BALANCED SCORECARD STEP-BY-STEP FOR GOVERNMENT AND NONPROFIT AGENCIES

Second Edition

Paul R. Niven

WILEY

John Wiley & Sons, Inc.

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For my wife Lois, with much love and many thanks

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Preface

Although it was almost six years ago, it seems like last week. A retired client asked me to join him for coffee, and during our wide-ranging and, as usual, very enjoyable chat, asked if I had considered writing a "Balanced Scorecard Step-by-Step" book for the public and nonprofit sectors. My first book, written with the private sector as the target audience, had recently been released and, coincidentally, I had begun to receive correspondence from public sector and nonprofit leaders posing the same question. Many had purchased my first book, and while the overall guidance offered was relevant, they craved a text customized to fit the unique challenges they faced when implementing a performance measurement system. Intrigued, I engaged in some additional study and research, and found overwhelming evidence of the need for such a book. Many months of research, interviews, and writing later, in early 2003, *Balanced Scorecard Step-by-Step for Government and Nonprofit Agencies* was released. I have been amazed and very humbled at the success of the *First Edition,* which has been translated widely and used by organizations around the globe committed to improving their performance by focusing on the execution of strategy.

This *Second Edition* contains the same core implementation guidance offered in the first volume, but has been significantly updated and enhanced to ensure it reflects the latest theory and practice of performance management for the nonprofit and public sectors. Every single word covering the pages of the *First Edition* was put to the tests of relevancy, accuracy, and importance during the alteration process. In addition to modifying topics appearing in the earlier edition, this text contains expanded coverage of subjects that have matured significantly since its first printing in 2002. My coverage of Strategy Maps—powerful communication tools signaling to everyone, within the organization and beyond, the drivers of organizational success—has been completely revamped with entirely new sections on how to facilitate a Strategy Map session as well as increased coverage of developing objectives for each perspective. The book also features a robust examination of strategy-centered review meetings. I have provided my latest thinking, based on years of field experience, on how to conduct productive meetings that put strategy at the heart of the agenda. Finally, the book will introduce you to a new, and vitally important topic—the Office of Strategy Management (OSM). You'll learn how this promising function seamlessly marries the worlds of strategy formation and execution.

THE BALANCED SCORECARD

In the early 1990s, Robert Kaplan and David Norton sought to solve a measurement problem plaguing corporations around the globe. The dynamics of business were changing rapidly; globalization, customer knowledge, and the rise of intangible assets were all converging to forever change the way business was conducted. Strategy was considered a potent defense for succeeding in this changing landscape. However, the facts suggested that about 90% of organizations were unable to execute their strategies.

Kaplan and Norton made the startling discovery that performance measurement systems utilized by most firms were incapable of providing the information needed to compete in this new knowledge economy. Most were unchanged from those developed by the early industrial giants at the turn of the twentieth century. Characterized by an almost exclusive reliance on financial measures of performance, these systems were ill-prepared for the challenges faced by modern organizations. Kaplan and Norton believed that organizations should attempt the introduction of balance to their measurement systems. Specifically, the historical accuracy and integrity of financial measures must be balanced with the drivers of future financial performance in an attempt to view a wider spectrum of performance and execute strategy. Their radical, yet profoundly simple, approach was labeled a "Balanced Scorecard" and featured measurement in four distinct, yet related areas: customer, internal processes, employee learning and growth, and financial.

Since its introduction in 1990, the Balanced Scorecard has been embraced by corporations around the world. Recent estimates suggest that at least 60% of Fortune 1000 organizations use a Balanced Scorecard system. For-profit companies have used the system to generate improved financial results, foster accountability, align employees with corporate goals, enhance resource allocation decisions, improve collaboration, and most critically, execute their strategies.

USING THE BALANCED SCORECARD IN THE PUBLIC AND NONPROFIT SECTORS

Public and nonprofit organizations today face unprecedented challenges in carrying out their vital mission-oriented tasks. Increased public scrutiny, demands for accountability, cries of enhanced transparency, and donations linked to stipulations of success, are but a few of the piercing calls you must answer in meeting stakeholder expectations. And of course, you're required to achieve all of this and more in an environment marked by shrinking budgets, strict regulations, and changing workforce demographics.

Speaking of demographics, the retirement of 76 million baby boomers in the United States will push the ranks of the elderly to more than 20% of the country's population during the next 20 years. In Japan and Europe during the same period, the legions of elderly will account for almost 30% of the population.[i] Balancing the needs of retirees (all of whom will require increasing levels of government services) with younger citizens, while still holding taxes to politically sustainable levels, leads to one undeniable conclusion: It's imperative we get the most from every government dollar.

