reaped swift benefits from its commonsense principles: increased financial returns, greater employee alignment to overall goals, improved collaboration, and unrelenting focus on strategy, to name just a few. To reap those rewards, however, an organization must possess the tools necessary to craft an effective Balanced Scorecard.

ABOUT THIS BOOK

In the mid-1990s I was working with an organization that, like so many others, was about to undergo significant change. The industry structure was changing, competitors appeared more nimble and threatening than ever, and customers were demanding better service with no price increases. A new strategy was developed that, if effectively implemented, would see the organization enhance employee skills, develop new processes, build loyal customers, and ultimately deliver breakthrough financial performance. But how could the strategy be successfully executed? The organization's chief financial officer investigated the Balanced Scorecard approach and determined it was the right tool at the right time. Acting as the executive sponsor for the initiative, he appointed me to lead a team charged with the responsibility for developing a new management system featuring the Balanced Scorecard as the cornerstone. Two years later his intuition paid off in a big way. Employee knowledge of strategy had increased significantly, internal processes were functioning more efficiently than ever, customer loyalty was on the rise, and, despite many adverse factors beyond the organization's control, financial returns were on target.

The organization described above is Nova Scotia Power, Inc. (NSPI), a Canadian electric utility company. As the results demonstrate, their Balanced Scorecard implementation was a great success and has been featured in case studies, shared at conferences throughout North America and beyond, and earned the organization a spot in the Balanced Scorecard Collaborative's Hall of Fame. Lessons learned from this pioneering organization are shared to illustrate many points in this book. As successful as the implementation was, it certainly was not without challenges. Our team quickly learned that building a Balanced Scorecard is far more than a "metrics project" but instead touches many disparate organizational processes. Building an effective team, generating support and enthusiasm for a change project, efficiently gathering and sharing data, coaching, training, and facilitating are just some of the many exciting and challenging tasks we faced. At that time, Balanced Scorecard literature and support services were at a nascent stage and we were left to our own devices when grappling with the many issues awaiting us. While the past number of years have seen a proliferation in Scorecard literature and related consulting and support products, few if any focus on the wide array of organizational activities that must accompany a winning Scorecard campaign. This book was written to fill the void existing between theory and application. Organizations embarking on a Scorecard effort must be aware of—and properly equipped with the tools to successfully navigate—the many potential pitfalls associated with a project of this magnitude. Based on my experience as a consultant along with extensive research, these pages guide the reader through the entire Balanced Scorecard process on a step-by-step basis. From determining your objectives for the Scorecard to testing your mission, to developing measures and targets, to placing the Scorecard at the center of your management system, to tips for sustaining your success, you'll find all this and more. Let's now take a look at how the book is organized and consider how you can use it to best suit your needs.

HOW THE BOOK IS ORGANIZED

Balanced Scorecard Step-by-Step is comprised of five parts, encompassing 14 chapters. Part One is entitled "Introduction to Performance Measurement and the Balanced Scorecard" and is designed to do just that—familiarize you with the field of performance measurement and provide a solid grounding of Scorecard background and principles. Chapter One elaborates on the discussion started in this introduction by examining how the Scorecard solves two fundamental modern business issues—reducing a reliance on financial performance measures and implementing strategy. In Chapter Two the rising prominence of human capital in today's enterprise is reviewed, and evidence presented that suggests the Scorecard methodology is here to stay.

