BALANCED SCORECARD STEP-BY-STEP FOR GOVERNMENT AND NONPROFIT AGENCIES

Paul R. Niven

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For my wife Lois, with much love and many thanks

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Preface

While researching this book, I had the pleasure to speak with many people working in, and involved with, both the nonprofit and government fields. Intent on supplementing my own knowledge of these organizations, I subjected those charitable enough to share their time with me to dozens of questions on every conceivable topic of even remote relevance to the Balanced Scorecard. One person, however, turned the tables on me. Dennis Feit, of the Minnesota Department of Transportation, began our interview by putting forth these questions to me: "You're trying to change something with this book. What is it?"' And, second, "Why is that important?" In many respects this entire book represents my answer to his challenging and valuable questions. However, in this short space I will provide a condensed response, and in so doing introduce you to what lies ahead.

In the early 1990s, Robert Kaplan and David Norton sought to solve a measurement problem plaguing corporations around the globe. The dynamics of business were changing rapidly; globalization, customer knowledge, and the rise of intangible assets were all rapidly converging to forever change the way business was conducted. Strategy was considered a potent defense for succeeding in this changing landscape. However, the facts suggested that approximately 90 percent of organizations were unable to execute their strategies.

Kaplan and Norton made the startling discovery that performance measurement systems utilized by most firms were not capable of providing the information needed to compete in this new knowledge economy. Most were remarkably unchanged from those developed by the early industrial giants at the turn of the twentieth century. Characterized by an almost exclusive reliance on financial measures of performance, these systems were ill prepared for the challenges faced by modern organizations. Kaplan and Norton believed that organizations should attempt the introduction of balance to their measurement systems. Specifically, the historical accuracy and integrity of financial measures must be balanced with the drivers of future financial performance in an attempt to view a wider spectrum of performance and execute strategy. Their radical, yet profoundly simple approach was labeled the Balanced Scorecard, and featured measurement in four distinct, yet related areas: customer, internal processes, employee learning and growth, and financial.

Since its introduction in 1990, the Balanced Scorecard has been embraced by corporations around the world. Recent estimates suggest at least 50 percent of Fortune 1000 organizations use a Balanced Scorecard system. For-profit companies have used the system to generate improved financial results, align employees with strategy, base resource allocation decisions on company goals, and improve collaboration.

Public and nonprofit agencies have been slower to accept the Balanced Scorecard system of performance measurement. Many possible explanations exist, including the reluctance to experiment with tools conceived with a for-profit audience in mind, and the notion that measurement efforts may obscure the true mission orientation of the organization. These justifications, and others like them, are what I am attempting to change with this book. In my work as a Scorecard practitioner and consultant, I have seen this remarkably adaptable tool successfully applied in organizations large and small, public, private, and nonprofit alike. Now, why is this important?

Are nonprofit and government organizations so dissimilar to their private sector colleagues that a Balanced Scorecard approach to measurement is irrelevant? While you're considering your response, review this quote: *"The issues are many and complex, but taken together they might be characterized by two superordinate and related challenges—sustainability and the ability to adapt to a rapidly changing world. Organizations must cope with increased competition, more diversity among constituents, higher expectations from the public, increasing costs, declining support, rapidly changing technology, and substantially different ways of conducting business. Surviving in such an environment (sustainability) depends upon the ability to adapt."*[i] If you believed this was written in reference to modern corporations, you're wrong. This quote was specifically directed toward nonprofit organizations. Your challenges, as clearly articulated, are remarkably similar to those of private-sector firms. Modern corporations facing increased competition, increasing costs, and diverse constituents have embraced the Balanced Scorecard as a beacon to guide them through these dark woods of change all around us. There is no reason to believe nonprofits, facing virtually identical challenges, will not derive the same, if not greater, benefits.

The lines separating public and private organizations are equally blurry. In an era when investor demands of greater disclosure and increased governance are pounding boardrooms across the nation, public-sector agencies face equally vexing challenges. Demands of accountability and transparency in public-sector performance are ringing ever louder. A consistent information and reporting framework for performance is widely viewed as inhibiting their ability to draw the curtain on performance and results. Forward-thinking public-sectors agencies, representing all levels, are beginning to see the benefits offered by a Balanced Scorecard system in this arena. The City of Charlotte, North Carolina, profiled in Chapter Thirteen, has been using the system for several years and credits it with focusing employees on strategy and improving overall city results.

Making the transition to this new world of measurement is not without its share of potential pitfalls. This book has been written to help you navigate this sea of change and to capitalize on the many benefits of the Balanced Scorecard, while concurrently avoiding costly implementation errors. Here's a look at what you'll find in the chapters ahead.

