The Balanced Scorecard: *20 Years and Counting*

By Mark L. Frigo

TO COMMEMORATE the 20th anniversary of their introduction of the balanced scorecard (BSC) performance management system, *Strategic Finance* interviewed Robert S. Kaplan, Marvin Bower Professor of Leadership Development, Emeritus at Harvard Business School, and David P. Norton, founder of multiple consulting companies, including the Nolan-Norton Company, where the original BSC was developed; Renaissance Solutions; and the Balanced Scorecard Collaborative.

Kaplan and Norton introduced the balanced scorecard in a January-February 1992 *Harvard Business Review* article titled "The Balanced Scorecard: Measures that Drive Performance" and a 1996 book, *The Balanced Scorecard: Translating Strategy into Action*, that has been translated into 24 languages. The BSC was originally introduced to improve corporate performance measurement by balancing lagging metrics of financial performance with nonfinancial metrics that drive future performance. Their fifth and most recent book, *The Execution Premium: Linking Strategy to Operations for Competitive Advantage* (2008), captures the accumulated lessons from the previous 15 years and describes how the BSC has become the number one management system for strategy execution. During the last 20 years, Kaplan and Norton have helped create a new body of knowledge for strategy execution that's now being used throughout the business, nonprofit, and public sectors.

The Evolution of the Balanced Scorecard

MLF: What was the impetus behind the balanced scorecard? What motivated you to get involved with research about the balanced scorecard, and why did you decide to develop it further?

RK & DN: We introduced the balanced scorecard because we believed that exclusive reliance on financial measures couldn't drive sustainable value creation. Financial measures are lag indicators that report on the outcomes from past actions. Exclusive reliance on financial indicators encouraged behavior that sacrificed long-term value creation for short-term performance.

The creation of the balanced scorecard in 1990 reflected the changing nature of technology and competitive advantage in the latter decades of the 20th Century. In the Industrial Age competition of the 19th and much of the 20th Centuries, companies achieved competitive advantage from their investment in and management of tangible assets such as inventory, property, plant, and equipment. In an economy dominated by tangible assets, financial measurements were adequate to record investments on companies' balance sheets. Income statements could also capture the expenses associated with the use of these tangible assets to produce revenues and profits. But by the end of the 20th Century, intangible assets had become the major source for competitive advantage. In 1982, tangible book values represented 62% of industrial organizations' market values. Ten years later, the ratio had plummeted to 38%, and by the end of the 20th Century the book value of tangible assets accounted for less than 20% of companies' market values.

Clearly, strategies had to change from managing tangible assets to those that leveraged the company's intangible assets, such as customer relationships, innovative products and services, high-quality and responsive operating processes, skills and knowledge of the workforce, the information technology that supports the workforce and links the firm to its customers and suppliers, and the organizational climate that encourages innovation, problem solving, and improvement. But with companies not measuring their intangible assets, many failed in the implementation of their new strategies. They couldn't manage what they couldn't describe or measure. Consequently, shortly after the introduction of the BSC, it soon became the premier management system for effective strategy execution, a theme that we embraced for the next two decades.