Part Two of the book, "Step-by-Step Development of the Balanced Scorecard," provides you with a detailed review and description of the elements necessary to construct this new and powerful management tool. Chapter Three lays the foundation for the work ahead by examining objectives for a Balanced Scorecard, securing executive sponsorship, creating a team, and preparing a development plan. The core elements of any effective Balanced Scorecard—mission, values, vision, and strategy—are the subject of Chapter Four. You'll discover why each of these elements is crucial to the success of a Balanced Scorecard. With the Scorecard building blocks firmly in place, Chapter Five provides an in-depth view of what it takes to build indicators that act as a faithful translation of strategy. Determining which perspectives are right for you, gathering relevant background material, working with your executive team, and measures in each of the four perspectives are all covered in detail. Narrowing your performance measures down to a select few that weave together in a series of cause-and-effect linkages to describe an organization's strategy is the subject of Chapter Six. The final chapter of Part Two is titled "Setting Targets and Prioritizing Initiatives." The critical role of target setting and the Balanced Scorecard is presented along with a review of different types of targets. Ensuring that organizational plans and initiatives are aligned with the Balanced Scorecard and strategy is also given extensive coverage in Chapter Seven.

"Embedding the Balanced Scorecard in the Organization's Management System" is the title of the book's third part, and marks the Scorecard's transition from a measurement system to a strategic management tool. Aligning every employee's actions with overall organizational goals is the subject of Chapter Eight. This "cascading" of the Balanced Scorecard is critical should organizations hope to enjoy the benefits of greater employee knowledge of, and focus on, key organizational strategies. In Chapter Nine the role of the Balanced Scorecard in the budgeting process is examined. The chapter equips readers with specific techniques to align spending with strategy. The often challenging topic of incentive compensation is tackled in Chapter Ten. Readers will find a comprehensive review of critical compensation planning and design elements.

"Sustaining Balanced Scorecard Success" is the theme of Part Four. Frequent reporting of results is critical in gaining support of the Scorecard as an effective management tool. But should organizations buy one of the many performance management software packages available or build their own reporting solution? Chapter Eleven probes this question and offers several tools to be used when making the decision. A "new management review meeting" is also explained in the chapter. "Maintaining the Balanced Scorecard" is presented in Chapter Twelve. Business rules, processes, and procedures (including those for gathering data) necessary to embed the Scorecard in the fabric of organizational life are carefully reviewed. The Scorecard's "home" in the organization is also considered.

The Balanced Scorecard was originally conceived with the profit-seeking enterprise in mind. However, public-sector and not-for-profit organizations were quick to grasp the many advantages conferred by a Balanced Scorecard and have been adopting it almost since its inception. Part Five, "Balanced Scorecards, in the Public and Not-for-Profit Sectors and Concluding Thoughts" examines this rising trend in Chapter Thirteen, "Balanced Scorecards in the Public and Not-for-Profit Sectors." Readers from these sectors will learn that with some modifications the Scorecard architecture is ideally suited to their mission-driven organizations.

The important role of organizational change in securing a successful Scorecard effort is presented in the book's final chapter. There you will also discover the "top ten implementation issues" and receive guidance on the use of outside consultants when constructing a Scorecard.

This book can be used by organizations at any stage of Balanced Scorecard development. Those launching a Scorecard effort will of course benefit from the step-by-step advice guiding them from initial design to final product. But for organizations that have developed a Scorecard measurement system but have yet to transform it into a management system, Parts Three and Four will be most valuable. Finally, even organizations that have been using the Balanced Scorecard for some time will benefit from a review of the topics presented here. The techniques and advice presented can act as an audit of their own systems to ensure maximum effectiveness. To learn more about the topics covered in this book, and my ongoing work in Performance Management, please visit my web site at *www.primerusconsulting.com.*

Nearly 2,500 years ago the Greek playwright Euripides noted the importance of balance in our lives when he said, "*The best and safest thing is to keep a balance in your life, acknowledge the great powers around us and in us. If you can do that, and live that way, you are really a wise man.*" I truly believe the same applies to organizations.

