

Performance Management - Models and Strategies

KAPLAN AND NORTON'S BALANCED SCORECARD FRAMEWORK

Kaplan and Norton's balanced scorecard framework has changed the face of performance measurement in the 1990s. The authors introduced the idea, which is borne out of the need for an alternative to managing organisational performance exclusively through financial measures, in the January-February edition of the Harvard Business Review¹.

The following section outlines the framework, as described in Kaplan and Norton's seminal article and subsequent books². The authors developed the balanced scorecard approach in response to what they described as outdated and misleading techniques for evaluating organisational performance. They found that traditional measures resulted in leaders managing their organisations by "looking in the Rear-view mirror", so they developed a technique which included measures that drive future performance. The technique has since been used by many organisations including The Royal Bank of Scotland, at the strategic level, and Hewlett Packard, to measure the effectiveness of the product development cycle.

Kaplan and Norton suggest measuring organisational performance in four key areas:

- Financial
- Customer
- Internal Business Process
- Learning and Growth.

These areas can be split into two sections. The first section includes current financial measures, and operational issues are addressed in the customer, internal business and learning and growth sections:

Within these areas, Kaplan and Norton provide a number of suggestions for quantitative measures to assess organisational performance.

¹ Kaplan and Norton, 'The Balanced Scorecard: Measures That Drive Performance', Harvard Business Review, January-February 1992.

² For example, see 'The Balanced Scorecard', Kaplan and Norton, Harvard Business School Press, 1996; still the definitive book on the subject.

Financial

The financial area is split into three parts, under the headings; Revenue Growth, Cost Management and Asset Utilisation:

Revenue Growth

- Sales and market share
- Number of new customers and markets
- Number of new strategies.

Cost Management

- Revenue per employee
- Unit cost reduction.

Asset utilisation

- Inventory reduction
- Cash-to-cash cycle
- Return on capital
- Productivity/Efficiency.

Customer

Kaplan and Norton suggest that organisations must first identify the market segment that they aim to supply. For each segment, they must focus on the type of measure that they use to fit the characteristics of the business.

Market Share

- % of segment captured.

Customer Retention

- Number of defections
- Increase in sales to current customers
- Frequency of orders, visits or contacts with customers.

Customer Acquisition

- Number of new customers
- Ratio of sales to inquiries
- Average cost to acquire a new customer
- Average order size.

Customer Satisfaction

- Number of complaints
- Number of customers that indicate their satisfaction.

Customer Profitability

- Total profit per customer
- Total cost per customer.

Internal Business Processes

Kaplan and Norton acknowledge that, although improvements in internal business processes do not have any bearing on the management of business at the strategic level, they do contribute towards noticeable improvements in business in the long term. They suggest the following measures for these processes:

Identify or 'make' the Market

- Profitability by segment
- % of revenue from new customers.

Design

- Time to market
- Break even time.

Build

- Number of defects
- Process time.

Deliver

- % on time delivery
- % defects

After-sales Service

- Average satisfaction rating
- Number of reorders
- Number of customers who do not reorder.

Learning and Growth

The learning and growth area is concerned with infrastructure, ie. the foundations required to achieve objectives in other areas of the business. Kaplan and Norton cite three relevant categories:

1. Employee Capabilities

- Employee satisfaction
- Staff turnover
- Productivity
- Number of employees qualified for key jobs.

2. Information Technology

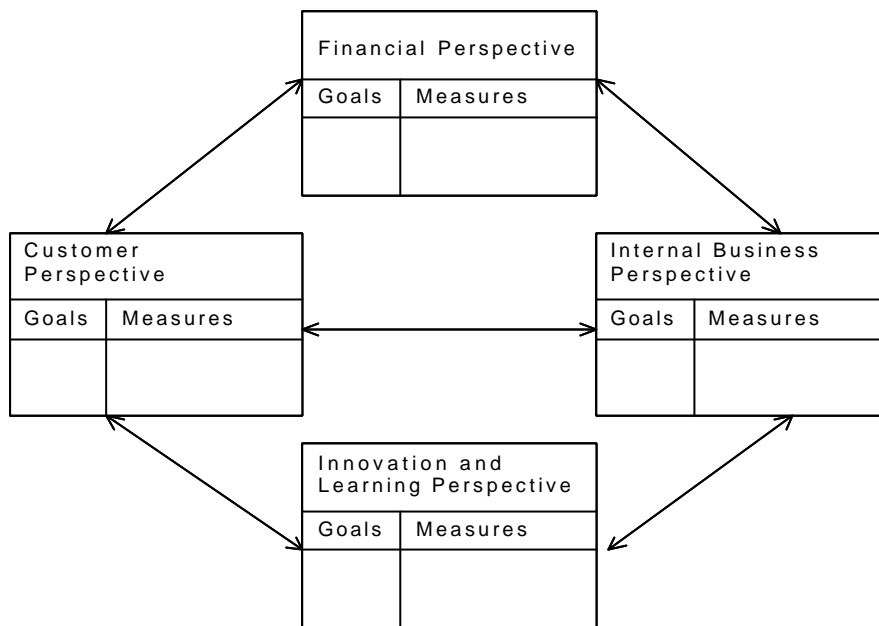
- Information coverage ratio
- Return on data

3. Motivation and Alignment

- Suggestions received
- Suggestions implemented
- Rewards provided.