In the years to come, enhanced productivity, performance improvements, and strategy execution will be transformed from private sector topics that drive bestseller lists to survival imperatives for every public sector agency.

Nonprofit organizations are certainly not immune to the tempest of change swirling about our modern world. Whether it's a small local arts organization or a national charity, virtually all of the demands faced by public and private sector firms are shared by nonprofits. The laser of scrutiny is being applied with unprecedented vigor everywhere in the nonprofit world; even charitable foundations established by professional athletes have come under the glare of public inquiry. The *Wall Street Journal* recently dedicated a two-page feature story to an examination of philanthropy in the sports world.[ii] Given the "gotcha" mentality so popular in our watchdog culture, it's absolutely essential that nonprofits demonstrate results while simultaneously exhibiting prudent financial stewardship.

Take another look at the list of achievements private sector firms have seen from their investment in the Balanced Scorecard: accountability, collaboration, alignment, resource allocation improvement, enhanced financial results, and strategy execution. Each and every one of those benefits is equally available to government and nonprofit agencies willing to implement the Balanced Scorecard system with rigor and discipline. The City of Charlotte, North Carolina, profiled in Chapter 12, embraced the Scorecard framework over a decade ago and has reaped many of the benefits noted above. So too have countless other public sector and nonprofit agencies around the globe. They've discovered that with minor modifications, and

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[i] Thomas Dohrmann and Lenny T. Mendonca, "Boosting Government Productivity," *The McKinsey Quarterly,* 2004, Number 4, pp. 89–103.
[ii] G. Bruce Knecht, "Big Players in Charity," *Wall Street Journal*, Saturday/Sunday, April 28–29, 2007, p. P1.

rendered with care and precision, the tool can be customized to benefit any organizational setting or structure.

Making the transition to this new world of measurement, management, and strategy execution is not without its share of potential pitfalls. This book has been written to help you navigate this sea of change, and capitalize on the many benefits of the Balanced Scorecard, while concurrently avoiding costly implementation errors. Let's look at what you'll find in the chapters ahead.

HOW THE BOOK IS ORGANIZED

This *Second Edition* of *Balanced Scorecard Step-by-Step for Government and Nonprofit Agencies* is comprised of 13 chapters and an appendix, spanning the entire spectrum of a Balanced Scorecard implementation. The opening chapter introduces the Balanced Scorecard tool, providing an historical perspective and discussing the many facets of this tool. Adapting the Balanced Scorecard to the public and nonprofit sectors is the subject of Chapter 2. You'll learn that with only minor "geographical" modifications, the Balanced Scorecard is well-suited to meet your measurement and strategy execution challenges.

Upon embarking on a Balanced Scorecard implementation, you'll quickly discover it is more than a "measurement" initiative. In fact, the Scorecard will touch many disparate elements of your organization. The next four chapters outline the many and varied elements that must be in place to ensure your Scorecard outcomes are successful. Chapter 3 is entitled "Before You Begin" and discusses a number of items that must be considered prior to building a Scorecard, including: your rationale for engaging in this effort, gaining executive sponsorship for the initiative, and building an effective team. Many organizations rush into the Scorecard building process without the aid of training on the subject. Poorly designed Scorecards, and little if no alignment throughout the organization, frequently result from this decision. Chapter 4 provides a training curriculum for your Balanced Scorecard initiative and also discusses the importance of communication planning. In Chapter 5, we begin our transition to the core elements of the Balanced Scorecard beginning with mission, values, and vision. The Scorecard will ultimately act as a translation of these critical enablers of organizational success. In this chapter we'll explore the nature of these building blocks and offer tools for developing or refining your current statements. Strategy is at the core of every Balanced Scorecard, and Chapter 6 examines this widely discussed, but often poorly understood subject. A straightforward approach for developing strategy is offered.

The next block of chapters will provide you with a guided tour through the development of a Strategy Map of objectives and Balanced Scorecard of performance measures. Chapter 7, which has been extensively updated for this edition, outlines the Strategy Map concept of graphically displaying the key objectives that serve as the translation of your strategy. You'll find advice on everything from how to interview executives to customizing your Map. Chapter 8 ushers in an examination of how to populate your Balanced Scorecard by examining measures, targets, and initiatives. You'll learn how to develop measures in each of the four perspectives, why targets are critical, and how initiatives can mean the difference between success and failure on performance.