Paul R. Niven
San Diego, California
September 2001

Contents

Part One

Introduction to Performance Measurement and the Balanced Scorecard

CHAPTER 1

Performance Measurement and the Need for a Balanced Scorecard

> When you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind.
>
> —*William Thompson (Lord Kelvin), 1824–1907*

Roadmap for Chapter One The purpose of this opening chapter is to provide you with an overview of Performance Measurement and the Balanced Scorecard system. While you may be anxious to get right to the work of developing your new performance management tool, I urge you to spend some time on this chapter since it essentially serves as the foundation for the rest of the book. When you begin developing a Balanced Scorecard your organization will rely on you not only for advice on the technical dimensions of this new process, but also on the broader subject of performance measurement and management. You can enhance your expert credibility within the organization by learning as much as possible about this subject. This is especially important if your current function is one that typically does not get involved in projects of this nature. Think of this chapter as a primer for the exciting work that lies ahead.

The Balanced Scorecard assists organizations in overcoming two key issues: effective organizational performance measurement and implementing strategy. We begin the chapter by discussing performance measurement, and specifically our reliance on financial measures of performance despite their inherent limitations. From there we move to the strategy story and review a number of barriers to successful strategy implementation. With the issues clearly on the table we introduce the Balanced Scorecard and how this tool can overcome the barriers related to financial measures and strategy execution.

Our Balanced Scorecard overview begins with a look back at how and when the Scorecard was originally conceived. Next, we pose the question, "What is a Balanced Scorecard?" and elaborate on the specifics of the tool as a measurement system, strategic management system, and communication tool. In these sections you will be introduced to the theory underlying the Balanced Scorecard and the four perspectives of performance analyzed using this process. The chapter concludes with two important topics: the critical task of linking Balanced Scorecard measures through a series of cause-and-effect relationships, and finally, a discussion of what is actually meant by the word *balance* in the Balanced Scorecard.

TWO FUNDAMENTAL ISSUES

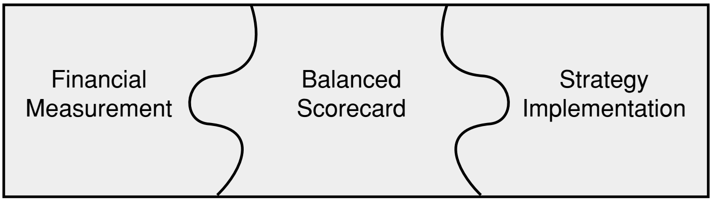
Welcome to your performance measurement and Balanced Scorecard journey. During our time together we will explore the many facets of this topic, and it is my hope that both you and your organization will be transformed as a result. As this book is being written, the Balanced Scorecard concept has been with us for just over 10 years. The Balanced Scorecard was born from a research study conducted in 1990 and has since become a critical business tool for thousands of organizations around the globe. In fact, recent estimates suggest that a whopping 50 percent of the *Fortune* 1000 has a performance management system (Balanced Scorecard) in place.[1] Before we discuss the nature of the Balanced Scorecard, let's examine its origins and attempt to determine just why it has become such a universally accepted methodology.

Two fundamental business issues have been greatly enhanced as a result of the Balanced Scorecard: the problem of effective organizational performance measurement and the critical issue of successful strategy implementation. In the following sections we'll examine both of these issues and then return to an overview of the Balanced Scorecard and discuss how it solves each. We'll begin with the subject of measurement—where we've been, what has changed, and where we're going (see Exhibit 1.1).

MEASURING ORGANIZATIONAL PERFORMANCE

Take another look at the quote from Lord Kelvin that opens this chapter: *"When you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind."* Over the years I have seen a lot of quotes on measurement posted on walls and in binders, and some are great, like this Einstein admonition: *"Not everything that can be counted counts, and not everything that counts can be counted."* When

Exhibit 1.1 The Balanced Scorecard Solves Fundamental Business Issues



you start the work of implementing your Scorecard project, it is a pretty good bet that at least one member of your team will have that quotation pasted somewhere in their workspace, and no wonder—the words are profound and revealing. But for sheer power of language I have to defer to the Lord Kelvin quote above. I love the words *meager* and *unsatisfactory*. To me, that paints a real picture of the importance of performance measurement. I don't know the specific date of Lord Kelvin's quote, but if we assume it was written around the middle of his life, say 1850, that is more than 150 years ago, and he is talking about the power and importance of measurement then. Measurement is every bit as important, no, more important than ever in today's environment.

