Lecture Text

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Building Strategy-Focused Organizations with the Balanced Scorecard

(*edited for clarity*)

Introduction
I am Bob Kaplan, and I'm very happy to greet you all. Some of you are already friends, and I am looking forward to making some new ones. Over the next seventy-five minutes I'm going to be sharing with you the work that I've been doing with Dave Norton, who is with a consulting company, on introducing a new performance management system in organizations, and we'll talk about that idea.

We started out with private organizations, for-profit organizations. But in the last six years these ideas have also migrated to nonprofit and public-sector organizations. And I'll talk briefly about those. I'm going to give you a very quick tour of this work.

The Balanced Scorecard
So let me start with the approach, which is called the Balanced Scorecard. And some of you may be familiar with it, and others may not. For those who are not, this slide is Balanced Scorecard 101. And the idea that we had, which goes back ten or twelve years, was that in today's competitive environment, companies compete not on their physical tangible assets, but by their intellectual and knowledge assets—employee capabilities and motivation, information technology, new products, quality, and relationships with customers. In this environment, financial measurements are inadequate to manage and guide enterprises where so much of the value creation comes from the non-tangible or things other than the physical assets—inventory, property, plant, and equipment—which historically has been the focus of companies' balance sheets.

We didn't want to throw away the financial measures since we still think those are ultimately objectives that organizations are striving for, for-profit organizations. But they were insufficient by themselves to guide near-term improvements and direction, near-term being one to three or four years.

Balancing Perspectives
And so we retained the financial, but we introduced three other perspectives, one relating to customers. Who are our customers and how do we create value for them? Then we have internal processes. What are the processes we have to excel at to succeed with our targeted customers, and also deliver the value to our financial shareholders? And the foundation, which we call the learning and growth, is the capability for the organization to continue to improve and get better. And this has to do with the people that we have, their capabilities, their match with the kinds of requirements for the internal processes. But it's also systems, and particularly information systems, how well they are deployed and available for the employees to do their process work in relationships with customers. And third is the organizational climate and alignment. And I'll go back to that more comprehensively in some later slides.

But the key idea of "the balance" or "the Balanced Scorecard," at least initially, was to balance the financial measures with non-financial measures in these three other perspectives. There are some within my profession of accounting who actually want to put valuations on intangible assets. There is a little sub-literature out there. I actually believe that it is doomed to failure. You will not be able to put values on individual intangible assets for, I think, reasons that will become clear as I give you some examples. But the fundamental reason is that the intangible assets have no value in themselves. Their value is all contextual. It's only when you embed them in an organization with a coherent strategy and match them, or as economists say complement them, with other intangible and tangible assets that they get value.

So these assets get value by being in this entire network of other related tangible, intangible assets. But you can't take that total value and break it up into its individual parts. But you can still measure it. And we think measurement matters. It'll matter for other parts of this slide.

Objectives: What do we want to accomplish?
In building the Balanced Scorecard, we now start with objectives in these four perspectives. And the objectives are the word statements of what we are trying to accomplish. The problem with many organizations' strategic plans is that they talk about what they're going to do in the traditional sense, their list of actions, their list of programs and initiatives: "We're going to expand into new markets." "We're going to launch new products." "We're going to train our people, upgrade their skills."

But missing from that is why. Suppose you do all those things. How will you know whether it's been successful? And so plans, programs, actions, and initiatives are means to an end, but not an end in themselves. So we want to find out what are we trying to accomplish, even without people. It's not like we want to train our people. We want them to have the right skills for the jobs that they're asked to do or for the processes we're asking them to approve. We want good products coming out of our product development layouts. So we want to know what are we trying to accomplish. And that's what we have in these objectives.

Measures: How do we quantify the objectives?
Then we get to the measures. The measures are ways of quantifying the objectives. The words in strategic objectives, however well we craft them, have different meanings for different people. Even people who sat in the same room for five weeks to craft the word statements of objectives or strategies end up leaving that room thinking they're in agreement with each other and again have very different interpretations of what the words mean.

So we actually find that in measurement, the key value here is to clarify what we mean by the words, and reduce the inherent ambiguity that exists in words so that everyone really understands exactly what we mean. And so the measurement gives us that quantification for communication.

Targets: What are we striving to achieve?
Targets are the value we want the measures to take on. What is success? What are we striving to achieve?

Initiatives: What programs do we need to hit our targets?
And then we get to the initiatives, because we want to make stretch targets. What are the programs, short term, which could be six months to two or three years, that we have to undertake that will contribute to us being able to hit stretch targets for our strategic measures?

So this is the basic structure of the Balanced Scorecard, where our thinking was even ten years ago, about what it was and how it could contribute to organizational success.

Implementing Strategy

But we soon found that we had to think a lot more about strategy. And we started on this journey to deal with the defect in performance measurement. So that was really where we were. And our first paper, in January 1992 in the *Harvard Business Review*, dealt with a performance measurement problem. How do you pick up the value of these intangible assets?

What we discovered is that actually business had a much bigger problem than measuring intangible assets. The big problem was how to implement strategies, especially new strategies, that are different from what the organization happened to do. And this remains until the current time. And in Bain's study of the management tools most used by senior executives, things relating to strategy, mission, and vision are at the top of the list to senior executives. They think this is really important for them to do.

And yet we have data coming out indicating that most organizations have difficulty implementing strategies. A high percentage of organizations are failing to implement their new strategies. Why is that? What we came to realize is that this gap had developed in management tools and management systems, because we had the senior executives at the top doing these mission, vision, values, and strategy statements. It's the kind of thing senior executives do. They like to do it. They go offsite, and they work on this for a few days every year. And then they write it up, and often communicate it to employees. They have little cards they can carry around with them. And they have videos of the president talking about the vision and the strategy. So that's management trend one.