HOW THE BOOK IS ORGANIZED

Our Balanced Scorecard journey together consists of 14 chapters separated into four distinct, yet related, parts. Part One serves as an introduction to the field of Performance Measurement and, more specifically, the Balanced Scorecard. Chapter One introduces the Scorecard tool, providing an historical perspective and discussing the many facets of this tool. Adapting the Balanced Scorecard to the public and nonprofit sectors is the subject of Chapter Two. You'll learn that with only minor "geographical" modifications, the Balanced Scorecard is well suited to meet your measurement challenges.

Upon embarking on a Balanced Scorecard implementation, you'll quickly discover it is more than a "measurement" initiative. In fact, the Scorecard will touch many disparate elements of your organization. Part Two of the book, "Pouring the Foundation for Balanced Scorecard Success," outlines the many and varied elements that must be in place to ensure your Scorecard outcomes are successful. Chapter Three, entitled "Before You Begin," discusses a number of items that you must consider prior to building a Scorecard, including: your rationale for developing a Scorecard, gaining executive sponsorship for the initiative, and building an effective team. Many organizations rush into the Scorecard building process without the aid of training on the subject. Poorly designed Scorecards, and little if no alignment throughout the organization, frequently result from this decision. Chapter Four provides a training curriculum for your Balanced Scorecard initiative and discusses the importance of communication planning. Chapter Five begins the transition to the core elements of the Balanced Scorecard, specifically addressing mission, values, and vision. The Scorecard will ultimately act as a translation of these critical enablers of organizational success. In this chapter we'll explore the nature of these critical enablers and I'll offer tools for developing or refining your current statements. Strategy is at the core of every Balanced Scorecard, and Chapter Six examines this widely discussed, but often poorly understood subject. A straightforward approach for developing strategy is offered. Part Two ends with an examination of the Balanced Scorecard's place within the larger context of your performance management framework. The Scorecard will not exist in a vacuum, so you must determine how it complements your current management framework.

In Part Three of the book, "Developing Your Balanced Scorecard," you'll take a guided tour through the development of a strategy map and Balanced Scorecard. Chapter Eight outlines the strategy map concept, that of graphically displaying the key objectives that serve as the translation of your strategy. The critical concept of cause and effect is also explored. Chapter Nine fills in the remaining pieces of your Scorecard, with measures, targets, and initiatives. You'll learn how to develop measures in each of the four perspectives, why targets are critical, and how initiatives can mean the difference between success and failure on performance.

The final part of the book, Part Four, "Maximizing the Effectiveness of the Balanced Scorecard," is dedicated to helping you get the most out of your Balanced Scorecard system. We begin in Chapter Ten, which probes the concept of cascading the Balanced Scorecard. This term refers to the process of generating goal alignment throughout the organization through the development of Balanced Scorecards at each and every level of the agency. In an era of shrinking budgets, we're constantly reminded of the importance of aligning spending with results. Chapter Eleven provides a method of linking the Balanced Scorecard to your budgeting process, and in so doing aligning spending with strategy. Chapter Twelve canvasses the many reporting options available to Scorecard-adopting organizations. Whether you choose to buy an automated software package or develop your own tool, in this chapter, you'll find the information you need to make an informed decision. In Chapter Thirteen we're treated to an insider's view of the highly successful Balanced Scorecard implementation at the City of Charlotte, North Carolina. These pioneers of public sector Scorecard use share the secrets of their success, along with the challenges they've faced. The book concludes in Chapter Fourteen with a glimpse into what is necessary to sustain your Scorecard success. We'll examine the dynamic nature of the Balanced Scorecard and consider key roles necessary to maintain your momentum. The book also includes a glossary of key Balanced Scorecard and Performance Management terms.

It's a pleasure to serve as your guide through the rewarding territory that is the Balanced Scorecard. My goal is to steer you through the terrain that follows by offering a text that is exhaustive in scope without being excessively complex or unduly simplistic. Let's get started!

Paul R. Niven
San Diego, California
January 2003

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[i] Thomas Wolf, *Managing a Nonprofit Organization in the Twenty-First Century* (New York: Fireside, 1999), p. 314.

Acknowledgments

Isaac Newton once remarked, "If I have seen farther than others, it is because I was standing on the shoulders of giants." And so it is that I am able to deliver this book to you. The individuals mentioned below, and countless others, are largely responsible for giving me the opportunity to share the ideas in this book with you. In many ways, I am merely a vessel through which their ideas, inspiration, and wisdom passes from me to you, and hopefully from you to many others.

