The Balanced Scorecard in a Strategy-Focused Organization

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Abstract. **Many portfolio managers reported that the ability to execute strategy was more important than the quality of the strategy itself. They consider that strategy implementation is the most important factor shaping management and corporate valuations. This, in spite that generally, strategy formulation is considered more important. The ability to execute strategy can be more important than the strategy itself.**

The Balanced Scorecards are used for describing a strategy in modern organizations and for measuring the results of implementing that strategy. For creating balanced scorecards we use strategy maps.

Keywords: **Balanced scorecards, strategy maps, strategy-focused organization.**

CREATING THE STRATEGY-FOCUSED ORGANIZATION

Why the organizations do have difficulty in implementing well-formulated strategies? One problem is that strategies – the unique and sustainable ways by which organizations create value – are changing, but the tools for measuring strategies didn't follow them. In the industrial economy, companies created value with their tangible assets, by transforming raw materials into finished products. Nowadays, opportunities for creating value are shifting from managing tangible assets to managing knowledge-based strategies that deploy an organization's intangible assets: customer relationships, innovative products and services, high-quality and responsive operating processes, information technology and databases, employee capabilities, skills and motivation.

In an economy based on tangible assets, financial measurements were adequate to record investments in inventory, property, plant, and equipment on companies' balance sheets. Income statements could capture the expenses associated with the use of these tangible assets to produce revenues and profits. But today's economy, where intangible assets have become the major sources for competitive advantage, calls for tools that describe knowledge-based assets and the value-creating strategies that these assets make possible. Without such tools, companies had difficulties in managing something they can not describe or measure. Companies also have had problems attempting to implement knowledge-based strategies in organizations designed for industrial-age competition.

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Organizations operating under central control, through large functional departments, develop strategies at the top, strategies that are implemented through a centralized command-and-control culture. Managers could use slow-reacting and tactical management control systems such as the budget. But, the budget system is inadequate for today's dynamic, rapidly changing environment. So, it's no surprise that companies using it, have difficulties implementing radical new strategies designed for knowledge-based competition. Organizations need a new kind of management system, one designed to manage strategy, not tactics.

Most of today's organizations operate through decentralized business units and teams that are much closer to the customer than large corporate staffs. These organizations recognize that the competitive advantage comes more from the intangible knowledge, capabilities, and relationships created by employees than from the investments in physical assets and access to capital. For these companies, strategy implementation requires that all business units, support units and employees are aligned and linked to the strategy. The strategy must become a continual and participative process. Organizations need a language for communicating strategy as well as processes and systems that help them to implement strategy and gain feedback about their strategy. Success comes from having strategy become everyone's everyday job.

Many organizations introduced the Balanced Scorecard, first for measuring the results of the implemented strategies. A short comparison between the financial indicators and the Balance Scorecard approach shows that the last is much more appropriate because it measures not only the financial performance, but also measures the drivers, the lead indicators, of future performance (while the financial indicators report on outcomes, the consequences of a past action).

But what are the appropriate measures of future performance? If financial measures can cause organizations to do wrong things (they can sacrifice long term value creation for short-term performance), what measures would prompt them to do the right things? The answer is: measure the strategy! Thus, all of the objectives and measures on a Balanced Scorecard – financial and non-financial – should be derived from the organization's vision and strategy. A lot of companies that were loosing money for some consecutive years, have brought in a new management team to turn performance around. Each new management team introduced new strategies for making the companies more customer-driven. The strategies did not rely simply on cost reduction and downsizing; they required repositioning the organization in its competitive market space. The new strategies required that the entire organization adopts a new set of cultural values and priorities.

The Balanced Scorecard has become an integral part of the change management process. The Scorecard allows the managers to look beyond financial measures and concentrate on factors that create economic value.