Management trend two was coming from the Japanese management approach. So for those of you who were here maybe in the mid-'70s, we were just getting exposed to this, this idea of quality coming in from Asia. A real surprise to find out that Toyota built cars that didn't fall apart as you drove them out of the new car showroom, that they were really very good at this.

And so there was a focus on quality. But they achieved the quality not the way U.S. and European companies did, through engineers designing the products and running quality control tests. They achieved the quality by giving more decision-making authority and more information to frontline employees, the ones who are closest to the process.

And so we empowered them to improve their processes, make them higher quality, fewer defects, more yield, faster, more responsive, shorter lead times. So a combination of empowerment to the front lines to make their processes better, faster, cheaper. So that was terrific.

But the problem was that there was no connection between what was happening at the top and what people were doing in the front lines, in the back offices of the organizations. So they're trying to move the organization in a new direction, and they heard the terms, but they didn't know what they meant for them, because they were also being told to improve quality and shorten lead times and satisfy customers. So they took existing processes and made them better. But what they didn't do is think about what they should do differently to help the organization succeed in their strategy.

Early Adopters of the Balanced Scorecard

And so what we saw in the early adopters in the mid-1990s were organizations using the Balanced Scorecard, in effect, to solve this problem. They came to us not because they felt there were defects in their measurement systems; they came to us because they felt this could be a tool to help them implement new strategies more successfully than they did in the past.

And, in the late '90s, Dave Norton and I started to be able to see whether these organizations were successful. And we got these quite remarkable results. And I'll talk about Mobil, which went from last in its industry in profitability to first in two years. This is a mature commodity industry with strong competitors: Shell, British Petroleum, Chevron, and Exxon. To go from last to first in profitability, and sustain it for five consecutive years, was unheard of in the industry. Major change in cash flow from -$500 million to +$700 million.

Cigna Insurance, also going from the bottom to the top quartile. And usually progress for insurance companies is measured in decades, if not centuries, given the long lags between how you act today and when results start to show up in the future.

A little bit later in the '90s, Saatchi used the Balanced Scorecard for a new worldwide strategy, and saw big increases. And Saatchi is a small agricultural producer. It's not just big, old economy companies. This is a small company, 200 employees trying to compete against similar companies in Mexico and Brazil, with labor costs 10 percent of the United States. And they shared with the employees their strategy to become much more efficient, much higher quality, much more responsive. And you can see the results: dramatic decreases in cost per pound. Quality goes up. Rework goes down. Absenteeism goes down. Named the number one supplier by Kroeger several years in a row. Healthcare organizations, even human resources group, using the Balanced Scorecard.

So we're getting successes, and they're out there. And we talk to the executives. We go back to them and ask how did this work? Obviously, they had strong leaders. They had a good strategy, maybe good products, good positioning in the marketplace. How did the Balanced Scorecard help you amidst all that? What was its contribution?

And they came back and said, "It closed the gap. It enabled us to drive strategy down to the front lines of the organization. Our employees could understand the strategy and help us implement it. It meant we could align all of our business units and our support groups, human resources, IT, and the like. And it really got us all focused on implementing the strategy." People pay attention to what you measure, especially if you throw some compensation behind it.

And so, if people are going to pay attention, what's the most important thing for them to pay attention to? And the answer that came back from these organizations is the strategy. That is the most important thing. Quality is important. Cost is important. And these will all be elements. But overriding, we want them to help us succeed with our strategy.

Principles of Becoming Strategy Focused

So as we studied how they did this, we formulated that all these organizations, sometime in their journey, were following these five principles that we call the "principles of becoming strategy focused." And that's what I'm going to take you through, a quick tour through these five principles.

First they did the normal thing that people associate with the Balanced Scorecard, which is to create that set of objectives and measures across the four perspectives. Translate the strategy into your strategic objectives and measures in these four perspectives.

But then they could align the whole organization, cascade out the scorecards to business units and to shared-service groups, and some of them even going externally to organizations that they have alliances with, the idea of cascading a strategy out and integrating it across organizations, getting it out to people, making strategy everybody's job. And we'll talk about how that gets accomplished.

Embed it in management processes. Because a lot of these programs get started, and there's a lot of energy and enthusiasm behind them, but it's difficult to sustain. So we learned that if you want to sustain the strategic focus, you have to change the processes and systems that are ongoing in the organization: the planning and budgeting system, the target-setting system, the reporting system, the agenda for management meetings. All of these have to modify to get this focus on strategy, not just operations.

And the critical one, of course, that overlaid everything was the role of executive leaders. In every one of those Hall of Fame companies, we know who the leader was who drove this process. And it was his/her vision to take it in that direction. And they were the ones who launched this and created the energy behind it, and sustained it, and made it happen. So these are the five principles. Let's go into what this means.

Principle One: Translate the Strategy to Operational Terms
Principle one is to create that first Balanced Scorecard, starting from the strategy and going to what success looks like from the shareholders' point of view, the financial, return on capital, economic value added, whatever your favorite high-level metric is.

And the other three perspectives are designed to explain to people how we achieve those financial results that we've set as targets.

Customer perspectives
And it certainly starts with customers. Some people have thought this is a stakeholder theory because we have customers and we have people. But actually, I'm not that big a believer in stakeholders. The reason customers are here is not because they're a stakeholder. It's because I haven't figured out where to get revenues from without customers. I mean if someone would give us revenues, I would drop customers in a heartbeat because they're actually quite difficult people often.

And so they're not there because of some altruistic purpose on our part. They're there because, if I want revenues, and especially revenue growth, that's where I have to get it from. So I have to understand who they are and how I'm going to create that value. And, in a sense, we're very much in Mike Porter's ideas of positioning ourselves, thinking about those segments, because we can't be everything to everyone.