The final five chapters of the text are dedicated to helping you get the most out of your Balanced Scorecard system. We begin in Chapter 9 which probes the concept of cascading the Balanced Scorecard. This term refers to the process of generating goal alignment throughout the organization by the development of Strategy Maps and Balanced Scorecards at each and every level of the agency. In an era of shrinking budgets, we're constantly reminded of the importance of aligning spending with results. Chapter 10 provides a method of linking the Balanced Scorecard to your budgeting process, and in so doing aligning spending with strategy. Chapter 11 canvasses the many reporting options available to Scorecard-adopting organizations. Whether you choose to buy an automated software package or develop your own tool, you'll find the information you need to make an informed decision. This chapter also includes a robust dialog on the concept of strategy-centered management meetings. Like you, I've sat through my fair share of boring and unproductive meetings. With the advice offered in this chapter I'm throwing down the gauntlet—no more bad meetings! In Chapter 12, we're treated to an insider's view of the Balanced Scorecard at the City of Charlotte, North Carolina. These Scorecard pioneers share their secrets for success, and offer pitfalls that must be avoided on the road to strategy execution. The final chapter provides you with a glimpse into what is necessary to sustain your Scorecard success. A highlight of the chapter is an introduction to the Office of Strategy Management (OSM) concept. You'll also learn how one organization utilized the concept to tremendous advantage. The book concludes with an appendix outlining the critical nature of terminology to your implementation and a glossary of key Scorecard-related terms.

It's a pleasure to serve as your guide through the rewarding territory that is the Balanced Scorecard. My goal is to steer you through the terrain that follows by offering a text that is exhaustive in scope without being excessively complex or unduly simplistic. Let's get started!

February 2008

Paul R. Niven
San Diego, California

Acknowledgments

Isaac Newton once remarked that "If I have seen farther than others, it is because I was standing on the shoulders of giants." And so it is that I am able to deliver this book to you. The individuals mentioned below, and countless others, are largely responsible for giving me the opportunity to share the ideas in this book with you. In many ways, I am merely a vessel through which their ideas, inspiration, and wisdom pass to you, and hopefully from you to many others.

This being a second edition, rigorous scrutiny was applied to every page, with an eye towards updating, clarifying, and enhancing each subject covered. Upon reading the previous paragraph, however, I was unable to change a single word. It rings as true today as it did over five years ago when I completed the first manuscript for this text. Without the kindness, knowledge, and spirit of learning I received from those listed below, this book would never have reached your hands.

NEW ACKNOWLEDGMENTS FOR THE SECOND EDITION

Interest in, and enthusiasm for, applying the Balanced Scorecard to public and nonprofit environments has grown substantially since the *First Edition* of this book appeared. I've been extremely fortunate during that time to work with several organizations from both sectors that have provided immense assistance in advancing my knowledge and expanding the horizons of the Scorecard framework.

From the Corporation for Enterprise Development (CFED) in Washington DC, my thanks go out to Andrea Levere, Genevieve Melford, and Kim Pate for their honesty, sincerity, and earnest commitment to this tool. At the Regulatory Affairs Professionals Society (RAPS), also in DC, I am deeply indebted to Sherry Keramidas for her enthusiastic support of the Balanced Scorecard. Food for the Hungry U.S. (FHUS) provided perhaps the most inspirational environment I've ever had the pleasure of working in. My sincerest thanks to the entire senior management team, but in particular: Ben Homan, Loren Kutsko, Matt Panos, and Peter Mawditt. At the Coordinating Office for Terrorism Prevention and Emergency Response (COTPER) of the CDC in Atlanta, thank you to Rich Besser and Galen Carver for your tireless work in support of the principles of performance management. Merl Waschler and Katherine Cecala of the Valley of the Sun United Way in Phoenix have been ardent supporters of the Balanced Scorecard and I thank them for their vision and inspiration. At the Rural Health Resource Center, an outstanding organization demonstrating passionate commitment to the ideals of performance improvement, my thanks to Terry Hill and his enormously talented staff. Finally, to David Hay, Sharon MacFarlane, Christian Richard, and Karin Row of New Brunswick (NB) Power in Fredericton New Brunswick, thank you for your support, generosity of time and spirit, and dedication—I enjoyed every minute we spent together. Christian Richard receives the "above and beyond the call of duty" award. In the midst of guiding the organization's new Office of Strategy Management with passion and poise, and adjusting to life at home with a new baby girl, Chris, in a request from me, wrote over 20 pages of notes on NB Power's Scorecard implementation that proved immensely helpful.

