BALANCED SCORECARD STEP-BY-STEP

Maximizing Performance and Maintaining Results

Second Edition

Paul R. Niven

WILEY

John Wiley & Sons, Inc.

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This being a second edition it seems fitting that

I dedicate the book to my "second parents," my wife's

mother and father, Harry and Pat Ackstein.

Thank you both for your love, generosity, and support.

About the Author

Paul R. Niven is a management consultant and noted speaker on the subjects of performance management and the Balanced Scorecard. As both a practitioner and consultant he has developed successful performance management systems for organizations large and small around the globe. His clients include Fortune 500 companies, public sector agencies from all levels, and nonprofit organizations. He may be reached through his Web site at www.senalosa.com.

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Preface

Four years ago I wrote *Balanced Scorecard Step-by-Step* to provide a systematic implementation guide to readers incorporating or considering incorporating the Balanced Scorecard methodology in their organization. My experiences as a Balanced Scorecard practitioner with a large Canadian company taught me that tremendous results are possible with the tool, but to attain those results, you must overcome numerous pitfalls that can derail or significantly damage the implementation effort. I have been amazed and humbled at the success of the first edition, which has now been translated in over a dozen languages. The many e-mails, calls, and letters I have received from readers who have benefited in some way from the guidance offered in the book have been very gratifying and demonstrate that, with a little help, every organization can derive tremendous success from the Balanced Scorecard system.

This second edition contains the same core implementation guidance found in the original volume but has been updated and enhanced to include guidance on a number of topics that were still relatively immature as of the first printing in 2002. The most significant change is my expanded coverage of strategy maps, powerful communication tools signaling to the entire workforce (and beyond) what is critical in executing the organization's strategy. The text also provides new and updated information on the linkage between the Balanced Scorecard and corporate governance, the critical importance of strategy-centered management meetings, and an emerging trend, the Office of Strategy Management. In addition to entirely new sections, you will find the latest thinking on all aspects of the Balanced Scorecard journey, honed from my work as a consultant and researcher.

THE BALANCED SCORECARD

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, many are dissatisfied with their measurement efforts. In fact, at any given time, as many as 50 percent of organizations are making changes to their performance measurement systems.[1]

Increasingly, organizations are concluding 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. Although the methods of modern business have transformed dramatically over the 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. These systems may have been perfectly suited to the machinelike, physical asset–based nature of early industrial endeavors, but 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 importance of a differentiating strategy is more important today than it has ever been. Whether you're a high-tech newcomer or an established manufacturing veteran, executing strategy effectively is crucial in an era of globalization, customer power, 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 for all of an organization's stakeholders and, in the process, to allow organizations to implement their differentiating strategies successfully. 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 Process, and Employee Learning and Growth. Organizations around the globe have embraced the Balanced Scorecard and reaped swift benefits from its commonsense principles. Such benefits include increased financial returns, greater employee alignment with overall goals, improved collaboration, and an 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.

1. Mark L. Frigo, "The State of Strategic Performance Measurement," *IMA 2001 Survey.*

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 customer loyalty, and ultimately deliver breakthrough financial performance. But how could the strategy be executed successfully? 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 just described is Nova Scotia Power, Inc. (NSPI), a Canadian electric utility company. As the results demonstrate, its Balanced Scorecard implementation was a great success and has been featured in case studies and shared at conferences throughout North America and beyond, and has earned the organization a spot in the Balanced Scorecard Collaborative's Hall of Fame. As successful as the implementation was, however, it was not without challenges. Our team quickly learned that building a Balanced Scorecard is far more than a metrics project; instead it touches many disparate organizational processes. Building an effective team; generating support and enthusiasm for a change initiative; efficiently gathering and sharing data; and 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. Although Scorecard literature and related consulting and support products have proliferated in recent years, few if any focus on the wide array of organizational activities that must accompany a winning Scorecard campaign. This book has been written to fill the void existing between theory and application. Since its original publication in 2002, it has guided thousands of organizations worldwide through their Balanced Scorecard journeys.