My deepest gratitude is extended to the many individuals kind enough to share their time and information with me. Special thanks to Bobbi Bilnoski at the Concitti Network, Colleen Tobin formerly of Women's World Finance, Rhonda Pherigo from the Center for Nonprofit Management, Bruce Harber of the Vancouver Coastal Health Authority, Dr. Howard Borgstrom from the Department of Energy, Nancy Foltz at the State of Michigan, Rick Pagsibigan from the Red Cross of Southeastern Pennsylvania, Abbi Stone and Katy Rees from the San Marcos campus of the California State University, consultant Donald Golob, author and consultant William P. Ryan, Jake Barkdoll and the Balanced Scorecard Interest Group, Betty Cabrera at the Dallas Family Access Network, Diane Williams of the Safer Foundation, Dennis Feit from the Minnesota Department of Transportation, Philippe Poinsot from the United Nations Development Programme, and Jeff Celentano from the City of North Bay, Ontario.

I've also benefited tremendously from knowledge gained during many consulting engagements focused on Balanced Scorecard development. The following individuals have been particularly influential in my thinking: From the County of San Diego, California, Nicole Alejandre, Jackie Baker Werth, Tom Phillip, Chris Heiserman, John Ramont, and Randall Krogman. Bob Whip of Horizon Fitness, Art Rothberg of Fusura, Jay Forbes, Allan MacDonald, and Dennis Barnhart at Aliant, Ed VanEenoo, Cheryl Fruchter, and Dave Rowlands at the City of Chula Vista, California, and Isaac Hashem from Southwest Properties.

An innumerable number of other individuals have an imprint on this book. Let me conclude by mentioning just a few: Lisa Schumacher, Tiffany Capers, and Matt Bronson from the City of Charlotte, North Carolina. My open and insightful interview with them was a highlight of this project. Joe and Catherine Stenzel have been wonderful friends and great supporters for many years, my thanks to both of you. Steve Mann provided invaluable assistance with early interviews and research on this book, despite recently retiring! Brett Knowles provided me with wise counsel and provided contacts who are featured in this book. Andra Gumbus of Sacred Heart University offered insight and assistance that is greatly appreciated. From the Balanced Scorecard Collaborative I would like to thank Bob Kaplan and Michael Contrada. Both have offered me guidance and encouragement as we attempt to advance the Scorecard field. Teemu Lehto at QPR Software has been a great business partner, and I thank him for his many valuable ideas. Jeannine Owens from PB Views has been a mentor, coach, and great source of inspiration. Finally, I would like to thank Teri Anderson. Teri gave me my start in the performance measurement field several years ago, and has been a supporter and great friend ever since.

Part One

Introduction to Performance Measurement and the Balanced Scorecard

CHAPTER 1

Introduction to the Balanced Scorecard

Roadmap for Chapter One Before you can begin developing a Balanced Scorecard for your organization you must have a solid foundation of Scorecard knowledge and understanding from which to build. This chapter will provide that base.

We'll begin by considering just why measurement is so important to the modern public and nonprofit organization. We'll then look at three factors that have led to the rising prominence of the Balanced Scorecard since its inception over a decade ago. You'll learn that accounting and business scandals in the for-profit world have led to a demand for greater accountability and disclosure from all organizations. Next we'll examine financial measurements and their significant limitations. The final factor escalating the growth of the Balanced Scorecard is the inability of most organizations to effectively execute their strategies, so we'll also review a number of barriers to strategy implementation.

The Balanced Scorecard has emerged as a proven tool in meeting the many challenges faced by the modern organization. The remainder of the chapter introduces you to this dynamic tool. Specifically, we'll examine the origins of the Scorecard, define it, look at the system from three different points of view, and consider just why the word "balance" is so important to the Balanced Scorecard.

WHY MEASUREMENT IS SO IMPORTANT

Recently I read about an historical incident that I'd like to share with you. In the dense fog of a dark night in October 1707, Great Britain lost nearly an entire fleet of ships. There was no pitched battle at sea; the admiral, Clowdisley Shovell, simply miscalculated his position in the Atlantic and his flagship smashed into the rocks of the Scilly Isles, a tail of islands off the southwest coast of England. The rest of the fleet, following blindly behind, went aground as well, piling onto the rocks, one after another. Four warships and 2,000 lives were lost.