In addition to clients, I have benefited from the insights and kindness of many others, including my consulting partner Dennis Barnhart. Thank you for your wise counsel and boundless capacity for learning. To Tor Inge Vasshus and Eric Peterson of Corporater, thank you for embracing the true spirit of partnership as we work together to expand the frontiers of the Scorecard. Oh, and by the way, you've built an incredible software product! And finally, to Gerardo Pustelnik and Claudio Nassar of Strategy Execution Consulting in Mexico City (my Latin American partners), thank you for your energy, commitment, and dedication to strategy execution.

ACKNOWLEDGMENTS FROM THE FIRST EDITION

There is a charming story about George Bernard Shaw perusing the shelves of a used bookstore one day and coming across one of his own volumes. Upon turning the cover he found the inscription: "*To_______, with esteem, George Bernard Shaw*." He promptly bought the book and returned it to_______, adding the line: "*With renewed esteem, George Bernard Shaw*." So it is with this *Second Edition,* I would like to offer renewed thanks to the following people.

My deepest gratitude is extended to the many individuals kind enough to share their time and information with me. Special thanks to Bobbi Bilnoski at the Concitti Network, Colleen Tobin formerly of Women's World Finance, Rhonda Pherigo from the Center for Nonprofit Management, Bruce Harber of the Vancouver Coastal Health Authority, Dr. Howard Borgstrom from the Department of Energy, Nancy Foltz at the State of

Michigan, Rick Pagsibigan from the Red Cross of Southeastern Pennsylvania, Abbi Stone and Katy Rees from the San Marcos campus of the California State University, consultant Donald Golob, author and consultant William P. Ryan, Jake Barkdoll and the Balanced Scorecard Interest Group, Betty Cabrera at the Dallas Family Access Network, Diane Williams of the Safer Foundation, Dennis Feit from the Minnesota Department of Transportation, Philippe Poinsot from the United Nations Development Programme, and Jeff Celentano from the City of North Bay, Ontario.

An innumerable number of other individuals have an imprint on this book. Let me conclude by mentioning just a few: Lisa Schumacher, Kim Eagle,Tiffany Capers, and Matt Bronson from the City of Charlotte, North Carolina. They were gracious enough to submit to interviews for both editions of this book. Joe and Catherine Stenzel have been wonderful friends and great supporters for many years; my thanks to both of you. Steve Mann provided invaluable assistance with early interviews and research for the *First Edition* of this book, despite recently retiring! Andra Gumbus of Sacred Heart University offered insight and assistance that is greatly appreciated. Finally, I would like to thank Teri Anderson. Teri gave me my start in the performance measurement field many years ago, and has been a supporter and great friend ever since.

1

Introduction to the Balanced Scorecard

Roadmap for Chapter 1 Before you can begin developing a Balanced Scorecard for your organization, we must ensure that you have a solid foundation of Scorecard knowledge and understanding from which to build. This chapter will provide that base.

We'll begin by considering just why measurement is so important to the modern public and nonprofit organization. We'll then look at three factors that have led to the rising prominence of the Balanced Scorecard since its inception over seventeen years ago. You'll learn that our changing economy, which places a premium on intangible assets, demands more from our measurement systems. Financial measurements and their significant limitations will then be examined. The final factor escalating the growth of the Balanced Scorecard is the inability of most organizations to effectively execute their strategies. We'll review a number of barriers to strategy implementation.

The Balanced Scorecard has emerged as a proven tool in meeting the many challenges faced by the modern organization. The remainder of the chapter introduces you to this dynamic tool. Specifically, we'll examine the origins of the Scorecard, define it, and look at the system from three different points of view: as a communication tool, measurement system, and strategic management system.

WHY MEASUREMENT IS SO IMPORTANT

One of the themes of this book is that regardless of what sector your organization represents, there is a role for measurement to improve your performance. So it is in the vein of connecting measurement to virtually any field of endeavor that I offer this historical account to begin our expedition together. In the dense fog of a dark night in October 1707, Great Britain lost nearly an entire fleet of ships. There was no pitched battle at sea; the admiral, Clowdisley Shovell, simply miscalculated his position in the Atlantic and his flagship smashed into the rocks of the Scilly Isles, a tail of islands off the southwest coast of England. The rest of the fleet, following blindly, went aground and piled onto the rocks, one after another. Four warships and 2,000 lives were lost.