While we are discussing sound bites, let's include one from the person many consider the greatest management thinker of our time, Peter Drucker. He suggests that few factors are as important to the performance of an organization as measurement, and measurement is among the weakest areas in management today. Is measurement really in such a deficient state? In 1987 a survey by the National Association of Accountants and Computer Aided Manufacturing-International (CAM-I) suggested that 60 percent of the 260 financial officers and 64 operating executives surveyed in the United States were dissatisfied with their performance measurement system.[2] The passage of time has apparently not improved the situation. More recent studies suggest that about 80 percent of large American companies want to change their performance measurement systems. The findings of these studies probably would not come as a great surprise to Bill Jensen. Jensen is the author of *Simplicity—The New Competitive Advantage*. In discussing performance management, Jensen suggests that most companies fail to provide employees with the information they need in a format and context that is relevant to their unique requirements. *"Working smarter means that any and all corporate data relevant to an individual's work should be available in formats that can be customized."*[3]

The research clearly demonstrates that many organizations both need and desire a change to their existing performance measurement systems, but is it possible to isolate any one key issue in the deficient state of performance measurement? Many would suggest the problem rests in our almost exclusive reliance on financial measures of performance.

Financial Measurement and Its Limitations

As long as business organizations have existed, the traditional method of measurement has been financial. Bookkeeping records used to facilitate financial transactions can literally be traced back thousands of years. At the turn of the twentieth century, financial measurement innovations were critical to the success of the early industrial giants like General Motors. That should not come as a surprise since the financial metrics of the time were the perfect complement to the machine-like nature of the corporate entities and management philosophy of the day. Competition was ruled by scope and economies of scale, with financial measures providing the yardsticks of success.

Financial measures of performance have evolved, and today the concept of economic value added (EVA) is prevalent. This concept suggests that unless a firm's profit exceeds its cost of capital, it really is not creating value for its shareholders. Using EVA as a lens, it is possible to determine that despite an increase in earnings, a firm may be destroying shareholder value if the cost of capital associated with new investments is sufficiently high.

The work of financial professionals is to be commended. As we move into the twenty-first century, however, many are questioning our almost exclusive reliance on financial measures of performance. Perhaps these measures would better serve as a means of reporting on the stewardship of funds entrusted to management's care rather than charting the future direction of the organization. Let's take a look at some of the criticisms levied against the overabundant use of financial measures:

- *Not consistent with today's business realities.* Today's organizational value-creating activities are not captured in the tangible, fixed assets of the firm. Instead, value rests in the ideas of people scattered throughout the firm, in customer and supplier relationships, in databases of key information, and cultures of innovation and quality. Traditional financial measures were designed to compare previous periods based on internal standards of performance. These metrics are of little assistance in providing early indications of customer, quality, or employee problems or opportunities.
- *Driving by rearview mirror.* Financial measures provide an excellent review of past performance and events in the organization. They represent a coherent articulation and summary of activities of the firm in prior periods. However, this detailed financial view has no predictive power for the future. As we all know, and experience has shown, great financial

results in one month, quarter, or even year are in no way indicative of future financial performance.