For such a proud nation of seafarers, this tragic loss was distinctly embarrassing. But to be fair to the memory of Clowdisley Shovell, it was not altogether surprising. Though the concept of latitude and longitude had been around since the first century B.C., still in 1700 no one had devised an accurate way to measure longitude, meaning that nobody ever knew for sure how far east or west they had traveled. Professional seamen like Clowdisley Shovell had to estimate their progress either by guessing their average speed or by dropping a log over the side of the boat and timing how long it took to float from bow to stern. Forced to rely on such crude measurements, the admiral can be forgiven his massive misjudgment. *What caused the disaster was not the admiral's ignorance, but his inability to measure something that he already knew to be critically important—in this case longitude.*[1]

We've come a long way since Clowdisley Shovell patrolled the seas for his native Great Britain. If sailing is your passion, today's instrumentation ensures that any failure of navigation may be pinned squarely on your shoulders. But for those of you who spend your days leading public and nonprofit organizations, and not cruising the high seas, how far have you come in meeting the measurement challenge? Can you measure all those things you know to be critically important? Today's constituents and donors are better informed than at any time in history. That knowledge leads to a demand of accountability on your part to show results from the financial and human resources with which you've been entrusted. To do that you must demonstrate tangible results, and those results are best captured in performance measures.

Over 150 years ago the Irish mathematician and physicist Lord Kelvin reminded us: *"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. . . . "* The goal of this book is to help you do just that: to measure all those things that you know to be important, those areas that truly define your success and allow you to clearly demonstrate the difference you're making in the lives of everyone you touch. Welcome to your Balanced Scorecard journey.

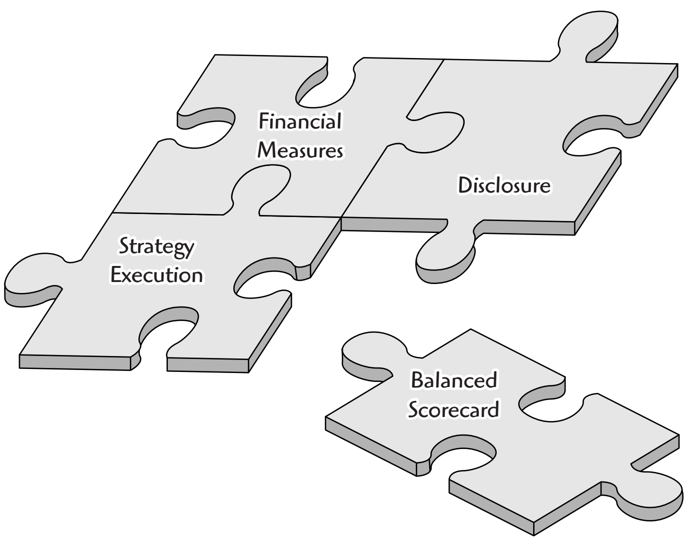
WHY THE BALANCED SCORECARD—AND WHY NOW?

Before we explore the Balanced Scorecard in detail, let's look at some of the factors that have given rise to this new framework for tracking organizational performance. Simply put, performance measurement and management have never been hotter. Three factors have fueled the need for improved performance reporting: the recent spate of corporate accounting scandals, a longstanding reliance on financial measures of performance as the one true way to gauge success, and the inability of many organizations to successfully execute their strategies. We'll look at each of these and discover how they've contributed to the need for a Balanced Scorecard system. We'll then return to an overview of the Balanced Scorecard and learn how this deceptively simple tool is revolutionizing the management of performance (see Exhibit 1.1).

Doing Business in the Post-Enron Era

As I write this in late 2002, it's difficult to pick up a newspaper, turn on a radio or television, or open up a news magazine without almost immediately hearing or seeing a reference to yet another corporate scandal. Everywhere you turn there is news that another organization has run afoul of the law in its almost maniacal pursuit of pleasing shareholders. Leading this infamous pack is of course Enron. Once the seventh largest company in the United States, Enron has become the butt of endless jokes; but more importantly, it's also become the defendant in countless lawsuits launched by those who have collectively lost billions since the company's demise. Of course Enron's $63.4 billion bankruptcy was later dwarfed by that of fellow-wrongdoer WorldCom. WorldCom sought Chapter 11 protection in a $107 billion disaster. The list goes on and on: Tyco, Xerox, Global Crossing, Adelphia, and dozens of others. Even those organizations once considered paragons of corporate virtue have been tainted by the sting of scandal. Johnson & Johnson, for example, an organization renowned for

Exhibit 1.1 The Balanced Scorecard Solves Business Issues



ethical business practices, was cited for irregularities at a manufacturing facility in Puerto Rico.[2] Not surprisingly, these activities have not gone unnoticed by you and me. Trust in organizations has never been lower. In one recent poll, 57 percent of respondents said they don't trust corporate executives to give them honest information.[3] Clearly, something has to change.