The Balanced Scorecard makes the difference, allowing focusing all organizational resources on a new strategy. This new management system has three distinct dimensions:

- ***Strategy***. Make the strategy the central organization agenda. The Balanced Scorecard allows the company to describe and communicate their strategy in a way that could be understood and acted on.
- ***Focus***. Create incredible focus. With the Balanced Scorecard as a 'navigation' aide, every resource and activity in the organization are aligned to the strategy.
- ***Organization.*** Mobilize all employees to act in fundamentally different ways. The Balanced Scorecard provided the logic and architecture to establish new organization linkages across business units, shared services and individual employees.

The principles of Strategy-Focused Organization

The Balanced Scorecard enabled the early-adopting companies to focus and align their executive teams, business units, human resources, IT and financial resources to their organization's strategy, creating breakthrough performance.

The principles are:

1. translate the strategy into operational terms – using
    - Strategy maps
    - Balanced Scorecards
2. align the organization to the strategy by creating :
    - Corporate Role
    - Business Unit Synergies
    - Shared Service Synergies
3. make strategy everyone's everyday job through :
    - Strategic Awareness
    - Personal Scorecards
    - Balanced Paychecks
4. make strategy a continual process
    - Link Budgets and Strategies
    - Analytics and Information Systems
    - Strategic Learning
5. mobilize change through executive leadership
    - Mobilization
    - Governance Process
    - Strategic Management System

A new approach to managing

Te Balanced Scorecard is originally proposed to overcome the limitations of managing only with financial measures. The financial measures reported on outcomes, but did not communicate the drivers of future performance, the indicators of how to create new value through investments in customers, suppliers, employees, technology, and innovation. The Balanced Scorecard provides a framework to look at the strategy used for value creation from four different perspectives:

1. **Financial**. The strategy for growth, profitability, and risk viewed from the perspective of the shareholder.
2. **Customer**. The strategy for creating value and differentiation from the perspective of the customer.
3. **Internal business process**. The strategic priorities for various business processes, which create customer and shareholder satisfaction.
4. **Learning and growth**. The priorities to create a climate that supports organizational change, innovation and growth.

Using the scorecard allows the companies to redefine the relationship with the customer, to reengineer fundamental their business process, teach their workforces new skills and deploy new technology infrastructure. A new culture emerges, centered on the team effort required to support the strategy. The management system provides the mechanism to mobilize and guide the process of change. Companies created a new kind of organization based on the requirements of their strategy, that means STRATEGY-FOCUSED ORGANIZATION. This organization puts strategy at the center of its change and management processes.

From a management control system, designed around a short-term, control oriented financial framework, in which the center was the budgeting activity, the companies evolved to a strategic management system, designed around a longer-term strategic view, whose center is the Balanced Scorecard. Companies had extended the financial framework to embrace financial metrics that correlated better with shareholder value, leading to the economic value added (EVA) and value-based metrics. But even today's best financial frameworks do not capture all the dynamics of performance in today's knowledge-based competition.

Strategy-Focused organizations use the Balance Scorecard to place strategy at the center of their management processes. The Balanced Scorecard makes a unique contribution by describing strategy in a consistent and insightful way. The simple act of describing strategy via strategy maps and scorecards is an enormous breakthrough. The Balanced Scorecard needs to be used as the central framework for a new performance management process.

TRANSLATING THE STRATEGY TO OPERATIONAL TERMS

In this era of knowledge workers, strategy must be executed at all levels of an organization. For the people to change their behaviors and adopt new values, the company must put the strategy at the center of the management process. If a company has to create a management process to implement strategy, it has first to construct a reliable and consistent framework for describing strategy. Nowadays, sustainable value is created from developing intangible assets, such as the skills and the knowledge of the workforce, the IT and the links with the customers and suppliers, and the organizational climate that encourages innovation, problem-solving and improvement. Each can contribute to value creation. But several factors prevent the financial measurements from measuring these assets and linking them for value creation:

1. **Value is indirect**
    - Improvements in intangible assets affect financial outcomes through chains of cause-and-effect relationships involving more stages. Example :
    - Investments in employee training lead to improvements in service quality
    - Better service quality leads to higher customer satisfaction
    - Higher customer satisfaction leads to increased customer loyalty
    - Increased customer loyalty generates increased revenues and margins
2. **Value is contextual.** The value of intangible assets depend on organizational strategy and context.
3. **Value is potential.** Companies can measure the costs of trainings, the spending on databases, the advertising to create brand awareness. But such costs are poor approximations of any realizable value created by investing in these intangible assets.
4. **Assets are bundled.** Intangible assets don't have value by themselves. They have to be bundled to other assets, tangible or intangible for creating value. The Balanced Scorecard provides a new framework to describe a strategy by linking intangible and tangible assets in value-creating activities.

BUILDING STRATEGY MAPS

A strategy map is a logical architecture that defines a strategy by specifying the relations between shareholders, customers, business processes, and competencies. Strategy maps provide the foundation to build Balanced Scorecards linked to an organization's strategy.

The cause-and-effect logic constitutes the hypothesis of the strategy.

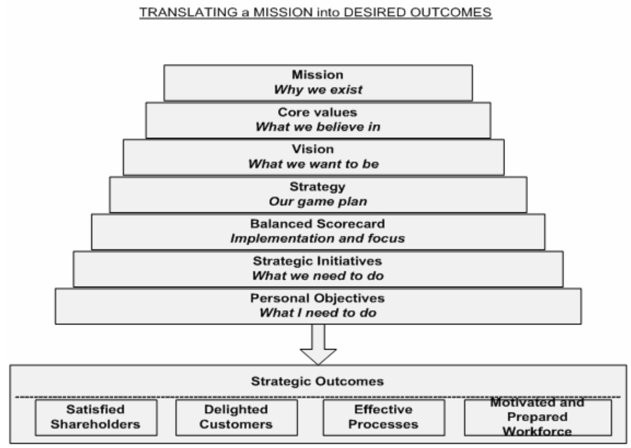
The financial perspective contains generally two themes: growth and productivity.

The value proposition in the customer perspective emphasizes the importance of the client to be satisfied.

The internal perspective contains the business lines for production

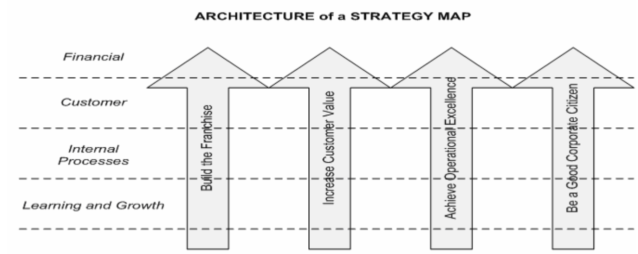
The learning perspective contains the skills and trainings.

Strategy is a step in a Continuum



Strategy is a hypothesis

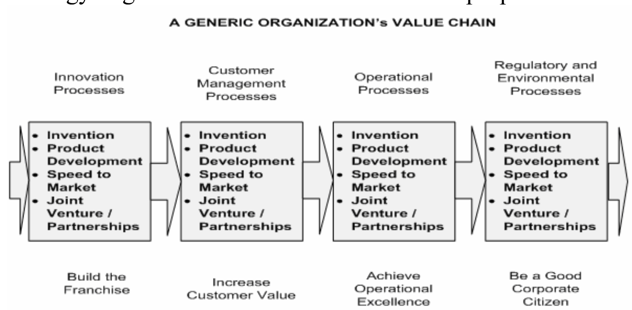
Strategy consists of complementary strategic themes