Internal perspectives
Once we understand our shareholder objectives and how we might achieve the revenue growth with customers, then we can turn to internal processes. So one of the things that distinguished the scorecard ten years ago from TQM and many other kinds of non-financial measurement approaches was that it took us a long time to get to our internal processes, the things we do everyday. But we had to understand what the external demands were before we thought about which processes were critically important.

Because often it was not sufficient to make our existing processes better, faster, cheaper. There might be entirely new processes that we have to introduce and excel at in order to deliver the value for our customers that we've identified. So it's the opportunity of identifying those entirely new processes that becomes quite important.

Organizational learning
And then we can get to the people. You always get to the people last, when you're at the bottom. It seems like they're the least important. I say, "Well wait. When you build a building or you have a tree, what's the most important part of those structures?" It's either the foundation or the roots. That's the thing on which everything else is built. And so, for the tree, keeping that metaphor, you have to feed the roots, fertilize them, nurture them.

And then the theory of the case is that if we do a good job there, we get good growth up above, we have better processes leading to more customer satisfaction and more business with customers. And eventually, we get this low-hanging fruit of great financial returns. So this is really the foundation. But I have to understand where I want to end up before I make my investments in employee skills, and the capabilities, and the information technology.

The Balanced Scorecard Strategy Map
We started out on this journey ten years ago. We would build scorecards starting with a blank piece of paper. We wanted to emphasize that we are not into benchmarking metrics. We don't care what measures Ford is using, or Milliken, or Motorola. Whatever measures they're using probably make sense for their strategy. You may be in a different market. You have a different strategy. Your measures should be different. So let's start with a clean sheet of paper, and work our way through this.

But after having done hundreds of these, and seeing hundreds more from organizations that came to us, showed us what they were doing, talked at conferences, we actually started to see a pattern that all good scorecards had. And we captured that pattern with this strategy map or a template. This is really a template. It's not a replacement for the thinking. But rather than starting with a blank piece of paper to get to the end of the journey, we're starting you halfway there because we're giving you a framework for organizing the way you think about your measures and your objectives.

Financial strategy
It starts at the top with improved shareholder value and, again, with your favorite shareholder value metric. And financial strategy, at its heart, is basically simple. There's two ways to make more money: either sell more or spend less. Everything else you do is kind of background music to that. It may be wonderful to have motivated, empowered employees, and zero defect processes, and loyal, motivated reliable customers. If it doesn't help you sell more or spend less, you don't make more money.

So those are the two things. How are we going to sell more? There are two ways of doing that. We can sell more to existing customers, deepen our relationships with them, or we can find new customers, or new markets, or new products and services: two places we can go for more revenues. And as for spending less, when we take our existing costs and accomplish the same outputs with fewer resources, spending goes down or costs per unit drops, and we try to use our assets more efficiently.

So this is nothing new. It goes back implicitly to the DuPont formula about a hundred years ago. The challenge is particularly on the revenue growth. What's the story behind revenue growth? And that's really what much of the rest of the scorecard is about.

Customer perspectives

For the customer perspective you have to think about your strategy. So Porter talks about low cost or differentiation. Well we think low cost is more than just the price the customer pays. It's the cost of acquiring the product and service. And that includes the quality of the product. Do they have to do inspection? Are there returns? And it's also the ease of purchase. From Dell computers, it's just easy to purchase on the Internet.

So if we talk about a low total cost, it includes price, but also the quality and the ease of purchase of the product. And certainly, you can succeed. This is, obviously, Southwest Airlines, Wal-Mart, Dell, and Toyota, who offer their customers a low total cost value proposition. Or you can be a product leader: Intel, Mercedes, pharmaceutical companies. Sony, very atypical Japanese company, succeeds by continual innovation, best product in the class, and gets price premiums.

And the third piece is customer solutions, being very close to your customers, not unique in any one product, but you offer a complete set of solutions. This was IBM, 1960 to 1980. They understood their customer very well, the information technology executive. Operationally excellent they were not. IBM did not have lowest prices, and they never delivered a new product on time. So they did not excel along those dimensions. Were they the leading product company? No. Other computer companies were bigger, faster, with more powerful computers. IBM won because it offered its customer, the IT executive, a complete solution: hardware, software that ran on the hardware, consulting to show how the MIS applications could work, training of employees, education, the whole range of services. No one ever got fired for buying from IBM. That was the saying.

Goldman Sachs. Not really a lot of product leadership in financial services. Things are imitated easily. It's not low price, but has trusted relationships with chief financial officers. So you can succeed with a customer solutions strategy. And there may be others. These are just indicative.

But you have to choose what your strategy is and how you create differentiated value that distinguishes you from your competitors.

Internal perspectives
And then you can think about what operating processes you do every day that are critical for the value proposition, as well as for lowering cost. What do I do with my customers, customer relationship management? What are the innovation processes? How do I create new products and services? And how do I continue to earn the right to operate? I have to meet environmental, health, and safety standards. I have to be a good citizen in the community. It may not directly relate to customers or financial, but it keeps me in business, to earn the right to continue to operate.

So these can be very important. And they can even be strategic, if you are known as the best employer in your community, or you have customer segments that value your social contributions.

Learning and growth perspectives
And then you can get to what competencies the people need. What technologies support them in their process improvements? And the organizational culture and climate faction.

A Good Balanced Scorecard
So this is now a language for strategy that didn't exist before. We can represent any strategy in this framework. And it's also a checklist, because a lot of times when you have measures that you think are doing your strategy, you're leaving out certain elements.