- *Tend to reinforce functional silos.* Financial statements are normally prepared by functional area: Individual department statements are prepared and rolled up into the business unit's numbers, which are ultimately compiled as part of the overall organizational picture. This approach is inconsistent with today's organization in which much of the work is cross-functional in nature. Today, we see teams comprised of many functional areas coming together to solve pressing problems and create value in never imagined ways. Our traditional financial measurement systems have no way to calculate the true value or cost of these relationships.
- *Sacrifice long-term thinking.* Many change programs feature severe cost-cutting measures that may have a very positive impact on the organization's short-term financial statements. However, these cost reduction efforts often target the long-term value-creating activities of the firm such as research and development, associate development, and customer relationship management. This focus on short-term gains at the expense of long-term value creation may lead to suboptimization of the organization's resources.
- *Financial measures are not relevant to many levels of the organization.* Financial reports by their very nature are abstractions. Abstraction in this context is defined as moving to another level, leaving certain characteristics out. When we roll up financial statements throughout the organization, that is exactly what we are doing—compiling information at a higher and higher level until it is almost unrecognizable and useless in the decision making of most managers and employees. Employees at all levels of the organization need performance data they can act on. This information must be imbued with relevance for their day-to-day activities.

Given the limitations of financial measures, should we even consider saving a space for them in our Balanced Scorecard? With their inherent focus on short-term results, often at the expense of long-term value-creating activities, are they relevant in today's environment? The answer is yes for a number of reasons. As will be discussed shortly, the Balanced Scorecard is just that: balanced. An undue focus on any particular area of measurement will often lead to poor overall results. Precedents in the business world support this position. In the 1980s the focus was on productivity improvement, while in the 1990s quality became fashionable and seemingly critical to an organization's success. In keeping with the principle of what gets measured gets done, many businesses saw tremendous improvements in productivity and quality. What they didn't necessarily see was a corresponding increase in financial results, and in fact some companies with the best quality in their industry failed to remain in business. Financial statements will remain an important tool for organizations since they ultimately determine whether improvements in customer satisfaction, quality, on-time delivery, and innovation are leading to improved financial performance and wealth creation for shareholders. What we need is a method of balancing the accuracy and integrity of our financial measures with the drivers of future financial performance of the organization.

The Strategy Story

Strategy formulation is quite possibly the most discussed and debated topic on the business landscape. For generations of business leaders the development of a winning strategy was often seen as the key differentiator of organizational success. Executives, academics, and consultants alike, all searching for the panacea of a winning strategy, have shaped the subject and contributed to the debate. Their work over the years has not been unproductive, and in fact has led to the development of numerous schools of strategic thought. In *Strategy Safari,* Mintzberg, Ahlstrand, and Lampel identified 10 such schools. They document strategy setting as formal processes, mental processes, emergent processes, and negotiation processes, to name but a few.[4]

As with financial metrics, strategy has come under fire recently by those who suggest our dynamic and rapidly evolving business environment render a long-term strategy ineffective and almost instantly obsolete. Proponents of this school do not believe business has the luxury of pausing to develop a strategy and doing so creates a debilitating inflexibility. Not so, says Michael Porter, perhaps the world's best-known academic thinker on the subject of strategy. He takes an opposite view and suggests that strategy has never been more important. Profitability in many industries is under pressure as a result of the practices of some Internet pioneers. Porter suggests that these organizations have competed in a manner that directly contradicts the laws of effective strategy. Specifically, these organizations have:

- Focused on revenue and market share through heavy discounting, giveaways, and advertising rather than profits.
- Avoided the delivery of real value and instead concentrated on indirect revenue from advertising, and "click-through fees" from partners.
- Attempted to be all things to all markets by offering myriad products and services rather than making the difficult trade-offs associated with strategy formulation.

By ignoring the fundamentals of strategy, these companies have adversely affected their industry structures, making it more difficult for anyone to gain a competitive advantage. As a result, it is more important than ever for companies to distinguish themselves from their competition. Porter suggests sustainable competitive advantage through operational effectiveness, and strategic positioning holds the answer.[5]