Organizations embarking on a Scorecard effort must be aware of—and properly equipped with the tools to navigate successfully—the many potential pitfalls associated with an initiative of this magnitude. Based on my experience as a consultant working with organizations around the globe plus extensive research, these pages guide the reader through the entire

Balanced Scorecard process on a step-by-step basis. From determining your guiding rationale for the Scorecard, to testing your mission, to building a Strategy Map, 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

This second edition of *Balanced Scorecard Step-by-Step* is comprised of 12 chapters, spanning the entire Scorecard experience. The opening chapter is designed to familiarize you with the field of performance measurement and provide a solid grounding of Scorecard background and principles. It elaborates on the discussion begun in this preface by examining how the Scorecard solves three fundamental modern business issues: reducing the reliance on financial performance measures, the rise of intangible assets to value creation, and the difficulty of implementing strategy. Chapter Two lays the foundation for the work ahead by examining the purpose of developing 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 Three. 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 Four explores the world of Strategy Maps, powerful communication tools signaling to everyone in the organization what is critical in executing strategy. You will learn why Strategy Maps are a decisive ingredient to overall Scorecard success and be provided with numerous tips on development and facilitation. Chapter Five provides an in-depth view of what it takes to build measures that act as a faithful translation of strategy, the backbone of any successful Balanced Scorecard. The critical role of target setting and the Balanced Scorecard is presented along with a review of different types of targets in Chapter Six. Ensuring that organizational plans and initiatives are aligned with the Balanced Scorecard and strategy is also given extensive coverage in that chapter.

Aligning every employee's actions with overall organizational goals is the subject of Chapter Seven. This "cascading" of the Balanced Scorecard is critical if organizations hope to enjoy the benefits of greater employee knowledge of, and focus on, key organizational strategies. In Chapter Eight 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 Nine, where you will find a comprehensive review of critical compensation planning and design elements. This chapter also reviews how the Balanced Scorecard can play a significant role in the improvement of corporate governance, a vital topic in the post-Enron era.

Frequent reporting of results is critical in gaining support for the Balanced Scorecard as an effective management tool. But should organizations purchase one of the many performance management software packages available or build their own reporting solution? Chapter Ten probes this question and offers several tools to be used when making the decision. The strategy-centered meeting is also explained in the chapter, providing the means to ensure the Balanced Scorecard forms the agenda for your management meeting process. Maintaining the Balanced Scorecard is presented in Chapter Eleven. It carefully reviews business rules, processes, and procedures (including those for gathering data) necessary to embed the Scorecard in the fabric of organizational life and introduces you to an emerging function in modern organizations: the Office of Strategy Management. 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 10 implementation issues and receive guidance on the use of outside consultants when constructing a Scorecard.

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
August 2006

Acknowledgments

When people learn I have written a number of books, among the first questions they ask is "How long does it take?" Since in addition to being a writer I am also a consultant, I typically default to the classic response of "it depends," as many factors contribute to the duration of the process, including: the amount of research required, maturity of the subject matter, experience with the topic, and of course other commitments that life lays in your path. Despite my fence-sitting answer, there is one thing I can say with virtual certainty: If it weren't for the keen insights, generosity of time and spirit, and passion of others, my books could not be written. And so it is with tremendous gratitude and deep appreciation that I thank the following individuals for their invaluable guidance, encouragement, and commitment both to me and to the ideals of the Balanced Scorecard.

I will begin with some of the many clients whose conference rooms and offices I have used as a laboratory for these many years and whose experiences and insights form the scaffolding that allowed these pages to emerge. From Aliant, Jay Forbes and Dennis Barnhart; Amy Kosifas from the Unified Port of San Diego; Norio Mitsubayashi and Stan Romanoff from Brother Industries (USA, Inc.); Marlon Fuentes, Junie Villongco, Jim Mahoney, Bart Johnson, Jake Reyes, Kevin Tirrell, and Leo Casco of Financial Freedom; from Ingram Micro, Krista Arellano and Jim Annes; Laurie Cason of the United States Navy; Ronnie Hepp and Mike Morino from the Recreation Vehicle Dealers Association; Allan Kingston and Regina Korossy of Century Housing; and Dr. Tom Lynch and Vicki Lynn of the Worcester Polytechnic Institute.

Many others have contributed to this book, including my editor Tim Burgard from John Wiley & Sons, Hazel Wiggington and Holly Smith of H2 Performance Consulting, Vik Torpunuri of e2e Analytix, Chuck Salmond of Bearing Point, J. P. Kirton of QPR Software, and Joe and Catherine Stenzel, editors of the *Journal of Cost Management*.

Finally, and most important, I would like to thank my wife, Lois. While I wrote this book she acted once again as first-line manuscript editor, chief supporter, and, through it all, a constant source of encouragement and love.