And so I ask, when people show me their Balanced Scorecards, when you get a list of twenty-seven measures, "Is this is a good or a bad scorecard?" I'm actually mapping those measures into this framework. Do they have something on revenue growth as well as cost reduction? Do I understand the value proposition they're delivering to the customer? If I can't understand it, their employees can't understand it. So they don't know what they need to focus on to create that value. Are they doing both short-term improvements in operations as well as long-term innovation, creativity? And are they investing in their people, in their systems, and in their organizational climate?

So this has proven to be a very robust framework. And in fact the next book, the one that Dave Norton and I are now working on, is exploring this idea of strategy maps in depth, and going into the details for different kinds of strategies.

Mobil's Strategy Map
But just as an example, let's do a case study on Mobil. This is our representation of the strategy map. When they were doing this in 1994, we hadn't developed the strategy map concept. So they did not have this. They just actually had a list of measures. But we found it was a really good Balanced Scorecard because we could actually take their measures and map it, and show these linkages of what made their strategy successful.

Financial perspectives
At the top part, they wanted to improve the return on capital. Productivity. They wanted to become more productive, lower their expenses so they could be lowest cost. They couldn't be lowest price because they paid more for the raw materials, the crude oil, than some competitors who had access to the Alaskan oil fields. But at least they wanted to be low cost in their conversion processes, going from inputs to outputs. And if they were going to expand, as they did, they wanted to do it without having to build more refineries or more pipelines. Those are very expensive. So they'd like to get more use out of the existing assets so that more of the free cash flow they generate doesn't have to be reinvested in expanding facilities.

But the exciting part, actually, was the revenue growth, because their financial objective was to grow faster than the industry. The industry is growing 1 percent a year. They wanted to grow 4 percent a year. For those of you in high tech, this sounds like it's hardly even worth waking up in the morning. But at the time, Mobil was selling the equivalent of ten billion gallons of gasoline, equivalent to all their products. So if you could grow 2 percent faster than the industry or the competitors, that's another 200 million gallons a year. And at a dollar a gallon, pretty soon you're talking about real money here. So even modest improvements in market share or rates of growth are a big deal.

But they were going to do this not by low price; they actually were going to charge higher prices. They're not going to meet the discounters' price. They'd like to charge their ten cents a gallon premium over the lowest discounted price. Economists tell you that you cannot do this. You cannot have a commodity non-differentiated product sell at a higher price and have higher sales. Economists have downward sloping demand curves. If you want to sell more, you have to lower the price. If you want a higher price, you'll sell less. So they're going to try to violate this traditional wisdom here by selling more at a higher price. And because they don't want to be locked into this 1 to 4 percent a year growth sector that they're in, how can they get revenues other than gasoline?

Now, you say, what are they going to do, go into microprocessors or operating systems for software, or routers? No. They're not going to be competitors for Cisco, or Microsoft, or

Intel. That's not plausible, given their capabilities and their expertise. But are there things we can do within our core business that will enable us to expand with things other than gasoline and petroleum product sales? That's the hope.

Customer perspectives
Now you have to get to the customer perspective to figure out how this is going to occur. And at the time they were doing this, fortuitously, they had done some market research. And so the marketing executive, who was not actually part of the senior executive team at that point, got called into the meetings and asked, "We have these financial objectives to grow faster than the industry in premium products, and to sell at higher prices. How can we do this? Is this feasible?"

The marketing executive said, "Well, I'm glad you asked. According to our study, we found that not all consumers out there are the same. There are five different segments we've identified. One of the segments is very price sensitive. No loyalty. Wherever they see the cheapest gasoline, that's where they'll go. So that's the bad news. The good news is that this is only 20 percent of the market. And we have found three segments that are 60 percent of the purchasers who actually are price-insensitive within a certain range—ten cents to twelve cents a gallon—and will look out for these stations, will come to our stations if we give them something beyond just the purchase of a commodity product. They're looking for a very good buying experience."

For some of them, it meant a very fast serve. You can get to a pump quickly, and you can get out quickly without having to wait for somebody to take your money. Others spend a lot of time in cars. They drive a lot, and so when they stop at the gasoline station, they need biological support as well. And so they're looking for available, clean, and safe restrooms. Some of these same people are also eating on the run, and so they're looking for a convenience store where they have high-quality products that they can purchase quickly. And others may want minor car services.

So the long and the short of the story is that they then identified the 60 percent of the people who would be price insensitive if you offered them something along this fast, friendly serve, and a full-service stop. And the choice is, do we try to go after the 20 percent, the low price, very price sensitive, be the Southwest Airlines or the Wal-Mart of the gasoline business? Or do we go upscale and try to win with the 60 percent? But you couldn't do both. And you only had one gas station. You couldn't have Mobil for price-sensitive shoppers, discounting, and no convenience store, and only one gas pump. Mobil for the high-end people. That would confuse people.

So they have to come there with one brand. And they decided to go for that upper segment. And so they start to build gas stations that look something like this. And so, here's a self-service pump, and a consumer. And she's filling up her car. What is she looking at while she's filling up the pump? It's kind of a neat convenience store there. It's glass. You can see in. And Mobil determined, if they can get this consumer, when she finishes filling up her pump, to drive another fifteen feet and park in front of the convenience store, and buy a cup of coffee, they and the dealer have just made more margin from selling that cup of coffee than they made selling twenty gallons of gasoline. And if you can make this attractive enough, instead of only getting her business once a week when she fills up her car, she might come there every morning to get her muffin and cup of coffee, maybe come back in the afternoon, pick up a snack for dinner. So we can get that business every day rather than just when she happens to buy her gasoline.

So anyway, that's the theory of the case, what's going to attract her into the store, and what will get her to purchase these other gasoline products.