Strategy balances contradictory forces: the financial perspective

Strategy describes a differentiated value proposition

Strategy aligns internal activities to the value proposition



Strategy transforms intangible assets

The balanced scorecard strategy map

A strategy map template

1. The financial perspective is realized through :
    - Growth from:
        - ✓ Fundamentally new sources ("build new franchise")
        - ✓ Expanded relations with existing customers ("increase customer value")
    - The productivity is achieved through expense and asset management.
2. The customer perspective, the heart of the strategy, defines how growth will be achieved. The value proposition defines the specific strategy to compete

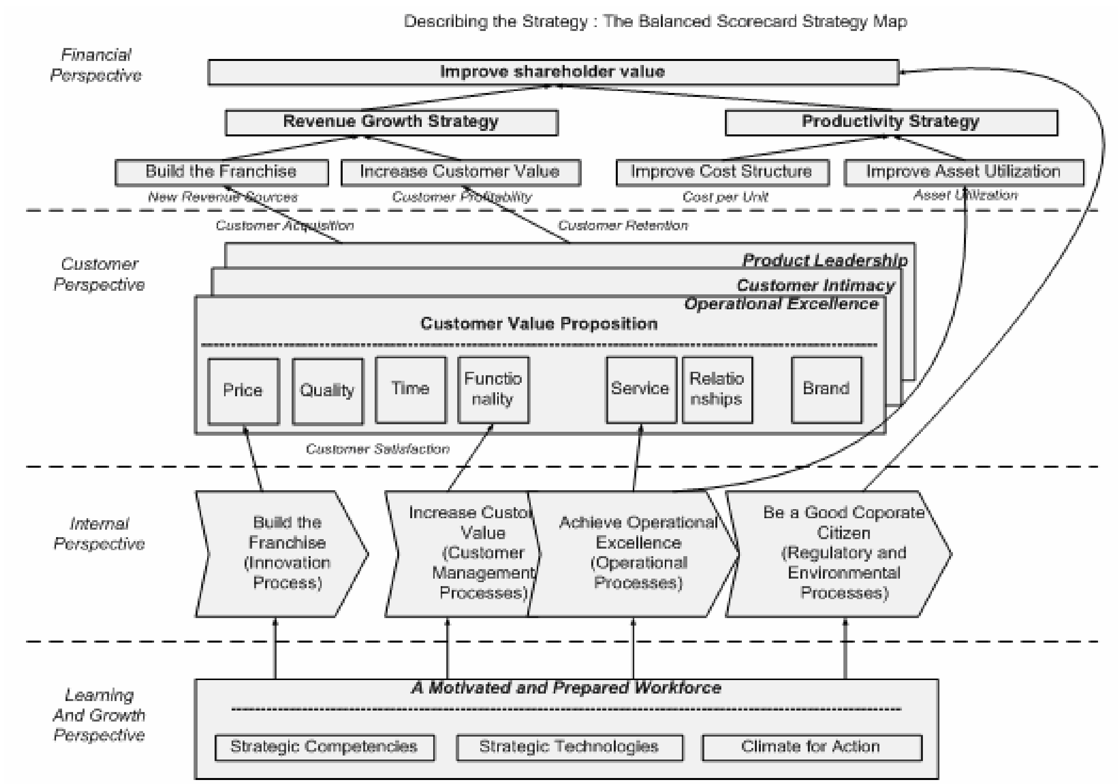
for new customers or increased share of existing customer businesses.

3. The internal perspective defines the business processes and the specific activities that the organization must master to support this customer value proposition.
4. The learning and growth perspective defines the competencies, know-how, technology and climate needed to support these high-priority processes and activities.

When properly constructed, the strategy maps portrays an integrated and logical description of how the strategy will be accomplished.

The template is a starting point for the design process of a strategy. Templates also foster a cause-and-effect mentality that encourages more innovative approaches to strategy implementation.

Templates are also useful to analyze or reverse-engineer an existing scorecard. A well-designed Balanced Scorecard should tell the story of the strategy. Thus if you were to begin with a scorecard, you should be able to reverse the logic and deduce the strategy.