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 chapter is to provide you with an overview of performance measurement and the Balanced Scorecard system. Although you may be eager 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 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 system, 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 engage 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 three key issues: effective organizational performance measurement, the rise of intangible assets, and the challenge of implementing strategy. We begin by discussing performance measurement and, specifically, our reliance on financial measures of performance despite their inherent limitations. Next we examine the rise of intangible assets in modern organizations and their impact on our ability to measure corporate performance accurately. 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, the growth of intangible assets, 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 *communication system* (with particular emphasis on the concept of Strategy Maps), *measurement system,* and *strategic management system.* Here 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 a review of the critical task of linking Balanced Scorecard objectives and measures through a series of cause-and-effect relationships, where you will discover how telling a powerful strategic story will be a great ally in your Balanced Scorecard implementation. Let's get started!

THREE 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 I write this second edition of *Balanced Scorecard Step-by-Step,* the concept itself has been with us for just over 15 years. Born from a research study conducted in 1990, the Balanced Scorecard has since become a critical business tool for thousands of organizations around the globe. In fact, recent estimates suggest a whopping 60 percent of the Fortune 1000 has a Balanced Scorecard in place.[1] Further evidence of the ubiquity of the Balanced Scorecard is provided by The Hackett Group, which discovered in 2002 that 96 percent of the nearly 2,000 global companies it surveyed had either implemented or planned to implement the tool.[2] 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.

Whether it's the freckle-faced kid enthusiastically peddling lemonade on a sweltering midsummer's day, the chief executive of a global conglomerate mulling a crucial decision, or a harried public sector manager attempting to do more with less, the common denominator among all is the overwhelming drive to succeed. And while hard work and desire still go a long way, business, as we all know, has changed dramatically in recent years, rendering success more difficult than ever to achieve. In the pages ahead we'll examine three fundamental factors that affect every organization, at times in game-changing ways: our reliance on financial measures of performance to gauge success, the rise of value-creating intangible assets, and, finally, the difficulty of executing strategy. While separate and distinct factors, the trio is bound together by the inspiring ability of the Balanced Scorecard to overcome and maximize them to their fullest potential. Let's begin our discussion with an examination of financial measures of business 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 be traced back literally thousands of years. At the turn of the twentieth century, financial measurement innovations were critical to the success of the early industrial giants, such as General Motors. That should not come as a surprise since the financial metrics of the time were the perfect complement to the machinelike 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 concepts such as economic value added (EVA) are quite prevalent. EVA 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 served better as a means of reporting on the stewardship of funds entrusted to management's care rather than as a way to chart the future direction of the organization. And as we all know, stewardship is an increasingly vital issue in light of the many corporate scandals we've witnessed recently and the surge of shareholder value and job losses left in their wake. 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 in cultures capable 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. We'll examine the rise of intangible assets in the next section of this chapter.
- *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 as experience has shown, great financial results in one month, quarter, or even year are in no way indicative of future financial performance. Even so-called great companies—those that once graced the covers of business magazines and were the envy of their peer groups—can fall victim to this unfortunate scenario. Witness the vaunted Fortune 500 list; two-thirds of the companies comprising

the inaugural list in 1954 had either vanished or were no longer large enough to maintain their presence on the list's fortieth anniversary.[3]

- *Tend to reinforce functional silos.* Financial statements in organizations are normally prepared by functional area: Individual department statements are prepared and rolled up into the business unit's numbers, which ultimately are 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. Regardless of industry or organization type, teamwork has emerged as a must-have characteristic of winning enterprises in today's business environment. As an example, consider these three fields of endeavor: heart surgery, Wall Street research analysis, and basketball as played by the well-compensated superstars of the National Basketball Association (NBA). At first glance they appear to have absolutely nothing in common; however, studies reveal that success in all three is markedly improved through the use of teamwork: The interactions of surgeons with other medical professionals (anesthesiologists, nurses, and technicians) are the strongest indicator of patient success on the operating table. When it comes to Wall Street "stars," it's not the individual analyst and erudite calculations that spell success, but the teaming of analyst and firm. Even in the NBA, researchers have found that teams where players stay together longer win more games.[4] 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. Interestingly, an emerging body of evidence is beginning to suggest that cost-cutting interventions such as downsizing frequently fail to deliver the promised financial rewards and in fact sabotage value. University of Colorado Business School professor Wayne Cascio documented that downsizing not only hurts workers who are laid off, but destroys value in the long-term. He finds that, all else being equal, downsizing never improved profits or stock market returns.[5]
- *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? I believe the answer is yes for a number of reasons. As we'll discuss shortly, the Balanced Scorecard is just that: balanced. An undue focus on any particular area of measurement often will lead to poor overall results. Precedents in the business world support this position. In the 1980s the focus was on productivity improvement; 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, innovation, and employee training are leading to improved financial performance and wealth creation for shareholders. What is needed, and what the Balanced Scorecard provides, is a method of balancing the accuracy and integrity of our financial measures with the drivers of future financial performance of the organization.