In response to the much-publicized shenanigans taking place in boardrooms around the country, the public is demanding greater disclosure of information. The rationale is that the more we know about a company's financial situation, the better equipped we are to discern the true state of its operations. On July 30, 2002, President George W. Bush took a great stride forward in this direction by signing into law the Sarbanes-Oxley Act. All companies required to file periodic reports with the Securities and Exchange Commissions (SEC) are affected by the Act. Proponents suggest it represents the most far-reaching U.S. legislation dealing with securities in many years.

While the act contains many provisions, two are particularly relevant to this chapter. First, Section 906, which is effective immediately, requires certification by the company's chief executive officer (CEO) and chief financial officer (CFO) that reports fully comply with the requirements of securities laws and that the information in the report fairly presents, in all material respects, the financial condition and results of operations of the company. Basically, company executives are making a pledge that what is in their financial reports is accurate and true. The act also requires plain English disclosure on a "rapid and current basis" of information regarding material changes in the financial condition or operations of a public company as the SEC determines is necessary or useful to investors and in the public interest.

Reforms such as the Sarbanes-Oxley Act represent tremendous advances in the pursuit of increased disclosure, but they miss a fundamental point: We need more than just financial information and disclosure to judge the health of an enterprise. To make an informed decision about any organization's true state of affairs, we require information that covers a broader perspective. This is the case whether we're talking about a Fortune 100 company, a local nonprofit health services organization, or state governments. We need to uncover the real value-creating and destroying mechanisms that are ultimately reflected in financial results. Even Wall Street is beginning to carry a torch for broader reporting. The accounting firm PricewaterhouseCoopers asked institutional investors and stock analysts what measures were most important to them. As you would expect, earnings and costs were consistently cited. But so too were nonfinancial indicators such as market share, new product development, and statements of strategic goals.[4] They could be on to something. Hewitt Associates found evidence that companies highly aligned with traditional metrics (financial) tend to be the worst performers in shareholder returns.[5]

All of the developments just described have prompted leaders and those who work in, and follow, organizations to further embrace concepts that place a premium on providing a balanced view of performance. Calls for use of the Balanced Scorecard are ringing out from observers around the globe. In

Canada, for example, the Society of Certified Management Accountants (CMA) has developed a new management accounting guideline entitled, "The Balanced Scorecard for a Board of Directors." The document serves to address corporate governance and management issues that have arisen in the wake of the Enron collapse.[6] France now mandates what it calls "sustainability reporting" for all publicly traded companies. The government has outlined indicators—in the areas of workplace, community, and environment—that companies must legally report on in annual reports.[7] Here in the United States, the American Institute of Certified Public Accountants (AICPA) has noted its support of the Balanced Scorecard in annual reporting to satisfy enhanced reporting requirements. Harvard University professor Jay W. Lorsch very nicely sums up the value of the Balanced Scorecard in this capacity: *"If directors were getting a Balanced Scorecard, they would be much more likely to be informed about their companies on an ongoing basis. The Scorecard's emphasis on strategy (linking it to all activities, day-to-day and long-term) could help directors stay focused."*[8]

Limitations of Financial Measurements

As the preceding discussion has clearly demonstrated, we require balanced performance information to fully assess an organization's success. Despite this realization, recent estimates suggest that 60 percent of metrics used for decision-making, resource allocation, and performance management are still financial in nature.[9] It seems that for all we've learned, we remain stuck in the quagmire of financial measurement. Perhaps tradition is serving as a guide unwilling to yield to the present realities. You see, traditionally, the measurement of all organizations has been financial. Bookkeeping records used to facilitate financial transactions can 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. The financial measures created at that 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.

Over the last hundred years, we've come a long way in how we measure financial success, and the work of financial professionals is to be commended. Innovations such as Activity-Based Costing (ABC) and Economic Value Added (EVA) have helped many organizations make more informed decisions. However, as we begin the twenty-first century, many are questioning our almost exclusive reliance on financial measures of performance. Here are some of the criticisms levied against the over-abundant use of financial measures:

- *Not consistent with today's business realities.* Tangible assets no longer serve as the primary driver of enterprise value. Today it's employee knowledge (the assets that ride up and down the elevators), customer relationships, and cultures of innovation and change that create the bulk of value provided by any organization. In other words, intangible assets. If you buy a share of Microsoft's stock, are you buying buildings and machines? No, you're buying a promise of value to be delivered by innovative people striving to continually discover new pathways of computing. 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. For more on the rising prominence of human capital, see Exhibit 1.2.

