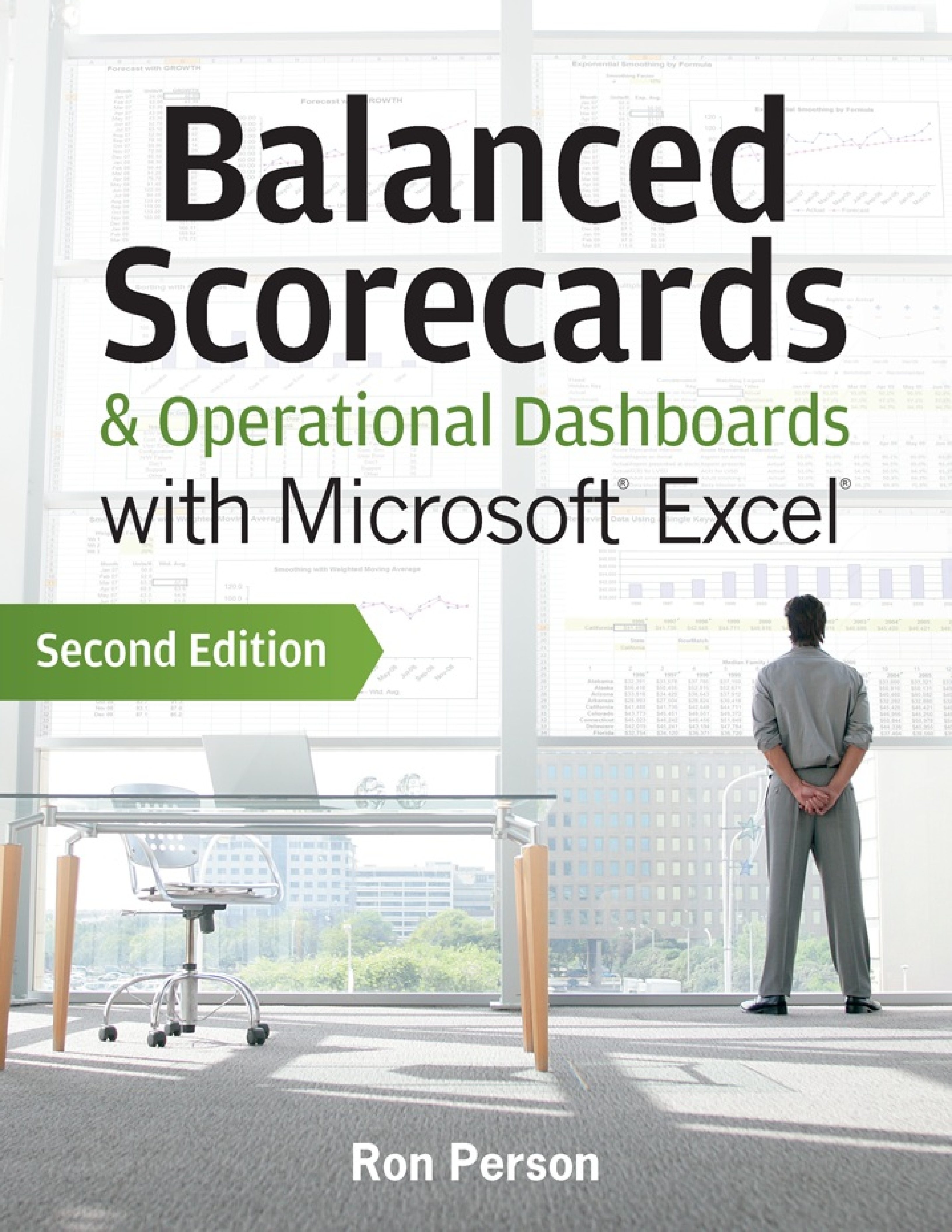


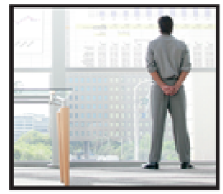
Balanced Scorecards

& Operational Dashboards with Microsoft® Excel®

Second Edition

Ron Person

Table of Contents



Balanced Scorecards & Operational Dashboards with Microsoft® Excel®

Second Edition

Ron Person

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Part I

Strategic Performance with Balanced Scorecards

In This Part

- Chapter 1: Accelerating Strategic Performance
- Chapter 2: Developing Your Strategic Foundation
- Chapter 3: Preparing to Build Your Balanced Scorecard
- Chapter 4: Step-by-Step to Building Your Strategy Map
- Chapter 5: Step-by-Step from Strategy to Action
- Chapter 6: Step-by-Step to Selecting Metrics and Setting Targets
- Chapter 7: Step-by-Step to Developing Your Implementation Plan
- Chapter 8: Step-by-Step to Rollout and Strategic Reviews

Chapter 1

Accelerating Strategic Performance

The essence of strategy is choosing what not to do.