For such a proud nation of seafarers, this tragic loss was distinctly embarrassing. But to be fair to the memory of Clowdisley Shovell, it was not altogether surprising. Although the concept of latitude and longitude had been around since the first century B.C., still, in 1700, no one had devised an accurate way to measure longitude, meaning that nobody ever knew for sure how far east or west they had traveled. Professional seamen like Clowdisley Shovell estimated their progress either by guessing their average speed or by dropping a log over the side of the boat and timing how long it took to float from bow to stern. Forced to rely on such crude measurements, the admiral can be forgiven his massive misjudgment. What caused the disaster was not the admiral's ignorance, but his inability to measure something that he already knew to be critically important—in this case longitude.[1]

We've come a long way since Clowdisley Shovell patrolled the seas for his native Great Britain. If you're a sailor, today's instrumentation ensures that any failure of navigation may be pinned squarely on your own shoulders. But for those of you who spend your days leading public and nonprofit organizations, how far have you come in meeting the measurement challenge? Can you measure all those things you know to be critically important? Today's constituents and donors are better informed than at any time in history. That knowledge leads to a demand of accountability on your part to show results from the financial and human resources entrusted to you. To do that, you must demonstrate tangible results which are best captured in performance measures.

Over 150 years ago the Irish mathematician and physicist Lord Kelvin reminded us that "When you can measure what you are speaking about, and express it in numbers, you know something about it; but when you cannot measure it, when you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind . . ." The goal of this book is to help you do just that: to measure all those things that you know to be important. Those areas that truly define your success and allow you to clearly demonstrate the difference you're making in the lives of everyone you touch. Welcome to your Balanced Scorecard journey!

WHY THE BALANCED SCORECARD?

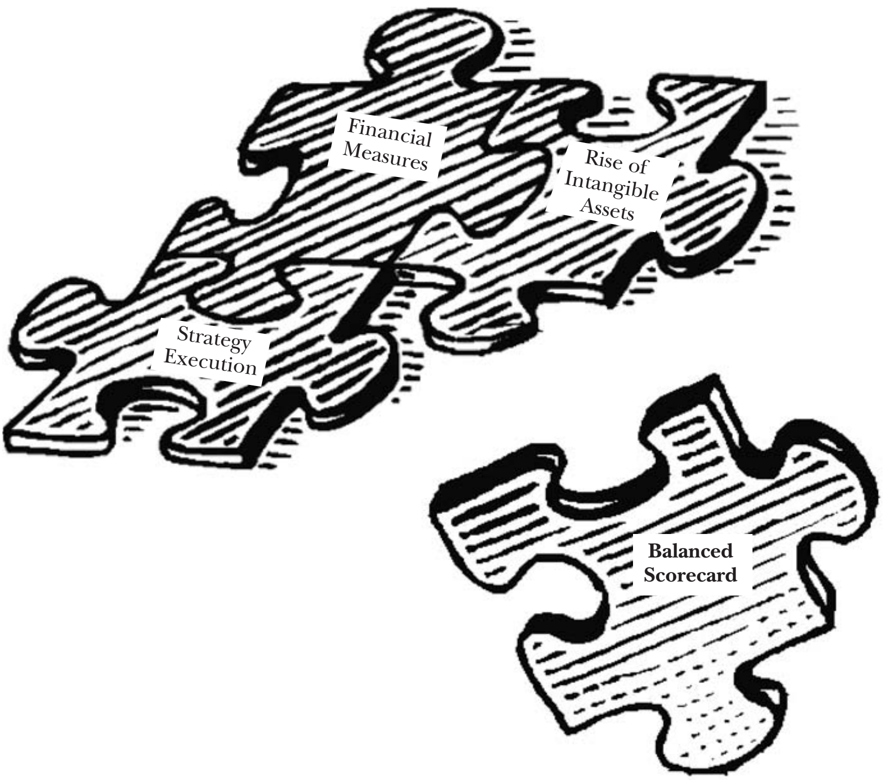
In the span of the Balanced Scorecard's lifetime—some 17 years—hundreds, if not thousands, of business ideas, fads, and fetishes have been paraded in front of a beleaguered, change-weary organizational world searching for the secret that will elevate them above the rest. Promising near instant success in a hyper-competitive world, most of these panaceas have come and gone with barely a whisper and yet the Scorecard drumbeat marches on, gaining momentum with each successive beat. The question is, why?

Before we explore the Balanced Scorecard in detail, it's important to examine some of the factors that have given rise to this proven framework for tracking organizational performance and executing strategy. Understanding these pillars of the Balanced Scorecard's success will not only enhance your appreciation of the tool, but the insights gained will also assist you as you begin implementing the system within your own organization. In the pages ahead, we'll examine these three factors that are fundamental to the success of any organization, whether public sector, nonprofit, or private: the increasing role of intangible assets in creating value in today's economy, our long-standing over-reliance on financial measures of performance to gauge success, and most importantly, the challenge of executing strategy. Let's look at each of these and discover how they've contributed to the need for a Balanced Scorecard system. We'll then return to an overview of the Balanced Scorecard and learn how this deceptively simple tool has revolutionized the management of performance (see Exhibit 1.1).

