“turning data into dollars”

Tom’s Ten Data Tips – March 2009

Balanced Scorecards

Balanced Scorecards (BSc) were an “invention” of Kaplan and Norton in the 90’s and grew out of the realization that driving a business on financials only has serious limitations and may well hinder future growth. “The Balanced Scorecard translates an organization’s mission and strategy into a comprehensive set of performance measures that provides the framework for a strategic measurement and management system” (Kaplan & Norton, 1996, p. 2).

1. “Balanced” Takes On Five Meanings

The term “Balanced” in BSc stands for these five contradictions:

- Balance between *external* measures for shareholders and customers, versus *internal* measures of (critical) business processes, innovation, and learning and growth.
- Balance between *short-term* and *long-term* measures.
- Balance between *financial* (typically about the past) and *non-financial* measures.
- Balance between *past* and *future*, also called *lagging* and *leading* indicators of performance. Historical results (e.g.: profits) versus efforts required to ensure future success (e.g.: innovation, R&D).
- Balance between *objective* and *subjective* measures, the ‘hard’, easily quantifiable indicators and somewhat more judgmental drivers of success.

2. Scorecard Creation *Must* Be A Joint Process

To achieve BI success one needs executive sponsorship, subject experts and IT. If one of these three legs is missing, the stool will become unstable.

- Senior management is responsible for defining clear and actionable goals so that the scorecard actually improves decision making rather than becoming an objective in and of itself.
- Subject experts are necessary to ensure that targets are measured and specified appropriately.
- IT needs to be involved because compiling the scorecard is akin to a data warehousing effort (in particular to support

downdrilling into the scorecard). Distribution and security of the scorecard are also clearly IT's responsibility.

3. The BSc Is *Not* Fundamentally About Measuring

A BSc is truly a new way to manage a business. The perspective of BSc's as some extension of performance measurement fails to capitalize on the interdependence between measures, their relation to strategy, and the lever to align performance evaluations with long-term strategic objectives.

The *measurements* are a means to an end: implementing strategy and at the same time gathering feedback about its appropriateness and effectiveness of execution (see also tip# 5). In this sense, it can aid in achieving sustainable organizational change and improvement. As such it represents a departure from more "traditional" (ubiquitous?) managing by financials.

4. A BSc Represents The "Theory Of The Business"

The chain of cause-and-effect relationships that links *each and every* element in the scorecard represents how implementation of strategy is expected to lead to a desired outcome. An example might be: better service improves loyalty, leads to higher profits and improves Return On Capital Employed (ROCE). The network that explicates all causal relationships is akin to what Peter Drucker has called the "theory of the business".

By representing all these (assumed!) causal linkages, and monitoring if the changes in metrics are in line with expectations, "double loop" learning takes place (see tip# 5).

5. The Balanced Scorecard Enables "Double Loop" Learning

When used properly, the BSc helps to clarify and gain consensus about strategy. It helps managers align departmental goals with corporate strategy. The annual planning cycle can be tuned to the 3-5 year plans that formed the strategic basis for BSc development. Strategic initiatives will follow from the underlying "theory of the business" that ensures cohesion between the pillars in the BSc. All this, however, still remains single-loop learning.

Examples of single & double loop learning: "… a thermostat that automatically turns on the heat whenever the temperature in a room drops below 68 degrees is a good example of single loop learning. A thermostat that could ask, “Why am I set at 68 degrees?” and then explore whether or not some other temperature might more economically achieve the goal of heating the room would be engaging in double-loop learning.” Chris Argyris (2008) Teaching Smart People How To Learn.

A BSc allows for double-loop learning. By turning the “theory of the business” into measurable expectations, the *assumptions* underlying corporate strategy are tested. This allows management to obtain feedback about the appropriateness of strategy and validity of underlying assumptions. When, for example, investments were made in technology to drive down delivery time, which in turn was assumed to lead to higher levels of customer satisfaction and so improve retention, we have a hypothesis that can be tested. Maybe some of the hypotheses were wrong, or maybe the way the strategy was implemented didn’t work?

6. Scorecard Results Must Be Communicated To All Ranks

Balanced scorecard projects are typically initiated by senior management. Needless to say they will be keen on tracking results. However, if only executives care about results, improvement will be driven via performance evaluations. Not only will progress be slow and cumbersome, but negative incentives are known to be poor drivers of change.

If the customer is to benefit, change needs to be initiated at the operational/front-office level as well. Exactly *there* is where you want to leverage creativity, and where capability resides to alter “business as usual”. That is why scorecard results need to permeate all management layers all the way to the shop floor level. A side effect is that the impact of strategy on operating practices will be much more widely understood (see also tip# 7).

7. Make Access To The Scorecard Easy

The largest group(s) of scorecard users will not have a BI or technical background. To stimulate adoption of outcomes and to facilitate actual usage, access needs to be as easy as can be. User friendliness has been demonstrated to be an important success factor for widespread acceptance. Nobody likes to work hard in order to get information.

Roadblocks to access should be eliminated where possible. Log-in and security procedures need to be in place, but *not* at the cost of convenience. A single log-in through for instance an LDAP server should take care of all roles and rights with one single procedure. Also, downdrilling and graphing data should take a minimal number of clicks.

8. A Balanced Scorecard Needs To Measure All Relevant Items

There are two aspects to comprehensive measurement of drivers of business performance and growth. First of all, the measure in the BSc need to be measured equitably. That is why you need domain experts, and a diverse team with preferably multiple ranks. Secondly, you need to make sure that *all* important drivers get measured. There are usually practical challenges to this, that need to be dealt with pragmatically. If a measure isn't very good, start using it anyway and concurrently strive to improve its accuracy. Dropping it because of measurement issues is not an option.

When business drivers have been identified but get omitted because of practicalities, this will alter behavior whose performance gets monitored. Even with the best of intentions, it is inevitable that employees will alter their behavior in line with what gets measured and, thus, will get rewarded. *Even* if it clearly reduces the effectiveness of what it is they are doing. You get what you pay for, and you don't get what you don't pay for.

9. Financial Objectives Depend On The Life Stage Of The Business

The business life cycle of companies can roughly be divided in three stages: growth, sustain, and harvest.
During growth, cash flow can be negative, Return On Capital (ROC) will be low, investments might be larger than revenues. Financial objectives will be things like growth *rate* percentages, growth in particular target markets, etc., related to revenue growth and mix.
Business in the sustain stage (the majority of companies) still require investments but now the ROC ought to be very good. Market share is constant, or maybe growing slightly. Streamlining production and continuous improvement are investment candidates. Financial targets revolve around profitability, margins, or operating income, all aimed at maximizing ROCE (Return On Capital Employed) or EVA (Economic Value Added). Cost reduction and productivity are central themes.

The harvest stage indicates that ongoing financial targets can no longer be met, obviating a sale. Targets will be related to maximizing cash flow for the holding corporation, and minimizing capital requirements. This should culminate in the best asset utilization and investment strategy.

10. In The End, It *Is* All About The Money

We're back at square one. Every company needs to make a (healthy) profit in order to survive. BSc's are a valuable tool to ensure long-term value creation with reference to the life cycle (see tip# 9), strategy (see tip# 4), and management dynamics (see tip# 3). Public or private companies alike owe it to their constituents that they create value which at some point in time means a positive cash flow. BSc's aid in demonstrating stakeholders how those goals will be achieved.