And Mobil has other customers because, actually, Mobil is not there at the point of sale. The point of sale that you saw there is independent franchisees, the dealers. They realized that for this new strategy to be this successful, they had to have the best dealers in the industry.

And so they actually created an objective and measures to attract and retain the best dealers, appealing to a basic human emotion, which is greed. Let's show them they can make the most money by being a Mobil dealer. And at first this looks contrary to Mobil's financial targets. But the theory of the case is that if we do a great job for the 60 percent of the purchasers, they'll come in, pay premium prices for premium products, and buy multiple products and services at the stop. There's more revenue and more margin Mobil can share with the dealers. Mobil can be the most profitable in the industry, and its dealers can be the most profitable of any franchise operator. It may not work, but it's a plausible theory.

Internal perspectives
The internal process mostly is on operational improvements that work—this seems a little at contrast with the customer intimacy strategy I just described to you. But you have to realize that, throughout Mobil's value chain, from acquiring crude oil to getting the gasoline out to the station, it's dealing with a commodity product. Nothing that happens in those assets is creating any differentiation.

And so if it's not differentiated there, then you have to be low cost, because any higher cost cannot be recovered. The only differentiation that occurs in this strategy is in the final point of sale, which is at the dealer's location. And, in effect, they understood this. So you see improved quality. That means higher yields, avoid downtimes, avoid stock outs, and run your costs down, keep your activity-based costs down.

And they had some entirely new processes. They had never really worried about dealers. Now they have much more intense processes to attract, retain, and upgrade dealers via dealer education, dealer management courses. So it did involve new processes they didn't do before, and much more thinking about what other products we can put in that gasoline station, the portal, financial service products. What other things can we do? Maybe pick up the dry cleaning and drop it off. If you get people to come there once a week, then there's a whole set of services you can think about that you can market through that one stop.

Learning and growth perspectives
Then they got down to their employees, the skills that they needed, changes in skills, the technology, and the alignment.

So the whole strategy is sitting here on one page. And I'll show you later how they communicated this out to their employees.

The Social Enterprise Program
I mentioned the Social Enterprise Program. And I don't know whether Dean Clark talked to you about that this morning. But it's a fantastic initiative at the school. And I've been involved in it for the last six years since they came to me about 1995, '96. They said, "We've been doing interviews with the leaders of nonprofit organizations, and what their needs are for improved management. And for everyone we spoke to in the top three was something called 'performance measurement.' Do you do performance measurement?"

I felt like Dustin Hoffman in "The Graduate." Performance measurement. I said, "Sure, we do it. And we have this new approach. It's working in the private sector." And I kind of knew it would work in the nonprofit sector, even though we had never done it. Because at least in the private sector, financial measures eventually tell you whether you're succeeding or not. And in the nonprofit or the public sector, the financial measures, which are typically the only measures that they have also, tell you nothing about the effectiveness of their organization. They tell you, if you raise money, you've spent money. Your expense ratios don't tell you whether the organization succeeds. I mean it's easy to balance your budget if you're a nonprofit or a public sector organization. Stop spending. That's easy. So balancing budgets is easy. What's hard is delivering on your mission, and doing it with constrained resources.

And we found we had to modify the architecture of the strategy map because we didn't want financial performance, like efficiency and expense ratios, to be at the top. But we did have to find out that they have two kinds of customers. When I buy Mobil gasoline, I pay for it, and I also receive it: I get the gasoline. But in nonprofits, there's one group of people who pay for it. They're called donors or funders. And there's another group who receive the services. Those are the recipients. And so we thought, "You should pay attention to both of those, both the funders as well as the recipients." Who are they? What do they value? How do we bond with them? And then think about the processes we have to excel at, and the employees, and the systems. So this is going on, and it's really inspiring how well this has worked.

Boston Lyric Opera

Just to give you one example: this is work we did locally with the Boston Lyric Opera. And this is now a case. In fact, we teach the Balanced Scorecard at Harvard now in the MBA Program in the first-year required course. And we don't teach it with Mobil or any other private sector. They see it with this case, the Boston Lyric Opera case. So we were introducing the social enterprise right there in our curriculum.

And they had a mission. It's not to be better than the Met or La Scala. Again, we don't have the resources or the history to do that. But they did want to be the training ground for the best young artists. And that's singers, conductors, set designers, directors, and the like. And so they wanted to have the young artists that appeared in these productions get intense training and then graduate into the major league of opera, and still offer distinctive, high-quality productions. That's kind of the mission statement, if you read it.

Customer perspectives

And so, doing this, they found out that they had multiple constituencies, not surprising for nonprofit organizations.

One of them was the supporters and the subscribers. If we sell out every performance this year of the opera, or any year, in this city, we have generated 34 percent of the budget. This is the most expensive art form there is, in this small opera house. Even at very high ticket prices, you raise a third of your budget. So it's constantly focused on raising money and gaining the support, first getting people to resubscribe, but especially to give generously. So there is a focus on the supporters, foundations.

Two is to have an impact on the national and the international opera scene. And they want to be known as not just another regional opera company, but for some kind of distinctiveness or BLO style, a residency program for the young artists, with a diverse repertoire. We're not going to do just Mozart, Puccini, and Verdi, but introduce people to some of the other less well known operas or contemporary operas and leverage our resources by collaborating with other opera organizations and other arts organizations around the world.

And the third important one is the community. How do we create the next generation of opera goers? How do we have opera have more of an impact in the Boston area?

As they were developing this scorecard and working through the strategy, there were board members included, and they had the senior management of the opera company, including the music director, Stephen Lord. He said, "The problem with opera in America is that people think you have to come dressed in suits and tuxedos and long gowns, and it's a big fancy thing. And opera, in the seventeenth and eighteenth century, was for the masses. We need to bring opera to the masses." And he said, "We should do opera in Fenway Park." And that was literally what he said. So that was that theme: build opera, build community support, and provide more educational programs in the community.