- *Driving by rear view mirror.* This is perhaps the classic criticism of financial metrics. You may be highly efficient in your operations one month, quarter, or even year. But does that signal ongoing financial efficiency? As you know, anything can, and does, happen. Financial results on their own are not indicative of future performance.
- *Tendency to reinforce functional silos.* Working in mission-based organizations, you know the importance of collaboration in achieving your goals. Whether it's improving literacy, decreasing HIV rates, or increasing public safety, you depend on a number of teams working seamlessly together to accomplish your tasks. Financial statements don't capture this cross-functional dependency. Typically, financial reports are compiled by functional area. They are then "rolled-up" in ever-higher levels of detail and ultimately reflected in an organizational financial report. This does little to help you in meeting your noble causes.
- *Sacrifice of long-term thinking.* If you face a funding cut, what are the first things to go in your pursuit to right the ship? Many organizations reach for the easiest levers in times of crisis: employee training and development, or maybe even employees themselves! The short-term impact is positive, but what about the long-term? Ultimately, organizations that pursue this tactic may be sacrificing their most valuable sources of long-term advantage.
- *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 and 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 process 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.

Exhibit 1.2 Rising Prominence of Human Capital

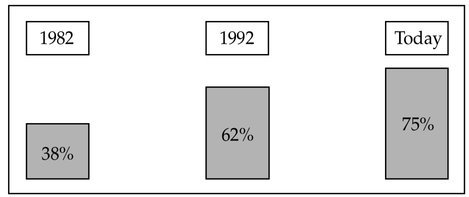
Writing in the Economist, Peter Drucker noted, "*They (knowledge workers) now account for a full third of the American workforce, outnumbering factory workers two to one. In another twenty years or so, they are likely to make up close to two-fifths of the workforces of all rich countries.*"***[i]*** Our organizational world is clearly in a time of change 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 the chart to the right which illustrates the transition in value from tangible to intangible assets. Since this research was completed the pace of change has continued unabated. Speaking on National Public Radio's Morning Edition, Ms. 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.*"***[ii]***

While Ms. Blair used the term "corporations" in the above quote, public and nonprofit organizations are certainly not immune to these changes. The challenges represented by this switch are well known in Washington. David M. Walker, Comptroller General of the United States said in a February, 2001 testimony to the U.S. senate that "*human capital management is a pervasive challenge in the federal government. At many agencies human capital shortfalls have contributed to serious problems and risks.*"***[iii]***

This transition in value creation from physical to intangible assets has major implications for measurement systems. Financial measurements were perfectly appropriate for a world dominated by physical assets. However, the new economy with its premium on intangible assets demands more from our performance measurement systems. Today's system must have the capabilities to identify, describe, monitor, and provide feedback on the intangible elements driving organizational success. The Balanced Scorecard focuses on identifying and translating all of an organization's value-creating mechanisms, including intangibles, into objectives, measures, targets, and initiatives. As such, organizations are turning to the Scorecard in ever-increasing numbers as a powerful framework in both measuring and managing intangible assets.

[i] Peter F. Drucker, The New Society," *The Economist,* September 15, 2001.
[ii] Interview on National Public Radios Morning Edition October 27, 2000.
[iii] Testimony by David M. Walker, Comptroller General of the United States before the Subcommittee on Oversight of Government, Management, Restructuring, and the District of Columbia Committee on Governmental Affairs, U.S. Senate.



Thus far in the chapter, I've taken a hard line on financial measures of performance. We just reviewed their many limitations; and a little earlier I suggested that a single-minded focus on financial success might have been among the causes for the epidemic of scandals currently plaguing the corporate world. With all that in mind, the question is: Do financial metrics deserve a place on your Balanced Scorecard? Absolutely. Despite their many shortcomings, financial yardsticks are an entirely necessary evil. This is especially the case in the public and nonprofit sectors. In an era of limited, often decreasing, funding, you must consistently tread the delicate balance between effectiveness and efficiency. Results must be achieved, but in a fiscally responsible manner.

Your stakeholders will be looking to you to achieve your missions, thus nonfinancial measures of performance become critical in your efforts. However, pursuing your goals with no regard to the financial ramifications of your decisions will ultimately damage everyone: You'll be the victim of decreased funding as it becomes clear that you're unable to prudently manage your resources. Your funders will be discredited and, potentially, unwilling to support you in the future. But most important, your target audiences will not receive the services they need as a result of your inability to reach them in both an effective and efficient way.

Strategy: Execution Is Everything!