Implications for measurement systems

Performance measurement systems typically are aggregations of standalone measures, such as return on capital, customer satisfaction, and defect rates. But stand-alone measures are limited in their ability to describe and manage an organization's value-creating processes. For example, a human resource measure, such as employee turnover. The benchmarked performance for retention of key employees does not indicate anything about the value of decreasing key employee turnover.

The cause-and-effect linkages in Balanced Scorecard strategy maps describe the path by which improvements in the capabilities of intangible assets get translated into tangible customer and financial outcomes.

For example, if the strategy is to improve the return-on capital financial performance, it can be realized through 2 strategic themes: operational excellence – reducing cost and improving quality – and customer management – developing long-term partnerships with targeted customers. Both themes required new capabilities and attitudes on the part of the workforce.

Measuring organizational performance requires such casual chains of value creation. Stand-alone measures cannot capture the means by which improvements in intangible assets and internal processes lead to increased performance in outcome measures. The linkage in strategy maps provide the recipes for such transformations and value creation.

Stakeholders and key performance indicator scorecards

Many organizations say they have a Balanced Scorecard because they use a mixture of financial and nonfinancial measures. Such measurement systems are more balanced then ones that use only financial measures. Yet, the underlying assumptions and philosophies that govern many of these scorecards are different from the strategy scorecards.

Stakeholders (constituent) Scorecards

The stakeholders scorecard identifies the major constituents of the organization – stakeholders, customers, and employees – plus often the suppliers and the community. The scorecard defines their goals and develops possible targets and measures for them.

For example, one can use the following themes:

- A compelling place to shop
- A compelling place to work
- A compelling place to invest

This means that the company builds its measurements around three dominant constituents: customers, shareholders and employees, using satisfaction measures for customers and employees. But from these scorecards, any indication of how these balanced scorecards are to be achieved is missing. A vision describes a desired outcome; a strategy must describe how that vision will be achieved and how employees, customers and shareholders will be satisfied. Thus a constituent scorecars is not adequate to describe the strategy of an organization and therefore is not an adequate foundation on which to build a management system.

The critical missing element from the constituent scorecard is the identification of drivers that will achieve the goals. In a well-constructed strategy scorecard, the value proposition in the customer perspective, all the processes in the internal perspective, and the lerning and growth perspective components of the scorecard define the how , that is as fundamental to the strategy as the outcomes that the strategy is expected to achieve.

Stakeholder scorecards are used effectively in practice, being the first step on the road of a strategy scorecard.

KPI Scorecards

KPI scorecards are found most frequently in manufacturing and health care organizations, especially those that have been implementing total quality management (TQM). The TQM approach generates many measures to monitor their processes and progress. When migrating to "Balanced Scorecard", they build on the already existing base, by classifying the many existing measurements into the four Balanced Scorecard categories (financial, customer, internal process and learning). KPI scorecards are helpful for departments and teams when a strategic program already exists at a higher level. Unless the link to strategy has been clearly thought, the KPI scorecard can be a dangerous illusion.

Only a strategy scorecard, build using the principles articulated before and embedded in a strategy map, can create a Strategy-Focused Organization.

CONCLUSIONS

Balanced Scorecards should not just become a collection of financial and non-financial measures, organized into three to five perspectives. The best Balanced Scorecard reflects the strategy of the organization. A good test for that is if you can understand the strategy by looking only at the scorecard. Many organizations, especially those that create constituent/ stakeholder scorecards or KPI scorecards, fail this test.

Strategy scorecards, along with their graphical presentation on strategy maps provide a logical and comprehensive way to describe strategy. They communicate clearly the organization's desired outcomes and its hypothesis about how these outcomes can be achieved. They enable all organizational units and employees to understand the strategy and identify how they can contribute by becoming aligned to the strategy. With the Balanced Scorecard that tells the story of a strategy, we have a reliable foundation for the design of a management system to create Strategy-focused Organizations.

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