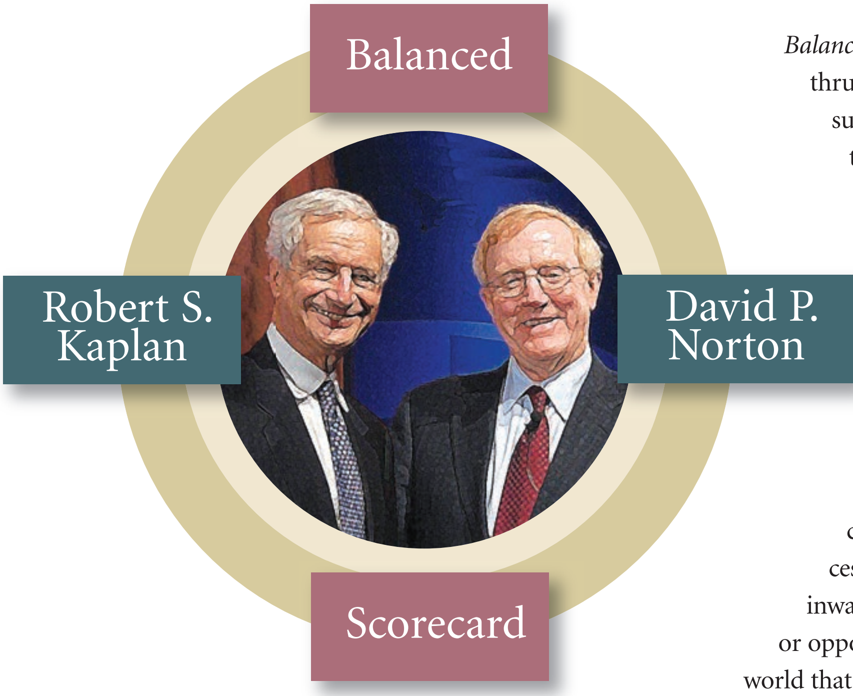
The BSC also provided a missing component and integration among various apparently conflicting management theories in the 1970s and 1980s that had been developed in complete isolation from each other. Quality and lean management emphasized employees' continuous improvement activities to reduce waste and increase company responsiveness. Shareholder value, based on the economist's principal-agent framework, placed heightened emphasis on financial performance measures. Stakeholder theory placed the firm as an intermediary attempting to forge optimal relationships among investors, customers, suppliers, employees, and communities. We attempted to retain the valuable insights from each of these theories in our BSC framework. Continuous process improvement of operations, customer management, and innovation is critical for current and future success. Shareholder metrics ultimately will increase if companies' performance with customers and processes improves. And to optimize long-term shareholder value, the firm had to internalize the preferences and expectations of its shareholders, customers, suppliers, employees, and communities. The key was to have a more robust measurement and management system that included both operational metrics as leading indicators and financial metrics as lagging outcomes, along with several other metrics to measure a company's progress in driving future performance.

Executive Leadership Is Key to Success

MLF: During the last 20 years you've studied many organizations that have used the BSC management system to achieve breakthrough performance. What are the keys to success you've observed at these companies?

RK & DN: The most important condition for success is executive leadership. We are unaware of any truly successful BSC project that wasn't led and sponsored by the CEO of the organizational unit. In *The Execution Premium*, we speculated that not only was executive leadership necessary for successful implementation, but it may also be sufficient. The strategy execution system described in the book provides the leadership team with a systematic and comprehensive sequence of management processes that provides the foundation for breakthrough performance.

Leading change, especially introducing a significant change in strategy, is the best trigger for implementing the



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BSC strategy management system. Often the change is obvious because of terrible financial performance, such as that experienced by Cigna Property & Casualty Insurance and Mobil Marketing and Refining in the early 1990s (two well-known BSC implementation examples [see p. 53]) and, more recently, by Volkswagen do Brasil between 1998 and 2006, as documented in a 2010 HBS case study, *Volkswagen do Brasil: Driving Strategy with the Balanced Scorecard*. Sometimes radical change is thrust upon the organization by external events, such as for the U.S. Army in the 1990s after the breakup of the Soviet Union and the rise of new and more asymmetric threats and the FBI after the September 11 terrorist attacks on the United States. But great leadership may be even more important when the organization is currently doing very well. As leadership scholar John Kotter said, "Complacency exists when people think what they are doing is right and they don't need to change.…The most common cause of complacency is past success.…Success and scale usually result in an inward focus, where people don't see the threats or opportunities that lie just outside.…But in a world that is changing faster and faster all the time, complacency is cancer. Not bad. Not a problem. Cancer." [*The Washington Post*, June 27, 2011]

To summarize, having a noncomplacent leader is probably the most important key to success for BSC implementation. We need the leader to establish the vision for what the organization needs to achieve over the next three to five years, typically an ambitious stretch performance target, to create a sense of urgency to start the journey immediately, and then a willingness to communicate the strategy to all employees and to motivate them to contribute to the implementation of the strategy.