—Michael Porter

The rate of change in the business world is accelerating. To get ahead—in fact, just to keep up—organizations of all types must accelerate their strategic performance.

They have to work with better performance, more precise focus, and better strategic alignment. For this to happen, all parts of the organization must clearly understand and be firmly aligned with strategic goals.

In the last two decades, a strategic management system has been developed that enables organizations to achieve the clarity and alignment necessary to accelerate strategic performance. That system is the Balanced Scorecard.

Managing with a 500-Year-Old System

Until recently, organizations have used the same accounting system to track assets and value production that was used 500 years ago in Venice, Italy. In 1494, Fra Luca Pacioli, Franciscan monk and friend of Leonardo da Vinci, wrote *Everything about Arithmetic, Geometry, and Proportions* (see Figure 1-1). It was the first best-selling business book to come off of Gutenberg's printing press.

Figure 1-1: Over 500 years ago, Fra Luca Pacioli, on the left, documented the double-entry accounting system we still use today.

Luca Pacioli’s Portrait, Gallery of Museum of Capodimonte, Naples

What made his book a best-seller throughout Europe was that it contained detailed instructions on how the merchants of Venice kept their accounts using double-entry accounting. The book included sections on

- Modern accounting cycles
- Double-entry accounting
- Journals and ledgers
- Assets, liabilities, capital, income, and expenses
- Closing
- Trial balances

The book blazed through the halls of commerce in Europe because, for the first time, it gave business people a way to value their tangible assets and measure how they were producing value. But what is surprising is that we still use the same accounting system used by the merchants of Venice 500 years ago.

The Failure of Modern Management Systems

Research by Margaret Blair of the Brookings Institute into the market value of corporations listed in the Compustat database shows that the market value of U.S. corporations has shifted significantly from tangible to intangible assets. As shown in Table 1-1, in the ten years from 1982 to 1992, the contribution of intangible assets to market value rose from 32 percent to 68 percent. Subsequent studies from multiple sources estimate that since 1998, intangible assets' contribution to corporate value is approximately 85 percent.[1]

Table 1-1: The Growth of Intangible Asset Contribution to Corporate Value

Year	Intangible Assets	Tangible Assets
1982	32%	68%
1992	68%	32%
1998	85%	15%

More recent research reflected in the Ocean Tomo 300 Patent Index shows that 80 percent of the market value of companies in the United States' Standard & Poor's 500 Index is due to intangible assets for the period from 2005 to 2010.

How can intangible assets such as people, processes, patents, and data be monitored and managed effectively using a 500-year-old system designed for use with tangible assets?

Ram Charan, international consultant and coauthor of *Execution*,[2] wrote an article in *Fortune* magazine titled “Why CEOs Fail.” In writing about highly experienced, well-known CEOs who lead their companies into failure, he said, “In the majority of cases—we estimate 70 percent—the real problem isn’t the high-concept boners the boffins love to talk about. It’s bad execution.”[3]

Charan goes on to write that most CEOs are hard-working, experienced, brilliant people. His research found one problem common to all the failures:

> Yes, strategy matters. A good, clear strategy is necessary for success—but not sufficient for survival. So look again at all those derailed CEOs on the cover [of the magazine]. They’re smart people who worried deeply about a lot of things. They just weren’t worrying enough about the right things: execution, decisiveness, follow-through, delivering on commitments.

So executives and managers face two serious problems. First, the source of value production has switched from tangible assets that can be monitored with current accounting systems to intangible assets that are difficult to manage. Second, most corporations fail at executing their strategy.

A Modern Strategic Management System

In 1992 Harvard professor Robert Kaplan and consultant David Norton published the article “The Balanced Scorecard —Measures that Drive Performance” in the *Harvard Business Review*.[4] The ideas in this article sowed the seeds of a strategic management system to translate strategy into action, to monitor strategic execution, and to align organizations around strategy.

Initial attempts to use the Balanced Scorecard seemed to either propel organizations to success or burden them with administrative overhead and dismal results. The difference between failure and success was often in the selection of metrics used to measure strategic execution. In 2000, Kaplan and Norton published another article in the *Harvard Business Review* titled “Having Trouble with Your Strategy? Then Map It.”[5] This article outlined how to build a visual map that shows the objectives and causal links necessary to execute a strategy. These causal links enabled executives to identify the key metrics that drive success. These two ideas, the Strategy Map and the Balanced Scorecard, combined with more recent developments, have built a strategic management system that is an important part of modern business management.