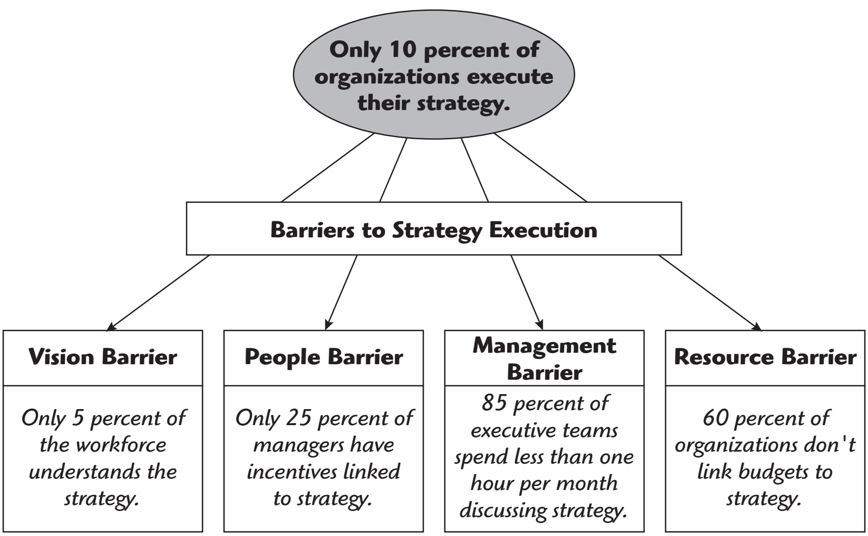
When I was conducting research for my book on private-sector Balanced Scorecard development (*Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results,* John Wiley & Sons, 2002), I knew I'd come across many references to strategy. After all, strategy is probably among the most discussed and debated topics we encounter in the world of organizations. But of course it's not just organizations that wrestle with strategy. The concept has entered the mainstream of our society. Professional sports teams all have a strategy to beat their opponents (and their owners have a strategy to separate us fans from our money!). I have a strategy for writing this book, and I'm sure you all employ strategies in achieving your daily tasks, both at home and at work. The interesting thing about strategy in the business sense of the word is that nobody seems to agree on what it is, specifically. There are as many definitions for the term as there are academics, writers, and consultants to muse on the topic. In fact there is even a book titled *Strategy Safari.*[10] I enjoy conjuring up that image of strategy—I picture myself cutting through the dense forest of research, attempting to find my quarry: the holy grail of strategy.

One point on which strategy gurus do seem to agree is this: The *execution* of a strategy is more important, and more valuable, than the *formulation* of a strategy. It's one thing to sit down and craft what is seemingly a winning strategy, but successfully implementing it is another thing entirely. For those who can execute, the rewards are significant. In the for-profit world, a 35 percent improvement in the quality of strategy implementation, for the average firm, is associated with a 30 percent improvement in shareholder value.[11] While shareholder value is not the end game of your organizations, you too will benefit greatly from an ability to carry out your strategies. Unfortunately, the vast majority of organizations fail miserably when attempting to execute their strategies. In fact, a 1999 *Fortune* magazine story suggested that 70 percent of CEO failures came not as a result of poor strategy, but of poor execution.[12] Why is strategy so difficult for even the best organizations to effectively implement? Research and experience in the area have suggested a number of barriers to strategy execution, and they are displayed in Exhibit 1.3. Let's take a look at these in turn.

The Vision Barrier

Employee empowerment, two-way communication, and information sharing—executives and managers alike frequently espouse the benefits of these concepts. Talk is cheap. The fact of the matter is that the vast majority of organizations have a long way to go when it comes to getting their most important messages—their vision and strategy—out to their most important constituents: their employees.

Exhibit 1.3 Barriers to Implementing Strategy



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

The previous section pointed out that many financial measures were developed at the turn of the twentieth century. Transport yourself back in time for a moment and put yourself inside one of those fortresses of industry, complete with towering walls and smokestacks billowing who-knows-what into the atmosphere. Chances are, as an employee there, you'd be told what to do, when to do it, where to do it, and how to do it. Would knowledge of the organization's vision and strategy have been the least bit relevant or helpful in your task? Probably not. But the world today is an entirely different place. Value is created largely from intangible assets like customer knowledge and information-rich networks. Today, to contribute in a meaningful way, you must know where the organization is headed and what the strategy is to get there. Only then can you combine your talents with others from across your agency to create value for your stakeholders and, ultimately, achieve your mission.

People Barrier

Debate has raged for decades as to whether incentive compensation plans really do lead to improved performance. We may never know the answer, but it is probably safe to suggest that an incentive of any kind tends to increase focus—at least temporarily. The danger with incentive plans is the possibility that managers will sacrifice long-term value-creating activities and initiatives in order to reach a short-term financial target and receive a monetary award. Strategy cannot be executed if the focus is continually on the short term. By its very nature, strategy demands a longer-range view of an organization's landscape. Financial incentives can distort or entirely block an organization's strategic view.