THE RISE OF INTANGIBLE ASSETS IN VALUE CREATION

As you read the heading for this section, what images flashed through your mind? An assembled throng of twenty-first century pocket-protector-wearing geeks at Google creating the next killer app of the Internet perhaps? Or maybe you wondered what the Red Bull–driven minds at Apple or Microsoft might dream up next? I can almost guarantee you didn't think about unloading timber ships at the London docks in 1970. But as much of a revolution occurred there as we're seeing in the halls of Silicon Valley today. In 1970, when a timber ship dropped anchor at the dock in London, it took 108 men about five days to unload it, equating to 540 man days. Today, that same ship would be stripped of its cargo in one, yes one, day. That's eight man days, meaning that over the past 37 years, workers have registered a whopping 98.5% improvement in the time to unload a ship. What could possibly account for this extraordinary enhancement? Steroid-popping stevedores? Hardly. The diminishing time requirement is a function of three things: containerization, modern processes for swift unloading, and enabling technology. Two out of those three of are quintessential examples of

Exhibit 1.1 The Balanced Scorecard Solves Fundamental Business Issues

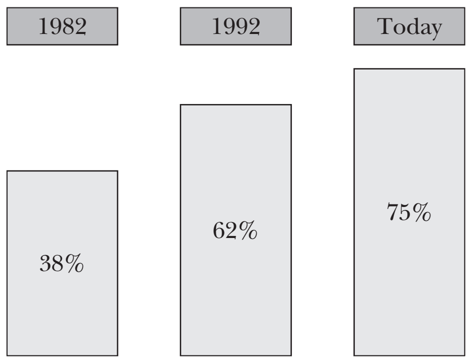


the power of intangible assets: processes and technology. They both emanate from and harness the only power we'll never run out of: brain power![2]

From barnacle-laden docks to computer-controlled manufacturing facilities to meeting rooms around the world, this scenario is transforming the way work is done in today's organizations. While this switch is probably evident to anyone working in today's frenzied times, it is also borne out of research findings by the Brookings Institute. Take a look at Exhibit 1.2 that illustrates the transition in value from tangible to intangible assets. Speaking on National Public Radio's *Morning Edition*, Ms. Margaret Blair of the Brookings Institute suggests that tangible assets have continued to tumble in value:

> If you just look at the physical assets of the companies, the things that you can measure with ordinary accounting techniques, these things now account for less than one-fourth of the value of the corporate sector. Another way of putting this is that something like 75% of the sources of value inside corporations is not being measured or reported on their books.[3]

Exhibit 1.2 The Increasing Value of Intangible Assets in Organizations



Adapted from *Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results, 2nd Edition,* Paul R.Niven (John Wiley & Sons, 2006).

Being keen-eyed denizens of the public and nonprofit sectors, I'm sure you noticed Ms. Blair's use of the term "corporations." Believe me, your organizations are being affected every bit as much as your corporate counterparts. The challenges represented by this switch are not going unnoticed in Washington, DC. David M. Walker, Comptroller General of the United States, said in a February 2001 testimony to the U.S. Senate that "human capital management is a pervasive challenge in the federal government. At many agencies, human capital shortfalls have contributed to serious problems and risks."[4] President George W. Bush, in his President's Management Agenda, echoes Walker's comments and adds that: "We must have a Government that thinks differently, so we need to recruit talented and imaginative people to public service."[5] Talented people, armed with the tools necessary to succeed and operating in an environment conducive to growth and change is the recipe for twenty-first century success.

Unfortunately, our measurement systems have failed to keep pace with the rate of change occurring in the workplace. As we'll see in the next section of the chapter, our performance measurement systems have focused almost exclusively on financial measures, and more specifically, they've relied on counting tangible things—inventory, monetary exchanges, and so on. However, the new economy, with its premium on intangible value creating mechanisms, demands more from our performance measurement systems. Today's system must have the capabilities to identify, describe, monitor, and fully harness the intangible assets driving organizational success. As we will see throughout this book, particularly in our discussion of the Employee Learning and Growth perspective, the Balanced Scorecard provides a voice of strength and clarity to intangible assets, allowing organizations to benefit fully from their astronomical potential.[6]

Financial Measurement and Its Limitations

Despite the changes in how value is created today, estimates suggest that 60% of metrics used for decision-making, resource allocation, and performance management in the typical organization are still financial in nature.[7] It seems that for all we've learned, we remain stuck in the quagmire of financial measurement. Perhaps tradition—where the measurement of all organizations has been financial—is serving as a guide unwilling to yield to the present realities. Bookkeeping records used to facilitate financial transactions can literally be traced back thousands of years. At the turn of the twentieth century, financial measurement innovations were critical to the success of the early industrial giants like General Motors. The financial measures created at that time were the perfect complement to the machine-like nature of the corporate entities and management philosophy of the day. Competition was ruled by scope and economies of scale with financial measures providing the yardsticks of success.