The Strategy Map represents how an organization will execute its strategy. The Strategy Map shows the objectives needed to execute the strategy and the causal links between objectives. The Strategy Map is a tool for clear communication and helps identify the “critical few” metrics to monitor strategic execution. You can learn more about Strategy Maps in Chapter 4.

The Balanced Scorecard is part of a system that translates strategy into action. The Balanced Scorecard gives a balanced view in four perspectives of how well an organization is driving execution and how successful the results are. The four perspectives in the Balanced Scorecard and Strategy Map give executives a more balanced view of their organizations. They go beyond financial measures to include finance, customer and marketplace, internal operations, and learning and growth. These categories include people, culture, intellectual property, and IT infrastructure.

The Strategy Map and Balanced Scorecard can take one to three years to fully implement in an organization, but the results can be impressive. A Balanced Scorecard helps you do the following:

- **Clarify strategy.** The discussions and thought that go into developing the Strategy Map bring clarity and understanding to the executive team in terms of the strategy and interplay between departmental silos. The graphical Strategy Map pinpoints for employees how they contribute to strategic success.
- **Translate strategy into action and execute it.** The Strategy Map, combined with an Action Plan and Implementation Plan, give everyone a clear road map showing how the strategy will be translated into action. The Balanced Scorecard is used to stay on track and to monitor execution.
- **Align business units around the strategy.** Most organizations develop “silos,” functional departments or divisions that are more concerned with their own success than they are with achieving success for the entire organization. But developing the Strategy Map and Action Plan requires that the walls between silos come down. Focusing on Strategic Themes that cross functional boundaries forces departments to work together, breaking down silos even more.
- **Communicate the strategy to all levels.** The process of cascading the Balanced Scorecard through the organization gives each level the opportunity to contribute to organizational success. It allows executives to communicate with functional managers about how to achieve strategic goals. It allows functional managers to provide feedback to executives about capability and capacity.

- **Monitor and manage strategic execution.** Research has shown that most executive staff members spend less than 10 percent of their time monitoring strategy and execution. Instead of leading through strategy, executive staff members often become embroiled in operational performance, something better left to managers. Using the Balanced Scorecard as an agenda gives executive meetings a central focus on strategic leadership.

Why Use a Balanced Scorecard?

Building a Strategy Map and Balanced Scorecard for an organization follows much the same process as taking a trip to a specific location. To take a trip you need to do the following:

- Select a destination.
- Agree on the type of trip.
- Agree on the route.
- Map the route.
- Plan time and resources.
- Travel.
- Stay on course.

Leading a business in our high-speed world isn't that different from flying a jet. Imagine boarding a small jet, pausing at the entry, and asking the pilot a few questions:

> You: "What is our destination?"
>
> Pilot: "The crew got together and talked about a destination. We couldn't agree, so we decided to go somewhere out West. If something better comes up while we're en route, we might change direction."

> You: “What route will we be taking?” (Maybe I’ll still go. It sounds adventurous, although it could be a waste of time and fuel. It shouldn’t be too dangerous.)
>
> Pilot: “Well, we aren’t sure about the exact route, but I’ve been that general direction before, so I don’t need maps. I’m experienced.”
>
> You: “I notice that your cockpit dashboard seems a bit sparse. There aren’t any flight instruments—just stacks of paper. How will you monitor the flight?” (This is starting to sound a bit iffy. The pilot may be experienced, but how will she communicate her experience to the copilot, the flight engineer, the flight attendants, the ground crew, other aircraft, and the Federal Aviation Administration?)
>
> Pilot: “Well, we’re comfortable with the detail of printed reports. While we’re in flight, I can request a short stack of printed reports that tell me the airspeed, altitude, attitude, and heading. The copilot gets a larger stack with operational data about radio settings, fuel, hydraulics, and technical details. We have to ask for the data, but it takes only a few minutes to get new reports. So we’re in pretty good shape as long as everything stays stable and we don’t have mechanical, weather, or crew problems.”
>
> You: “Sounds like quite an adventure you’re about to embark on. Sorry I won’t be able to go with you.”

This metaphor isn’t that far from how some organizations manage. Many start-ups and high-tech companies define their strategy as going after “targets of opportunity.” I’ve actually heard executives of high-tech start-ups proclaim that having a strategy puts up boundaries. They feel their business changes too fast for any type of strategy. This seems especially true for companies making the organizational leap from small company (less than $50 million) to big company (over $100 million).