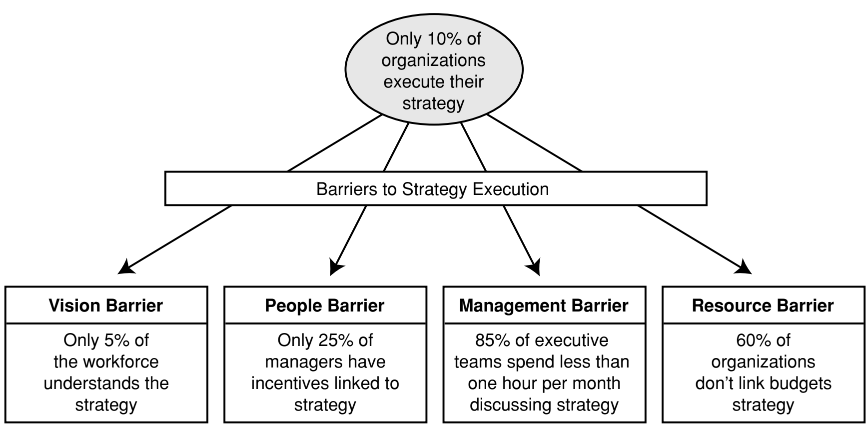
Implementing Strategy

If we accept the premise that strategy formulation is as critical in today's fast-paced, rapidly evolving business environment as it ever was, then we can move to a more fundamental issue—the effective implementation of strategy. While the development of winning strategies has never been a simple task, the successful implementation of those strategies has been a much more daunting task indeed. A 1999 *Fortune* magazine story suggested that 70 percent of chief executive officer (CEO) failures came not as a result of poor strategy, but of poor execution.[6] Why is strategy so difficult for even the best organizations to effectively implement? Research in the area has suggested a number of barriers to strategy execution, and they are displayed in Exhibit 1.2. Let's take a look at these in turn.

The Vision Barrier

The vast majority of employees do not understand the organization's strategy. This situation sufficed at the turn of the twentieth century when value was derived from the most efficient use of physical assets, and employees were literally cogs in the great industrial wheel. However, in the information or knowledge age in which we currently exist, value is created from the intangible assets—the know-how, relationships, and cultures existing within

Exhibit 1.2 The Barriers to Implementing Strategy



Adapted from material developed by Robert S. Kaplan and David P. Norton.

the organization. Most companies are still organized for the industrial era, utilizing command and control orientations that are inadequate for today's environment. Why is this the case when all evidence suggests a change is necessary? S.I. Hayakawa introduced a concept known as *cultural lag* over 50 year ago, and it goes a long way in explaining this organizational inertia. Hayakawa states, *"Once people become accustomed to institutions, they eventually get to feeling that their particular institutions represent the only right and proper way of doing things . . . consequently, social organizations tend to change slowly, and—most important—they tend to exist long after the necessity for their existence has disappeared, and sometimes even when their continued existence becomes a nuisance and a danger."*[7] Does this remind you of your company? If your structure is hampering employees' ability to understand and act on the firm's strategy, how can they be expected to make effective decisions that will lead to the achievement of your goals?

The People Barrier

Incentive compensation arrangements have been with us for quite some time, but have they been linked to the right things? Most systems provide rewards for the achievement of short-term financial targets, not long-term strategic initiatives. Recall the earlier admonition: What gets measured gets done. When the focus is on achieving short-term financial targets, clever employees will do whatever it takes to ensure those results are achieved. This often comes at the expense of creating long-term value for the firm.

The Resource Barrier

Sixty percent of organizations don't link budgets to strategy. This finding really should not come as a surprise to us because most organizations have separate processes for budgeting and strategic planning. One group is working to forge the strategy that will lead the firm heroically into the future, while independently another group is crafting the operating and capital budgets for the coming year. The problem with this approach is that human and financial resources are once again tied to short-term financial targets and not long-term strategy. I recall my days working in a corporate accounting environment for a large company. I was housed on the same floor as the strategic planners, and not only did our group not liaise regularly with them—we barely even knew them!

The Management Barrier

How does your executive team spend their time during their monthly or quarterly reviews? If yours is like most organizations, they probably spend the majority of their time analyzing the financial results and looking for remedies to the "defects" that occur when actual results do not meet bud-