Over the last one hundred years, we've come a long way in our measurement of financial success, and the work of financial professionals is to be commended. Innovations such as Activity-Based Costing (ABC) and Economic Value Added (EVA) have helped many organizations make more informed decisions. However, as we begin the twenty-first century, many are questioning our almost exclusive reliance on financial measures of performance, suggesting that these measures may be better served to report on the stewardship of money entrusted to management's care rather than a means to chart the organization's future. Here are some of the criticisms levied against the over-abundant use of financial measures:

- *Not consistent with today's business realities.* Tangible assets no longer serve as the primary driver of enterprise value. It is employee knowledge (the assets that ride up and down the elevators), customer relationships, and cultures of innovation and change that create the bulk of value provided by any organization—in other words, intangible assets. If you buy a share of Microsoft's stock, are you buying buildings and machines? No, you're buying a promise of value to be delivered by innovative people striving to continually discover new computing pathways. Traditional financial measures were designed to compare previous periods based on internal standards of performance. These metrics are of little assistance in providing early indications of customer, quality, or employee problems or opportunities.

- *Driving by rear view mirror.* This is perhaps the classic criticism of financial metrics. You may be highly efficient in your operations one month, quarter, or even year. But does that signal ongoing financial success? As you know, anything can, and does, happen. A history of strong financial results is not indicative of future performance. As an illustration of this rear view mirror principle, look no further than the storied *Forbes* lists, regaling spellbound executives since 1917 with drool-inducing tales of heroic capitalism. *Forbes* published a 70th anniversary issue in 1987, and of the 100 companies that graced the inaugural roll, 61 were dead and gone, with only memories of their former fiscal glory remaining. Of the 39 companies that existed, many were on life support, with only 18 still named on the list. Similar statistics can be trotted out for the Standard and Poor's 500 list of top companies. Forty years after it began in 1957, only 74 of the initial 500 companies existed. More than 80% failed to survive.[8]

- *Tendency to reinforce functional silos.* Working in mission-based organizations, you know the importance of collaboration in achieving your goals. Whether it's improving literacy, decreasing HIV rates, or increasing public safety, you depend on a number of teams working seamlessly to accomplish your tasks. Financial statements don't capture this cross-functional dependency. Typically, financial reports are compiled by functional area. They are then "rolled-up" in ever-higher levels of detail and ultimately reflected in an organizational financial report. This does little to help you in meeting your noble causes.
- *Sacrifice long-term thinking.* If you face a funding cut, what are the first things to go in your attempt to right the ship? Many organizations reach for the easiest levers in times of crisis: employee training and development, or even employees themselves! The short-term impact is positive, but what about the long-term impact? Ultimately, organizations that pursue this tactic may be sacrificing their most valuable sources of long-term advantage and often to no avail. Recent research suggests that tools such as downsizing not only damages workers who are laid off, but destroy value in the long-term. One study found that downsizing in the corporate world never improved profits or stock market returns.[9]
- *Financial measures are not relevant to many levels of the organization.* Financial reports by their very nature are abstractions. Abstraction in this context is defined as moving to another level leaving certain characteristics out. When we roll-up financial statements throughout the organization, that is exactly what we are doing: compiling information at a higher and higher level until it is almost unrecognizable and useless in the decision making of most managers and employees. Employees at all levels of the organization need performance data they can act on. This information must be imbued with relevance for their day-to-day activities.

Thus far, I've taken a hard line on financial measures of performance. We just reviewed their many limitations, and with only a modicum of exaggeration, it could be suggested that a single-minded focus on financial success may be among the causes for the epidemic of scandals currently plaguing the corporate world. So, do financial metrics deserve a place on your Balanced Scorecard? Absolutely. Despite their many shortcomings, financial yardsticks are an entirely necessary evil. This is especially the case in the public and nonprofit sectors. In an era of limited, often decreasing, funding you must consistently tread the delicate balance between effectiveness and efficiency. Results must be achieved, but in a fiscally responsible manner.