It is possible to be agile while having strategic objectives that cement the organization. For example, Eric Ries in his book *The Lean Startup* (Crown Business, 2011) describes the concept of Minimum Viable Product that evolves with agile adaptation to customer needs. At market failure points the lean startup method demands that a business pivot in a new direction. But nowhere does that prevent a business from having an overarching strategy and objectives. In fact, objectives such as minimum viable products, agile development, and pivots can be critical strategic objectives in themselves. They are objectives on which you want to build a culture. Without the use of strategic and operational dashboards to monitor customer and development metrics, high-tech companies can drive themselves crazy chasing customers and wasting resources.

Although the idea of a pilot flying by referring only to printed reports seems outlandish, consider how many organizations manage while looking only at financial reports. Financials show only lagging results from efforts that may be from months before. Doing this is almost the same as flying using printed reports alone.

Recent research confirms that executives and managers with over ten years' experience in an industry can have a good gut instinct for making decisions, but how can they communicate that gut instinct to the hundreds or thousands of people they must lead and manage? How can employees and managers without such experience understand the strategy and make good decisions?

The Strategy Map gives an organization an excellent visual tool to explain what is important for strategic success and how and where in the strategy each employee contributes. Executives and managers at multiple levels can use the Balanced Scorecard to monitor whether they are actually driving strategic success. If the results aren't happening as planned, the Strategy Map, Strategic Objectives, and Balanced Scorecard need to be revised until the organization has a valid model of what works.

Building a Balanced Scorecard

The activities for planning a trip listed in the preceding section correspond to similar activities in building a Strategy Map and Balanced Scorecard, as shown in Table 1-2.

Table 1-2: Building a Balanced Scorecard Is a Journey

Travel	Balanced Scorecard	Intent
Select a destination.	Destination Statement	State in one page what your organization wants to be at the end of your strategic horizon.
Agree on the type of trip.	Strategic Themes	Your trip's journey might have a theme of speed or low cost. Your Balanced Scorecard might have Strategic Themes such as customer intimacy or operational excellence. How you execute your Strategic Themes differentiates you from your competitors.
Agree on the route.	Executive and Division Alignment	Leaders, managers, and employees must all be going in the same direction.
Map the route.	Strategy Map	Identify the route and objectives that will get you to your destination.
Plan time and resources.	Action Plan and Implementation Plan	Identify the measures, metrics, and initiatives, and who is accountable.
Travel.	Prioritize, budget, and act	Execute the strategy.
Stay on course.	Balanced Scorecard	Monitor your Balanced Scorecard to make sure your organization is on track.

Does the Balanced Scorecard Guarantee Business Success?

No killer methodology guarantees success in business. The Strategy Map and Balanced Scorecard do not guarantee success. Organizations can still fail by having the wrong strategy, by having a poorly built Strategy Map and Balanced Scorecard, by failing to use the Balanced Scorecard after it is implemented, or by failing to modify the Balanced Scorecard if their hypothesis of what works is wrong.

I occasionally meet consultants and executives who proclaim, “We tried a Balanced Scorecard and it didn’t work.” Their perception may be true. Some research shows that approximately 30 percent of Balanced Scorecard attempts fail.

There are many reasons for failure, and the Balanced Scorecard fails in companies for a variety of reasons. Here are some of the most common:

- **Lack of senior executive commitment:** An executive at the highest level in the strategic business unit must sponsor the Balanced Scorecard. Without the commitment of the senior executive, managers and employees feel that the Balanced Scorecard is just another “management fad of the month.” The senior executive must make a case for change in the organization that will light a fire under everyone.
- **Lack of a case for change:** Organizations are difficult to change. The Balanced Scorecard is used to create a culture of high performance, translating strategy into action. Without a driving need for change, and an organization-wide awareness of the need, the Balanced

Scorecard will become just another performance management system that will fade.

- **Lack of an experienced consultant or facilitator:** Developing and implementing a Balanced Scorecard is difficult. It is critical to use an experienced facilitator or consultant to guide initial development and to train internal facilitators and managers who can carry on the work. You are betting the strategic success of your organization on this effort. You don't want to use a general business consultant who has read a book or a *Harvard Business Review* article on Balanced Scorecards. There are many traps to avoid, and you want someone who knows how to do so.
- **Too many metrics:** Too many metrics can create a confusing model of what drives strategic success. The Balanced Scorecard becomes an Operational Dashboard.
- **The wrong metrics:** Using the wrong metrics drives performance in the wrong direction.
- **Fear of measurement:** People in some organizations fear being measured. This fear could stem from many different causes, some of them valid. The way to approach this fear is that the Balanced Scorecard and operational performance are not there to identify and punish the poor performers. Rather, they are there to identify high performance and share the best practices that created the high performance. Handling this depends on the skill and practices of management.
- **Too long to develop:** Taking too long drains motivation and results in the loss of key resources and momentum.
- **Cultural mismatch:** Organizations with a cultural norm of low performance or organizations with dictatorial executives require a major cultural change before implementing a Balanced Scorecard.