The lists above provide an indication of the degree to which the balanced scorecard broadens the scope of performance measurement from traditional methods like earnings per share.

Kaplan and Norton believe that the balance scorecard's enduring contribution to measuring and managing performance lies in the concise, holistic picture of the organisation that it provides. Through gathering input from many different sources, it is possible to develop a detailed map of the interconnections and interactions that occur between different areas of the organisation. The scorecard can therefore be represented in diagrammatical form:



Source: Kaplan and Norton, 'The Balanced Scorecard', Harvard Business Review, January-February 1992.

From a practical point of view, Kaplan and Norton suggest using the scorecard at the strategic level of businesses initially, and letting the benefits "cascade" down to departments, groups and individuals. This involves completing scorecards for these subgroups to determine the extent of their contribution to organisational performance.

However, early adopters of the approach found some difficulty in linking their long-term aims with what they should do in the near future. To remedy this situation, in their 1996 article, the authors suggest using a four-stage process for linking long-term strategic objectives with short-term actions. The four stages are as follows:

1. Translating the vision
2. Communicating and linking
3. Business planning
4. Feedback and learning.

Translating the Vision

The first of the new processes is to integrate the long-term vision throughout the organisation, from senior management to front-line workers. Kaplan and Norton make the point that although mission statements make sense to those who devise them, they usually have little meaning to regular employees. For these individuals to operate in conjunction with the organisation's vision, this type of vision must also have a clear, operational meaning to every employee.

Communicating and Linking

Once the vision has been integrated throughout the organisation, the next stage is to link it to departmental and individual objectives. Kaplan and Norton espouse that the technique allows managers to use methods of analysis other than traditional short-term financial goals and reports. The scorecard allows managers to make sure that all levels of the organisation understand the practical implications of the strategic vision.

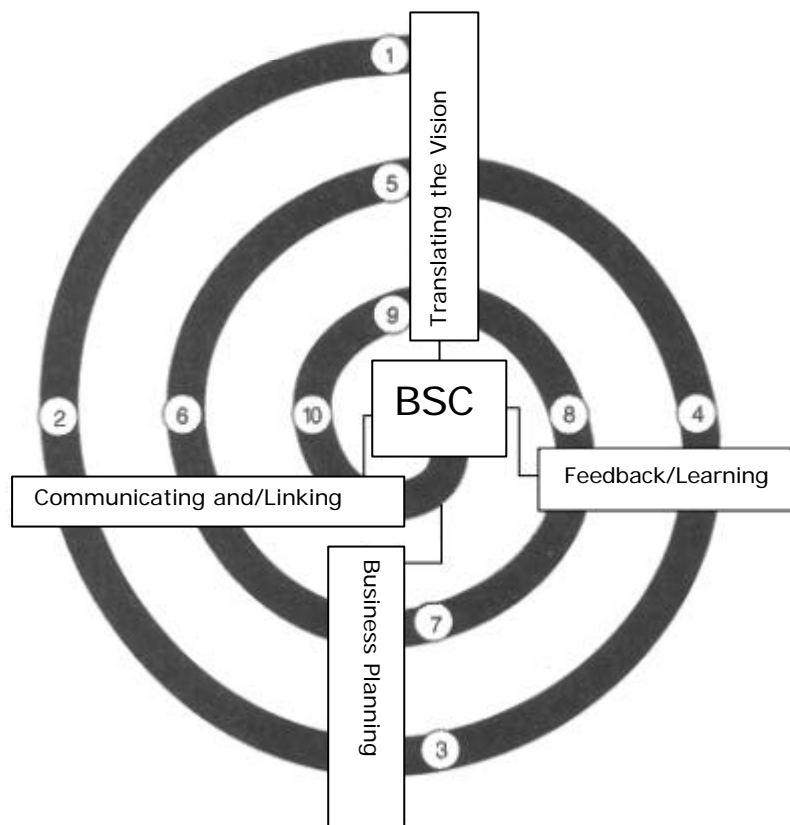
Business Planning

The third stage of the process allows organisations to align their business and financial intentions. Using the scorecard, managers are able to prioritise departmental initiatives and allocate resources so that long-term strategic goals are achieved.

Feedback and Learning

The final process involves organisations learning how to improve performance following feedback and review sessions. Traditionally, organisations used these sessions to address whether financial targets had been met. The scorecard allows a broader range of perspectives and evaluates learning opportunities. Kaplan and Norton describe this as a real-time learning process which has a direct impact on strategy.

The authors suggest that the process of compiling a scorecard should be an iterative process involving all four of the new processes. The iterative approach can be shown on this diagram:



Source: Kaplan and Norton, 'Balanced Scorecard as Strategic Management System', Harvard Business Review, January -February 1996.

Following their extensive research, Kaplan and Norton suggest that the main uses of the scorecard are:

- Clarifying and updating strategy
- Communicating strategy throughout the company
- Aligning unit and individual goals with the strategy
- Linking strategic objectives to long-term targets and annual budgets
- Identifying and aligning strategic initiatives
- Conducting periodic performance reviews to learn about and improve strategy

Although the balanced scorecard approach to measuring and ultimately improving performance was intended originally for organisations, it has proved to be more dynamic and flexible than even the authors anticipated. Adopters of the scorecard have found that it supplies a framework for co-ordinating and implementing a variety of management process at all levels of the organisation. For many, it has become an essential tool for implementing change.