Everything else is straightforward, including translating a clear strategy into a strategy map and BSC, identifying and funding strategic initiatives that drive performance improvement, aligning organizational units and employees to the strategy, linking operational improvement programs and local dashboards to strategic priorities, conducting strategy review and updating meetings throughout the year, and instituting a small Office of Strategy Management to oversee these strategy implementation processes. We know how to do all of these, and they have been successfully implemented in thousands of enterprises around the world. The one factor that is out of our control is the leader of the organizational unit that wants to implement the BSC strategy management system.

Building Relationships with External Constituencies

MLF: Organizations face the challenge of communicating and building relationships with external constituents, including suppliers, customers, and strategic

partners. How can the BSC management system be used to develop relationships with external constituents and to improve communication?

RK & DN: An exciting recent development in our methodology is its use for defining and governing exactly such strategic relationships. McKinsey surveys indicate that more than 50% of strategic alliances fail to deliver their anticipated benefits. The principal causes have been the lack of trust between the two parties, the absence of a shared vision about how to create synergies from the strategic relationship, and the inability to conduct regular meetings to discuss the progress or lack thereof of the relationship. In a January 2010 *HBR* article, "Managing Alliances with Strategy Maps," we described how companies such as Quintiles and Infosys co-create strategy maps and BSCs with strategic customers. The co-creation process builds shared understanding and trust across organizational boundaries. It also establishes a clear strategy and associated performance metrics for creating the synergies, a tool for communicating the relationship strategy within each partnering organization, and the foundation for quarterly strategy review meetings among key executives from both parties to discuss how to overcome problems being encountered in the joint strategy execution and identify new opportunities for value creation.

We are now trying to extend this approach as a mechanism for implementing Michael Porter's shared value approach, where corporations partner with local community groups, NGOs [nongovernmental organizations], and governments to identify, communicate, and implement a strategy that creates economic value for the company while delivering positive environmental and social impacts in the communities where it operates and sells. We are very excited about the potential for using strategy maps and scorecards to implement shared value strategies between the private, public, and NGO sectors.

Public-Sector and Nonprofit-Sector Applications

MLF: The initial applications of the BSC focused on company performance, and we see many public-sector and nonprofit organizations using the BSC management system. How are public-sector organizations using the BSC? Can you describe a few examples?

RK & DN: We have now inducted about four dozen public-sector, education, and nonprofit enterprises from around the world into the Balanced Scorecard Hall of Fame (http://www.thepalladiumgroup.com/about/hof/Pages/Overview.aspx). They have all used the BSC management system successfully to implement their strategies. The inductees include the previously mentioned U.S. Army and FBI; Metro de Madrid (one of the largest urban public transit systems in the world); and the cities of Barcelona, Spain; Christchurch, N.Z.; Busan, South Korea; Charlotte, N.C.; Dubai, UAE; and two in the Philippines. We are also seeing implementations at the province and country levels in Brazil and Abu Dhabi.

Nonprofits include the Boys and Girls Clubs of Puerto Rico, the National Federation for Coffee Growers in Colombia, the Citi Center for Performing Arts in Boston, and many K-12 school districts, healthcare institutions, and universities. These public-sector or nonprofit enterprises can't possibly describe, communicate, or implement their strategies using just financial metrics, so the BSC is the natural foundation for their management systems. When moving our framework from the for-profit to the nonprofit sectors, the main change is to elevate the Customer Perspective, which now represents citizens and constituents, to the top perspective of strategy maps and scorecards. The ultimate accountability for these enterprises isn't whether they can raise revenues or balance their budgets; their mission and accountability is to create a positive social impact in the lives of their citizens and constituents. The BSC management system motivates all their employees to deliver such social value, helps the management team allocate their limited resources to strategic priorities, and helps them monitor and guide whether their strategy and strategic initiatives are, in fact, improving the lives of citizens and constituents.