Internal perspectives
And then they worked through the internal processes, actually customer management, operational excellence; create the brand, product leadership or innovation, and then people and systems, and the financials at the foundation.

Those of you who live in the Boston area may know that several weeks ago, probably just two weeks ago, we had this amazing event called "Carmen on the Common." And it was a direct outgrowth of the scorecard, impacting the local community. And we think of opera as kind of popular. People have heard the tunes; so let's put it on in a public place. It was an enormous expenditure for the company, and enormous commitment.

And after 9/11, funding was down and subscriptions were down. But they said, "No. This is our strategy. We have to sustain this program, and get the support for it." And they thought maybe 10,000 people would come. And Friday evening, the first performance, 60,000 people showed up. And the second performance on Saturday night, 80,000 people showed up. And I have to say, for 90 percent of those people, it was their first opera experience. And they stayed. It was quiet. There were no cell phones going off. There was no drinking going on. It was spectacular. So they were feeling good about this. And they're running their organization with this.

So I'll just give this as a specific example. It's being applied in a lot of these nonprofits. And it's working. They are really held accountable for performance and delivering on the performance. And this is the way you should be going out and getting money, not because you do good things: trust us, give us money. But say, "This is our theory. This is what we're delivering. This is how we deliver it. We're going to measure it. Hold us accountable, and support us if we're successful."

The Story of Your Strategy
Phase one, chain of cause and effect linkages. And we're telling the story of our strategy. And the balance has shifted, not just financial and non-financial, but it's between the outcomes we're trying to achieve, financial and customer perspectives, and the drivers of those outcomes. What's the value proposition? What are the processes we have to excel at? What about our people and our systems?

Phase two: link and align organization around strategy
Two. OK. We've done this. We have the high-level strategy, but most of us are in multi-business organizations or multi-departments. Even at the Boston Lyric Opera, where are only thirty-five employees, they have a marketing department, and a development

department, and an operations department. Each one of those departments has to understand how they contribute to the overall strategy.

So typically the next phase is to share the high-level scorecard and strategy with each of the operating units, or the business units in this case, and ask them to come up with their scorecard. We don't dictate the measures from central. We communicate the strategy and ask each of the operating units to come up with their scorecard, their strategy, that's informed by the high-level strategy, but customized to their circumstance. So this is how you get integration, linkages, even synergy, we hope, across the multiple operating departments. They're all working on the same page.

And the interesting thing is now taking it out not just to operating units, but also to support groups. And again, this probably has been one of the bigger impacts, because typically, support groups don't have strategies. They're there because they're needed. But increasingly, companies are getting hardnosed about their spending. Why are we doing this function internally rather than outsourcing to, potentially, a more efficient supplier of information technology services, or marketing research, or even finance or payroll processing?

And so, for a shared service or support group to stay inside the organization, they have to have some unique strategy that says they're either lower cost than outside suppliers or they offer some differentiated service that you can't get on the outside, or they're better than the outside.

The unit that we've had the greatest success, the greatest feedback from, is the human resources group. They have been waiting for twenty-five years to become strategic. Executives keep asking them, "How can you demonstrate the ROI of HR investments?" And they found this very difficult. We now understand that it's very difficult because HR, by itself, doesn't link to the financials. HR creates value through this chain of improving processes that either enhances a customer value proposition or produces productivity and lower cost. And so, it gets there through this chain of effects. It eventually gets there, but typically not right away.

But now we have a theory of the case for the role of HR. And we find these five dimensions are the most important in the HR groups: skills of people, their leadership capabilities, creating the right culture in the organization, aligning the people to the organizational strategy, and this idea of sharing information, a learning organization. We found those are five dimensions that drive improvement in the organization. And those are really the output of the HR function. So this is the human resources scorecard. And then they can think about their internal processes and their people skills.

External partnerships

Now where this gets even more fun is when we go externally, and start to make strategies with external partners. And this comes up more often in the public sector. So three years ago, I guess it was, I went out to Washington State, at the request of the governor, Gary Locke, who really is into performance management, and was doing it, probably number one in the nation, even at that time, but wanted to make it better.

So a colleague at the Kennedy School and I went out for a few days to update them on the Balanced Scorecard, performance management systems, how to make it work. And the edict came down that the departments would implement this, which I believe they still are doing.

But I found out that the thing that was really keeping the governor awake at night was not performance management in the state agencies: it was salmon. And it's not like he had a bad meal. The problem was that salmon was disappearing from the waters around Washington State. And they had disappeared so much that they had become an endangered species, which was a specific designation by U.S. government legislation. And when there is an endangered species, if you can't get these species healthy and back into the habitats, the government can step in and start shutting down commercial operations, shutting down fisheries. They can literally blow up hydroelectric dams if they feel that it will save a few dozen salmon. There is no benefit/cost calculation here.

So the governor says this is a train wreck. And the problem was that no department had responsibility for salmon. He had bits and pieces of it, and aspects of it in his various departments. But he knew that each one of them having a performance measure wouldn't add up to getting more salmon. But it was more than just what he could do in Washington. There were six other neighboring states that affected the habitat for salmon, another country (Canada), and twenty-seven autonomous Indian tribes, all of whom liked to hunt and fish and had some impact on the salmon population. There are eight federal agencies prepared to come from Washington to help; twelve different state agencies. Then you have all the structure within the state: thirty-nine counties, 277 cities, plus hundreds of water and sewer districts, port authorities, and water suppliers. Fractured governance system. How are we going to get this organized to get salmon back in the water? And this is a simple diagram of the constituencies and the legislation involved that affects salmon.