Some executives and consultants have asked me if the Balanced Scorecard replaces Six Sigma, if it's more productive than Lean, or if it coordinates projects better than a Project Management Office. A Balanced Scorecard does not replace any of these. It works as a strategic management system that acts as an envelope to keep Six Sigma and Lean projects aligned with strategy. It works with accounting, budgeting, and the Project Management Office to optimize them for the organization, rather than just for individual silos.

Some organizational cultures just don't work well with a Balanced Scorecard. For example, some nonprofits, such as hospitals, work well with Balanced Scorecards and can use them to significantly increase their efficiency and performance. Other nonprofits, such as social service organizations, seem to have a great deal of difficulty working with measures and metrics. Often this is because they feel they provide intangible benefits, which are not measurable. Some for-profit high-tech companies, especially start-ups, feel that their business changes too rapidly to have any strategy. Their strategy is to go after any opportunity. Other for-profit high-tech companies, such as medical device manufacturers, have a focus that benefits greatly from a Balanced Scorecard.

I've seen organizations that have a cultural mismatch with a Balanced Scorecard and have no desire to change. Some of these organizations seem to have a culture of self-inflicted low performance. In particular, one director of an umbrella social services organization comes to mind. As part of a group of pro bono senior consultants, I volunteered to help the organization increase productivity and manage staffing problems. When our pro bono group presented our findings, along with numerous no-cost and low-cost solutions, the director scolded us: "We are here to help people. We are not your Silicon Valley corporation concerned with measuring, planning, and performance." Those of us on the consulting team who gathered later for an After-Action Review felt sad for the organization’s young clients. The director had the attitude that her organization couldn’t increase performance and care for people at the same time. By enabling low performance under her management, she was abandoning many children who might have gotten a head start on education. Low performance with no desire to change meant that many low-income families weren’t being served by the health and education clinic under her control.

Does the Balanced Scorecard Really Work?

The now-famous quote “What gets measured gets done” is most often attributed to management guru Peter Drucker. Although it seems to be an obvious truth, a more direct proof of the value of Balanced Scorecards is their acceptance and use among corporations worldwide. Bain & Company, an international consulting firm, does an annual survey on management tools among its 6,200-plus large corporate clients. Approximately 50 percent of the surveyed clients use a Balanced Scorecard, with an almost 80 percent satisfaction level. This makes the Balanced Scorecard one of the most widely used strategic tools and places it within the cluster of tools that garner high levels of satisfaction.

Although the Bain & Company survey shows the pervasive use of the Balanced Scorecard, many organizations don’t talk much about their success to the press. But successes that have been publicized cover a wide range of industries:

- Duke Children’s Hospital reduced costs by $30 million and increased net margin by $50 million in two to three years while increasing patient and staff satisfaction.
- Delta Dental of Kansas, the largest dental benefits provider in the state, is a 90-employee company that

saw its revenues jump from $63 million in 2001 to $172 million in 2006 (a 173 percent increase) while increasing employees' satisfaction with and understanding of their jobs.[6]

- Crown Castle International, the world's largest owner of telecom infrastructure, needed a strategic shift from its acquisition strategy in 2001 to a strategy of operational excellence in 2003. Even as its competitors faced meltdown, it saw cash flow rise from a negative $300 million to a positive $100 million, and its stock price beat market indices by more than 300 percent.[7]
- Keycorp, one of the nation's largest bank financial services organizations, has cascaded its four strategic themes through all 19,000 employees.[8] The Key Corporate and Investment Banking Group (KCIB) improved its return on equity (ROE) by 28.8 percent in three years, and its vendor satisfaction ratings also improved. In three years, its ratings went from 45–74 percent to 86–93 percent.

Do Small and Midsized Businesses Benefit from the Balanced Scorecard?

Executives of small and midsized businesses (SMBs) may have the impression that the Strategy Maps and Balanced Scorecards are for large corporations only. Actually, small and midsized businesses may find that Balanced Scorecards are easier for them to implement and that the payoff comes quicker. Of the Balanced Scorecard Hall of Fame winners, 20 percent are small and midsized businesses.

SMBs may have even more to gain from Strategy Maps and Balanced Scorecards than large organizations because