Risk Management

MLF: The management of risk has become a top priority at most organization since the 2008 financial crisis. In your work on risk management, you define three categories of risk: preventable risks, strategy risks, and external risks. How can organizations use the BSC and strategy maps along with the three categories of risk to identify and manage risk more effectively?

RK & DN: Risk management has been another recent innovation. Enterprises that strive to understand and manage the strategy risks [the second category of risk described in Robert Kaplan and Anette Mikes, "Managing Risks: A New Framework," *Harvard Business Review*, June 2012] need a clear representation of all the components in their strategy. The enterprise's strategy map provides a comprehensive picture of the outcomes, processes, and inputs to the strategy and thus serves as a great reference

The Balanced Scorecard at CIGNA and Mobil

CIGNA Property and Casualty (CIGNA P&C) had lost more than $1 billion in the four years before Gerry Isom became its president in 1993. That year it lost $275 million. But Isom was determined to turn the situation around by reshaping CIGNA P&C from a generalist insurance company willing to underwrite a risk in any sector to a specialist company that would underwrite only when it could be assured of better-than-average results. To do this, he reorganized several aspects of the company. For example, he expanded the six-member executive council to 10 with four new hires. Then he brought together 20 top performers from the business and the IT organization as a transformation team and created a transformation officer. Then he focused on making distribution management, underwriting, and claims management more responsive to changing market conditions. Next he implemented the balanced scorecard and made it part of everyone's job. Within two years, Cigna was beginning to show a profit. After six years, the company joined the top quartile of its industry and had more than $100 million in profits. In 1999, CIGNA sold its property and casualty division for $3 billion.

Mobil's U.S. Marketing and Refining Division was last in industry profitability in 1993, so its CEO started a turnaround program. He introduced a new strategy and transformed the centralized, functionally organized division into 17 independent business units and 14 internal service companies. When he realized that the new organization and strategy needed a different measurement system, he implemented the balanced scorecard. This way the new profit-center managers could develop customized strategies, and the divisional BSC could be linked to the business units and internal service company BSCs and then to the managers' compensation. Within two years, Mobil had moved from last in its industry to first. It maintained that position for five consecutive years.

point for identifying the various risks to it. For example, companies such as VW do Brasil and Infosys use their strategy maps as the starting point for their risk dialogues. For each strategic objective on the map, they ask, "What are the critical risks that could put attainment of this objective in jeopardy?" Once all the risks have been identified, they set priorities using a 2×2 risk map (scoring each risk on a 1 to 5 scale for likelihood and severity of impact). For the most consequential risks, they develop early-warning indicators (to populate a separate risk scorecard) and assign a manager to develop a risk mitigation plan, to monitor the emergence of the risk event, and to allocate resources to reduce, in a cost-efficient manner, the likelihood and impact of the risk event.

We are finding that basing the management of strategy risks on the BSC and strategy map avoids the trap of organizing risk management by functional silos, such as human resources risk, credit risk, brand risk, IT risk, and operational risk. It promotes strategy risk management as a senior executive responsibility and facilitates the management of strategy risk as a comprehensive and integrated process, not the fragmented approach that results from compartmentalizing risk into functional responsibilities.

What's Ahead?

The BSC management system has proven to be a robust and innovative framework that has continued to develop in many directions and applications. It represents a disciplined approach for managing strategy execution and performance measurement that can help organizations drive superior performance. The development of the new body of knowledge in strategy management that Kaplan and Norton have led has significantly increased the value of management accounting and elevated its value in organizations. The future of the BSC management system is based on a strong foundation that sets the stage for the types of innovations mentioned in this interview. **SF**

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