Resource Barrier

Sixty percent of organizations don't link budgets to strategy. If that's the case, then what are they linking their budgets to? For many organizations, it's as simple as looking at last year's budget and adding or subtracting a few percentage points as appropriate. This is a particularly damaging blow to the hopes of executing strategy. What is a budget if not a detailed examination of the priorities of the enterprise for the next fiscal year? If the budget is not linked to some form of strategic plan and goals, then what does that say about the organization's priorities? Does it even possess any, or is it simply spinning its wheels and wasting precious resources in the process? We'll return to the important topic of budgets in Chapter Eleven.

Management Barrier

Have you ever heard the phrase "management by walking around?" It suggests an approach of staying close to your employees by speaking to them frequently and informally, ensuring communication is two-way and beneficial to all. By contrast, I believe most of us live in the age of "management by firefighting!" We move from one crisis to the next, never taking the time to pause and reflect on our larger objectives, strategies, and mission. A client of mine uses the analogy of "working in the business"; that is, fighting fires, versus "working on the business," taking the necessary break to examine things from a wider perspective.

Many would argue there is literally no time to slow down, not even for a minute. Undoubtedly, we live in an era of fast-paced organizations, but virtually all of us attend regular management meetings. In order to have any chance of executing strategy, these meetings must be transformed. No longer should we sit around and examine the "defects" that result when actual results do not meet budget expectations. Instead, these meetings should be used to discuss, learn about, and debate our strategy.

THE BALANCED SCORECARD

Reading the preceding pages could make you feel as though your back is up against the wall when it comes to effectively measuring your performance. Review the considerable hurdles we've discussed: First, there are the many scandals erupting around us, forcing all organizations to provide ever-greater disclosure. Second, for the most part, we've been limited in our measuring options because of an almost exclusive reliance on financial measures that definitely don't tell the whole story. And, finally, as important as strategy is, a number of significant barriers make its execution truly elusive.

What is needed is a system that provides real insight into an organization's operations, balances the historical accuracy of financial numbers with the drivers of future performance, and assists us in implementing strategy. The Balanced Scorecard is the tool that answers all these challenges. In the remainder of the chapter we will begin our exploration of the Balanced Scorecard by discussing its origins, reviewing its conceptual model, and considering what separates it from other systems.

Note

The focus here is on the for-profit Balanced Scorecard model, since the tool was originally conceived with that audience in mind. Chapter Two will detail how the "geography" of the Balanced Scorecard has been successfully adapted to fit both the public and nonprofit sectors.

Origins of the Balanced Scorecard

The Balanced Scorecard was developed by Robert Kaplan, an accounting professor at Harvard University, and David Norton, a consultant from the Boston area. In 1990, Kaplan and Norton led a research study of a dozen companies with the purpose of exploring new methods of performance measurement. The impetus for the study was a growing belief that financial measures of performance were ineffective for the modern business enterprise. Representatives of the study companies, along with Kaplan and Norton, were convinced that a reliance on financial measures of performance was affecting their ability to create value. The group discussed a number of possible alternatives but settled on the idea of a scorecard, featuring performance measures capturing activities from throughout the organization—customer issues, internal business processes, employee activities, and of course shareholder concerns. Kaplan and Norton labeled the new tool the Balanced Scorecard and later summarized the concept in the first of three *Harvard Business Review* articles, "The Balanced Scorecard—Measures That Drive Performance."[13]

Over the next four years, a number of organizations adopted the Balanced Scorecard and achieved immediate results. Kaplan and Norton discovered these organizations were not only using the Scorecard to complement financial measures with the drivers of future performance, but they were also communicating their strategies through the measures they selected for their Balanced Scorecard. As the Scorecard gained prominence with organizations around the globe as a key tool in the implementation of strategy, Kaplan and Norton summarized the concept and the learning to that point in their 1996 book, *The Balanced Scorecard*.[14] Since that time, the Balanced Scorecard has been adopted by nearly half of the Fortune 1000 organizations, and the momentum continues unabated. So widely accepted and effective has the Scorecard become that the *Harvard Business Review* recently hailed it as one of the 75 most influential ideas of the twentieth century.

Once considered the exclusive domain of the for-profit world, the Balanced Scorecard has been translated and effectively implemented in both the nonprofit and public sectors. Success stories are beginning to accumulate and studies suggest the Balanced Scorecard is of great benefit to both these organization types. In one public sector study funded by the Sloan Foundation, 70 percent of respondents agreed that their governmental entity was better off since implementing performance measures.[15]

WHAT IS A BALANCED SCORECARD?

We can describe the Balanced Scorecard as a carefully selected set of quantifiable measures derived from an organization's strategy. The measures