So I said, "Governor, you have to think about this from the point of view of the customer here. Who is the customer? The salmon. And if you were the king salmon and you wanted to have a strategy to make your population healthier and more productive what would you do? I recommend that you get these organizations together and get them going on a monthly meeting and see if you can come up with a strategy, a strategy map, and a scorecard for salmon recovery."

And they did that. They had these interdepartmental task forces to create the salmon recovery scorecard. And this is actually second generation and it had the mission at the top. The customer is at the highest level: the salmon—a productive and wild diverse salmon population. Meeting the requirements of endangered species and the clean water act. Then they can identify critical processes that they have to do very well, a new perspective because they have to collaborate both with citizens and with all the other state agencies, local organizations, and the like. And there is the infrastructure of getting financing and information structures that support this. And behind every one of these bordered items is a one-paragraph description of much greater detail and multiple measures on each one of these objectives.

Now people can see where their organization fits and how they can contribute to this in some way and they can also see where the gaps are and provide funding to fill in the gaps, processes that no state agency is currently doing. And it doesn't have to be a state agency. You can have a university do some, or some other private partner. And they can manage the strategy across diverse organizational units.

Principle Three: Make Strategy Everybody's Job

Third principle: communicate to people. And again, we're communicating to them not what they're to do—we're not trying to reinvent the Soviet Union or East Germany here—but telling people what we want to accomplish, and hoping that they will do their jobs differently and better. They'll help us implement the strategy.

Chrysler
There are a variety of ways of doing this. This actually came from Chrysler, as part of its turnaround with the new CEO—this is the Chrysler division here in the United States. Right there in its weekly newsletter, even bigger than their racecar, they've created this Balanced Scorecard, their simple little strategy map. It's in the shape of a pyramid, and talks about, "This is the way we're going to manage our company." And they produced a one-page brochure, which every employee gets. And the inside cover says, "We're going to review our performance based on these new targets across the multiple perspectives and encourage employees to set performance goals that will contribute to the strategic objectives." So it's coming from the top.

Mobil mystery shopper
And Mobil came up with a simple brochure, a one-page brochure, not their complete scorecard, a little simplified. It's sent out to every one of their 7,000 employees. And an executive goes out to every facility at Mobil in the United States, and brings them together, hands out the brochures, and discusses it.

And I have to tell you; the truck drivers were all skeptical. Why are we here? The executive says, "We're here because we want you to understand the strategy." Truck driver says, "We don't have to understand strategy. We drive trucks. You guys in Fairfax, Virginia, you do strategy, we drive trucks." Adam Smith, separation of labor. This is what makes the economy run.

And the executive says, "No, no. It's important for you to understand the strategy. You have to stay." But they talk about the internal processes, safe and reliable, that how they drive trucks can affect the number of accidents and the number of breakdowns on the road. Lower your cost. Don't get lost. And watch how you drive, how you maintain your truck. Be a good neighbor. Don't pollute, either noise pollution through your exhaust system or spilling gasoline products on the streets, and maintain quality, on spec, on time.

So they can show them, even though these processes were mostly for refinery and pipeline operations, the things they want the truck drivers to pay attention to. So they said, "OK. We're glad to see that. Can we go now?" He said, "No. You have to understand the customer, too." The truck drivers said, "We don't do the customer. We drive trucks and we put gas into this hole in the ground."

The executive said, "No. We have new relationships with our dealers. They're our partners now. We want to have great relationships. You see that customer more often than any other Mobil employee. When you show up, treat the dealer with respect, be responsive, be on time so we can continue to meet the expectations of our dealers. And we have to understand that, even for our consumers, you contribute one element, this mystery shopper score that describes the quality of the buying experience through showing up on time with the right volume and mix of product. We won't stock out in any Mobil station around the country. And so your showing up on schedule, with the right mix of products, is one element in the mystery shopper score." But he also explained the whole aspect of fast, friendly serve, and clean restrooms, and great convenience stores, and friendly employees. And they said, "If we do this all, we're going to get this high financial figure. And you don't have to worry about the return on capital. But we believe that these will all drive that." Said, "Thank you very much," and then went out to drive trucks.

Within a few weeks, around the Mobil regional headquarters, they're getting phone calls from the field from the truck drivers. What are they calling about? Remember that brochure? Mystery shopper score, twenty-three attributes of the perfect buying experience?

A driver says, "Boy, we just delivered gasoline to a station, and you better get somebody there. That's a real mess. If a mystery shopper showed up there, it would flunk." They said, "What do you mean?" And he said, "Well, the credit card reader at the pump didn't work. The restrooms were filthy and overflowing. Convenience store was stocked out of merchandise. And the employees were yelling at the customers." Not that fast, friendly serve.

Is this useful information to Mobil? Yeah, you bet. Did it just happen that week, that all of a sudden we had bad stations? We've had that all the time. You have 6,000 stations in the United States. A bunch of them are not great. Why, all of a sudden, are the truck drivers, on their own, calling into the field? They're calling into headquarters. They never understood what the strategy was. No one had ever told them about strategy. Before they had a job to do. They had to drive the trucks. Now they're sharing with the drivers, "This is what we're trying to do to succeed." But the employees, on their own, come up with new ideas to help implement the strategy.

Boston Lyric Opera
Boston Lyric Opera, thirty-five employees. But they communicate the scorecard about loyal and generous supporters throughout the organization. This young woman who was working in set production, hammers and nails, building the sets for the production, understands for the first time the business model behind the opera company, and the value of loyal and generous supporters.