The Rising Prominence of Intangible Assets

What a difference 50 or so years can make. Writing in the *Harvard Business Review* in 1957, Harvard professor Malcolm P. McNair had this to say about organizations paying excess attention to their people: *"Too much emphasis on human relations encourages people to feel sorry for themselves, makes it easier for them to slough off responsibility, to find excuses for failure, to act like children."*[6] Can you imagine the reaction business leaders would have to this quote if it were uttered today? What was your reaction? If you're like most, you would probably disagree completely with McNair's pessimistic view and instead assert the now-prevailing notion that an organization's people—its "human capital"—represent the critical enabler in the new economy. *Harvard Business Review* editor Thomas Stewart recently captured the essence of this notion succinctly and powerfully when he said, *"The most important of all are 'soft' assets such as skills, capabilities, expertise, cultures, loyalties and so on. These are the knowledge assets—intellectual capital—and they determine success or failure."*[7]

In the previous section we discussed some of the limitations financial measures possess. Given these limitations and the growth in prominence of human capital, both business and investment communities are placing ever-increasing emphasis on nonfinancial indicators of performance. Business leaders are now questioning their almost exclusive reliance on financial data with its historical accuracy and integrity and have begun to look at the operational drivers of future financial performance: customer satisfaction and loyalty, continuous innovation, and organizational learning, to name but a few. On the investor side, Wall Street has made it clear that nonfinancial data matters greatly to valuation and is growing in prominence all the time. A 1999 Ernst & Young study found that "even for large cap, mature companies, non-financial performance counts."[8] One of the study's findings suggests that, on average, nonfinancial criteria constitute 35 percent of the investor's decision. The researchers also found that "the more non-financial measures analysts use, the more accurate are their earnings forecasts."[9] But just what is "human capital," and why is it important to the future of the Balanced Scorecard?

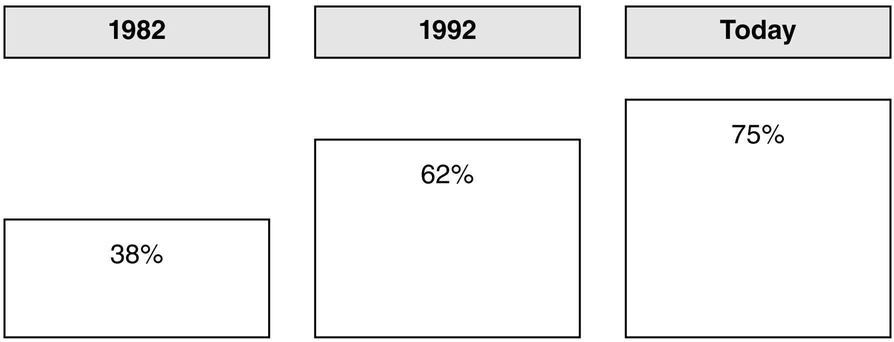
Before terms like "human capital," "intellectual capital," and "intangible assets" entered the business lexicon, there was another metaphor sweeping across organizations: "the employee as asset." Annual reports, press releases, and business literature were awash in statements proclaiming the great value companies placed in their human assets. By recognizing the value individuals bring to the firm, this metaphor represented a great improvement over the "employee as a cost object" philosophy that lay at the heart of the downsizing movement of the early 1990s. But consider the definition of an asset from our accounting studies: an object owned or controlled by the firm that produces future value and possesses a monetary value. Do we employees really fit that definition? Another school of thought has gradually developed that likens the employee more to an investor of human capital than an asset to be controlled by the organization. Author, consultant, and Babson college professor Thomas Davenport cogently describes this new paradigm: "*People possess innate abilities, behaviors, personal energy and time. These elements make up human capital—the currency people bring to invest in their jobs. Workers, not organizations, own this human capital . . . and decide when, how, and where they will contribute it.*"[10] The late Peter Drucker would label these investors "knowledge workers" and suggest they hold the key to value creation in the new economy. For the first time in business history the workers, not the organization, own the means of production—the knowledge and capabilities they possess—and they decide how and where to apply it.

