Strategy and the balanced scorecard. (Strategic Management).

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The balanced scorecard is a powerful management tool for strategy execution. When used as a true strategy scorecard, it can help management not only execute strategy but also refine it. Let's examine an important use of the balanced scorecard framework in today's business environment - strategy evaluation and refinement.

The Balanced Scorecard

The balanced scorecard, as developed by Robert Kaplan and David Norton (The Balanced Scorecard: Translating Strategy Into Action, Harvard Business School Press, 1996), is a strategy-focused approach to performance management that includes performance measures derived from the organization's vision and strategy. Scorecards include strategic objectives and performance measures in a hierarchy of areas, such as financial, customer, internal processes, and innovation. The strategic objectives and performance measures within the balanced scorecard framework are derived from the vision and strategy of the organization. Companies using the balanced scorecard include ABB Switzerland, AT&T Canada, Chemical Bank, Hilton Hotels, Sears, UPS, Wells Fargo Online Financial Services, and Wendy's International. The U.S. Army also has recently adopted it as part of its Strategic Readiness System.

The balanced scorecard provides a hierarchical framework that management can use to link or connect the unique strategic activities to the ultimate goal of financial value creation. At the top of the framework is financial performance, which is driven by a unique customer value proposition. This is in turn delivered by the right set of business processes (the value chain). At the base of the hierarchy is innovation and growth, which provide the capabilities and infrastructure for a continually evolving value proposition and processes. The cause-and-effect linkages within the balanced scorecard hierarchy can be powerful tools for strategy evaluation.

The IMA Survey

Some of the recent IMA surveys on performance management reflect these cause-and-effect linkages (Frigo, "Strategy, Business Execution, and Performance Measures' Strategic Finance, May 2002). The surveys found that, for balanced scorecard users, performance measurement systems better supported corporate strategies, and stronger linkages existed between performance measures in their performance measurement systems. The survey also found that the balanced scorecard facilitated identification of new performance measures. As organizations used the balanced scorecard and related strategy maps, they discovered cause-and-effect linkages and new performance measures that complete the linkages. The survey also found that the balanced scorecard improved the effectiveness of performance measurement systems in communicating strategy to employees.

Testing the Strategy

Strategy can be viewed as a set of if-then hypotheses. If certain strategic activities are undertaken, then expected financial results will occur--as will all the intermediate steps in between. How do we know whether a particular strategy is working, and, just as important, how soon do we know? How do customer performance measures link to financial results? And what is the time lag? Here, cause-and-effect analysis in the balanced scorecard framework can help. A recent study at Harvard Business School (Campbell, "Putting Strategy Hypotheses to the Test with Cause-and-Effect Analysis," The Balanced Scorecard Report, September-October 2002) examined how balanced scorecard cause-and-effect analysis could be used to evaluate the effectiveness of strategy.

Does Customer Loyalty Result in Financial Returns?

Using the goal tenets of Return Driven Strategy, we can posit that fulfilling unmet customer needs in large, growing market segments will lead to financial returns. But can we measure the magnitude and time response of the linkage? Fulfilling unmet customer needs can be measured in terms of customer loyalty or price premium. But how do we know whether fulfilling unmet needs results in financial returns?

Hilton Hotels provides an interesting example of how balanced scorecard measures can be used to test the strategy. The Harvard Business School study found that a 5% increase in customer loyalty at Hilton Hotels (as measured as the percentage of customers who indicated they are likely to return to Hilton) in a given year was associated with a 1.1% increase in annual revenues the following year at a typical property. This was based on a study of 42 hotels for over four years using multivariate regression analysis.

Will the Innovative Offering Work?

Many companies attempt to innovate offerings to stand apart from competitors. Using the tenets of Return Driven Strategy, we need to ask whether the innovative offering truly fulfills unmet customer needs in large, growing market segments. Can the organization operate effectively to deliver this innovative offering? Can it engage employees with the right skills to deliver the innovative offering? Is the offering consistent with its brand?

Store24, a New England convenience store retailer, was another company in the Harvard Business School study. Store24 adopted a "Ban Boredom" strategy in 1998 that focused on providing an entertaining shopping atmosphere (see Kaplan and Norton, The Strategy-Focused Organization, Harvard Business School Press, 2001, pp. 81-83). Within two years, Store24 abandoned the "Ban Boredom" strategy based on customer research that showed customers identified with Store24's traditional convenience-store strengths of fast and efficient service rather than an entertaining shopping experience. The company quickly adopted a new strategy, "'Cause You Just Can't Wait," which focused on speed and efficiency. You might conclude that the real unmet needs of the customer were faster and more efficient service. This may be true, but the balanced scorecard can provide a deeper and more rigorous analysis of the cause-and-effect relationships in evaluating the strategy.

The Harvard Business School study found some interesting relationships. First, better execution of the "Ban Boredom" strategy showed virtually no effect on profitability across all stores. But the study also found that better execution of the "Ban Boredom" strategy led to improved profitability in stores with more highly skilled crews. Conversely, it found that better execution of the "Ban Boredom" strategy led to declines in profitability at stores with lower skilled crews. For the "'Cause You Just Can't Wait" strategy, better execution was associated with improved profitability across all stores. This cause-and-effect analysis could be useful in refining the strategy and considering whether employee skills should be upgraded.

The balanced scorecard also can be used to evaluate and refine strategy at the departmental level. A recent study by the Institute of Internal Auditors Research Foundation (Frigo, A Balanced Scorecard for Internal Auditing Departments, Institute of Internal Auditors Research Foundation, 2002) examined how the balanced scorecard could be used to refine the strategy of an internal auditing department and align it with audit committee and corporate priorities. For example, one of the internal auditing departments in the study noticed it was missing the mark on improving controls and finding cost improvement opportunities, so it used its scorecard metrics and linkages to focus its activities on the key customer metrics in those areas.

Strategy

To achieve great results, companies must excel in the right combination of strategic competencies--innovation, operational excellence, and branding--to fulfill unmet customer needs in large, growing market segments. At the same time, these companies must use the right mix of supporting strategic activities, including strategic partnering, employee engagement, and value chain redesign. Strategy is a hierarchical network of interrelated activities. The cause-and-effect relationships in the balanced scorecard framework can help management to continuously evaluate and refine its strategy at various levels of this hierarchy.

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