She goes to the general manager, Jan Del Sesto, and she says, "Jan, we're putting on this opera production, *The Magic Flute.*" And she says, "It's pretty complex. We have these great special effects. The Queen of the Night pops out of the stage. We have this smoke-breathing dragon, and all kinds of special effects. Maybe our loyal and generous supporters would enjoy a backstage tour to learn how the magic in *The Magic Flute* is produced."

That's a fantastic idea. Half-day tour. And the donors and the board members just loved it. Why didn't Jan think of it? Well, she has lots of things on her mind. But you have to have all your employees thinking about how you can implement the strategy. Now you have everyone helping you implement the strategy, not just the MBAs and CEO.

Mobil Speedpass
And some of you may be using this, one of the ideas that came out of Mobil. A Mobil employee heard about fast, friendly serve. He said, "Well I think I can do better than a credit card reader," because people still have to fumble for their credit card, whether it's in kind of the black hole called a purse, or men, who have to get it from their wallet when they have their winter coats on and gloves.

He says, "One of the things people always have is their car keys when they drive. I can develop a device that goes on a key chain." This little transponder here. He goes to Texas Instruments. TI says, "We can do that. That's thirty-year-old technology." He goes to the gas pump manufacturer who says, "Yeah, it would be simple to put in a responder that can detect it." This is a huge deal. It may not be to you, but to Type A personalities like me, if you save a few seconds here, and you don't have to fumble, man, that's a win.

And this is a differentiator. So you want to think about how you differentiate a commodity business, because you're only carrying one of these on your key chain. And they actually changed the scorecard in midyear to put a campaign on to sign up a million consumers with Speed Pass in the next six months, and equip every Mobil station in the United States with this technology.

And so now you can not only use it in every Mobil station, you can use it in most of their convenience stores. So shopping in the convenience store is faster and friendlier, not just for you, but for all the people ahead of you. And it's been licensed to McDonald's. They're now testing it. Soon, you may be able to pay in McDonald's with a Mobil Speed Pass. Make more money on this than selling gasoline. Where did the idea come from? Somebody in the organization thought of it. So those are the things that come on.

Ann Taylor
But this is where you have to turn your communication department loose. Ann Taylor, which is kind of a right-brain organization, didn't use spreadsheets. And they had games. They created this game like Candyland. And they had the people play the game. And you advanced if you could answer questions about the strategy. And they had contests. And one of the employees plays the CEO in this game, and she was winning. And so he said, "All right. This is a tie." It was just fun. They had people doing skits about the strategy. So you can have fun. You can make this kind of fun.

Mobil: Compensation Tied to Strategy
Cascade down to personal objectives. And this is the way management by objective should have been, this clear line of sight, and then compensation, and linking to compensation. And when they started at Mobil, in 1996, they tied it to compensation.

And Brian Baker's peers at Mobil Corporate said, "Hey, Brian. You have 7,000 employees. Every month when your scorecard comes out, they kind of look at it, and they spend at least an hour calculating how much money they're making." And they said, "Seven thousand people, 10,000 hours a month doing these calculations. Isn't that a waste of time?" Brian said, "Hey, I think it's terrific. For at least one hour a month, I have every one of my employees looking at how our strategy did, where we fell short, and what they might do next month to help me get better at some of those critical measures. I think it's the best hour I get from the employees every month." And so it was great. And you saw the results.

A few years later, one of the employees' spouses, his wife, called up and said, "Do you know what the environmental score and the availability from the refineries will be this month?" And her husband worked in the pipeline division, didn't even work at refineries. They weren't sure. But they called around, and they gave her an estimate of what it would be. Trying to figure out what that call was about. Well she was about to go shopping for a major appliance. Recently, those measures had been tailing down, and had taken the bonus pool much lower. And if it didn't correct, she'd have to get the basic, entry-level model. But if you could turn this around, and get the refinery operating twenty-five hours a day with no environmental incidents, you're going to be back in substantial bonus territory.

So you can imagine the motivation. It's not just how are you doing, but you have 7,000 of your colleagues that you're working for and their spouses. So when you go home at night they say, "Hi, honey. Have a good day at the office?" or "at the plant? Any incidents? Any safety?" There's a lot of motivation. So people are doing this.

Principle Four: Continual Process
This is a new reporting system. So this is literally what the reports look like, the high-level reports, and the software so you can tie down, and drill down when you find a red dot where the problem is. You can see business units, trends, links to initiatives.

You have to create a learning environment. It's OK to report bad news. As one of the military people told us, there was a sign on the general's desk, "The only thing worse than bad news is bad news late." And so we want to surface problems and shortfalls. And it's not the problem of the person or the department where it's reported. This is a joint problem, and we're going to collectively come up with a solution that will deal with it.

Principle Five: Executive Leadership

So let me just kind of close with a little bit on leadership. In terms of the journey, we did a survey of online members. There were 125 who said they were moving forward with the scorecard. Fifteen percent said, "We're getting ready for the Hall of Fame." Two-thirds said, "It's working OK. We're delivering some results." Twenty percent, however, said, "Not getting any results yet, guys." But we asked some other questions, a summary of what I thought the most important questions were, the five principles. How is the executive team doing? How are you doing with strategy maps? Alignment of the businesses? Employees, do they know the strategy, and if their incentive is tied to it? Have you integrated it into the planning and budgeting process?

And the amazing results were the people who got no results were doing essentially none of this. Basically, they had what we call a "Key Performance Indicator Scorecard," a checklist, maybe a compensation system with several non-financial measures. But that was it. They weren't following any of the five principles. And the organizations driving breakthrough results, even though they may not have been all the way there, individually, they were all following these five principles.

So we feel that this stuff is working. There are more details in the book. You can stop by the bookstore. And I've just covered about fourteen chapters, or ten of the fourteen. Dave Norton's organization is doing a variety of conferences, research, training, and consulting.

Thank you very much.