CREATING VALUE IN THE NEW ECONOMY

Consulting organizations offer a compelling example of creating value from intangible rather than physical assets. Consultants don't rely heavily on tangible assets; instead they provide value for clients by drawing on relationships with subject matter experts throughout the firm and knowledge from past client experiences to provide innovative solutions. A client engagement I was involved with provides an example: The clients encountered a problem in loading data for their new performance measurement software. Building automatic data interfaces for the software (pulling data directly from source systems throughout their locations) would require significant human and financial resources and was not considered a viable option. The alternative of manual data entry was also deemed unacceptable as it would prove a time-consuming and non–value-added activity for system administrators. Our team was tasked with finding an innovative and cost-effective solution. We convened a team of experts on various subjects: the Scorecard software program, the Balanced Scorecard methodology, desktop applications such as MS Access and MS Excel, and client data sources. The newly formed team brainstormed various approaches that would satisfy the criteria of cost efficiency and very limited manual data entry efforts. In the end we determined our best approach was to build a new data entry tool in Excel. Data owners would enter their individual data in the spreadsheet and e-mail it to the system administrator, who would then automatically upload the information into the software. The spreadsheets were custom designed to contain only those measures for which each owner was accountable. This solution ensured both criteria were satisfied. The new system would cost very little to develop and implement and would eliminate manual data entry for system administrators. It wasn't the physical assets that led to this innovative solution to a client's needs, but instead the skillful combination of an array of knowledge held by the individual team members.

The situation just described is happening in organizations around the globe as we make the transition from an economy based on physical assets to one almost fully dependent on intellectual assets. While this switch is evident to anyone working in today's business world, it is also borne out by research findings of the Brookings Institute. Take a look at Exhibit 1.1, which illustrates the transition in value from tangible to intangible assets. Speaking on National Public Radio's *Morning Edition,* Margaret Blair of the Brookings Institute suggests that tangible assets have continued to tumble in value: "*If you just look at the physical assets of the companies, the things that you can measure with ordinary accounting techniques, these things now account for less than one-fourth of the value of the corporate sector. Another way of putting this is that something like 75% of the sources of value inside corporations is not being measured or reported on their books.*"[11] If you happen to be employed in the public sector, you may have noticed that Blair uses the term "corporations" in the quote. Believe me, your organizations are being affected every bit as much as your corporate counterparts. The challenges represented by this switch are not going unnoticed in Washington. David M. Walker, Comptroller General of the United States, said in February 2001 testimony to the U.S. Senate that "*human capital management is a pervasive*

Exhibit 1.1 Increasing Value of Intangible Assets in Organizations



challenge in the federal government. At many agencies human capital shortfalls have contributed to serious problems and risks."[12] U.S. President George W. Bush in his President's Management Agenda echoes Walker's comments and adds: *"We must have a Government that thinks differently, so we need to recruit talented and imaginative people to public service.*"[13] In yet another demonstration of the importance of intangible assets, companies are opening the purse strings for intellectual investments. (On second thought, opening the purse strings is a bit like saying World War II was a little skirmish, considering the fact that American companies spend a staggering 36 percent of their revenue each year on human capital–related investments.[14])

This transition in value creation from physical to intangible assets has major implications for measurement systems. The financial measurements that characterize our balance sheet and income statement methods of tabulation were perfectly appropriate for a world dominated by physical assets. Transactions affecting property, plant, and equipment could be recorded and reflected in an organization's general ledger. However, the new economy with its premium on intangible value-creating mechanisms demands more from our performance measurement systems. Today's system must have the capabilities to identify, describe, monitor, and fully harness the intangible assets driving organizational success. As we will see throughout this book, particularly in our discussion of the Employee Learning and Growth perspective, the Balanced Scorecard provides a voice of strength and clarity to intangible assets, allowing organizations to benefit fully from their astronomical potential.

The Strategy Story

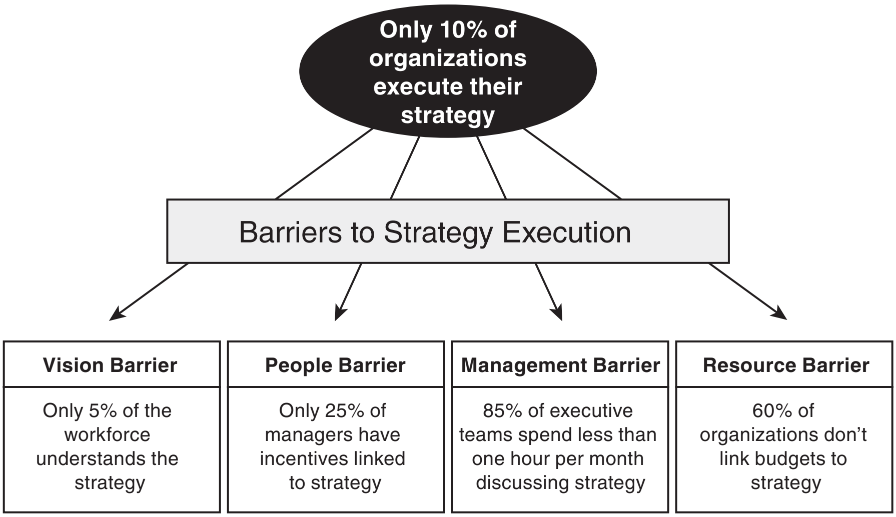
Could there possibly exist a more passionately discussed and debated subject on the business landscape than strategy? While military strategy has been with us for millennia and continues to influence our thinking—witness the ever-popular *Art of War* by Sun Tzu—business strategy is a relatively new phenomenon with its greatest contributions arriving in the twentieth century. Despite its brief tenure, the topic has spawned hundreds of books, thousands of scholarly articles, and countless gurus each espousing his version of the holy grail of strategy.

In every facet of my life I've always tried to cut through the clutter and arrive at the essence of an idea, the pearl of wisdom or nugget of knowledge I can use to effectively direct my energies. If I applied that same process to the pursuit of strategy's "one thing" I would surely drive myself slowly mad. You see, strategy is not a subject that can be ripped apart at the academic and practical threads to reveal the one right method or version of the truth. Every reader of this book, if appropriately prodded, could undoubtedly produce a coherent and cogent definition of "strategy." Ultimately we all cherish that spirit of discovery and rightly applaud our diversity of ideas, but practically, it makes the study of strategy a frustrating one. Fortunately for all of us, the one thing that pundits from every strategy corner do agree on is the fact that strategy execution or implementation is far more important than strategy formation.

During my career I've had the opportunity to sit in on a number of strategy-setting workshops and have always relished the spirited debates, the "aha" moments of breathtaking clarity, and of course the ever-present jugs of coffee and gourmet cookies. The freshly minted strategy emerging from these often grueling sessions is a justifiably pride-invoking achievement; however, producing this document is a far cry from actually living and breathing it day in and day out. But to succeed in any business today, that is precisely what we must do—bring the strategy to life with the unmistakable clarity necessary for everyone in the organization to act on it each and every day. Let's face it: We have to execute not only to thrive but simply to stay alive in a business world in which 84 percent of respondents in one recent poll said that competition in their industry had significantly increased in the last five years.[15] And leaders, you know how vital it is to execute your strategy quickly; an oft-quoted *Fortune* magazine study from 1999 found that 70 percent of CEO failures came not as a result of poor strategy but the inability to execute.[16] In fact, a team of researchers recently discovered that companies, on average, deliver only 63 percent of the financial performance their strategies promise.[17]

The good news is that strategy implementation has been proven to boost financial fortunes rather significantly; one study suggested a 35 percent improvement in the quality of strategy implementation for the average firm was associated with a 30 percent improvement in shareholder value.[18] Unfortunately, many organizations fall off the strategy execution track, frequently in dramatic fashion. So why does strategy execution prove so elusive for the typical enterprise? Scorecard architects Robert S. Kaplan and David P. Norton believe the answer lies in four barriers that must be surmounted before strategy can be effectively executed. These barriers are presented in Exhibit 1.2.

Exhibit 1.2 Barriers to Implementing Strategy



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

The Vision Barrier The vast majority of employees do not understand the organization's strategy. This situation was acceptable 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 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? Former United States Senator and college professor S. I. Hayakawa introduced a concept known as "cultural lag" over 50 years 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."*[19] 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 you expect them to make effective decisions that will lead to the achievement of your goals?

The People Barrier In its 2005 Reward Programs and Incentive Compensation Survey, the Society for Human Resource Management found that