Your stakeholders will be looking to you to achieve your missions, and thus, nonfinancial measures of performance become critical in your efforts. However, pursuing your goals with no regard to the financial ramifications of your decisions will ultimately damage everyone: You'll be the victim of decreased funding as it becomes clear that you're unable to prudently manage your resources. Your funders will be discredited, and potentially, unwilling to support you in the future. Most importantly, your target audiences will not receive the services they need as a result of your inability to reach them in both an effective and efficient way.

Strategy: Execution is Everything

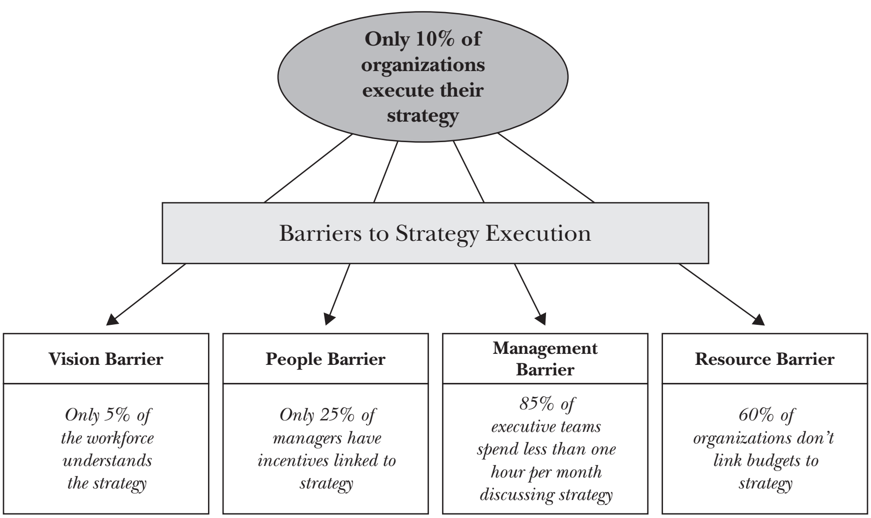
When I was conducting research for my book on private-sector Balanced Scorecard development, I knew I would come across many references to strategy. After all, strategy is probably among the most discussed and debated topics in the world of organizations. Of course, it's not just organizations that wrestle with strategy—the concept is one that has truly entered the mainstream of our society. Professional sports teams all have a strategy to beat their opponents (and their owners have a strategy to separate us fans from our money!). I have a strategy for writing this book, and I'm sure you all employ strategies in achieving your daily tasks both at home and at work. The interesting thing about strategy in the business sense of the word is that nobody seems to agree on what it is specifically. There are as many definitions as there are academics, writers, and consultants to muse on the topic. In fact, a favorite book of mine on the subject nicely summarizes both the confusion and the ultimate quest of those pursuing the strategy development challenge: *Strategy Safari*.[10] I enjoy conjuring up that image of strategy—picturing myself cutting through the dense forest of research, attempting to find my quarry: the holy grail of strategy.

One thing strategy gurus seem to agree on is this: despite the challenges of creating a strategy, ultimately it is more important and valuable to demonstrate the ability to execute the strategy. It's one thing to sit down and craft what is seemingly a winning strategy, but successfully implementing it is another thing entirely. For those who can execute, the rewards are significant. In the for-profit world, a 35% improvement in the quality of strategy implementation, for the average firm, is associated with a 30% improvement in shareholder value.[11] While shareholder value is not the end game of your organization, you too will benefit greatly from an ability to carry out your strategies. Unfortunately, the vast majority of organizations fail miserably when attempting to execute their strategies. A 1999 *Fortune* magazine story suggested that 70% of CEO failures were not a result of poor strategy, but rather of poor execution.[12] More recently, The Center for Creative Leadership has reported that 40% of CEOs fail in their first 18 months.[13] Why is strategy so difficult for even the best organizations to effectively implement? Research and experience in the area have suggested a number of barriers to strategy execution, and they are displayed in Exhibit 1.3. Let's take a look at these in turn.

The Vision Barrier Employee empowerment, two-way communication, and information sharing are terms whose benefits executives and managers alike frequently espouse. Talk is cheap. The fact of the matter is that the vast majority of organizations have a long way to go when it comes to communicating their most important messages—vision and strategy—to their most important constituents: employees.

An earlier section discussed the fact that many financial measures were developed at the turn of the twentieth century. Transport yourself back there for a moment and put yourself inside one of those fortresses of industry, complete with towering walls and smokestacks billowing who-knows-what into the atmosphere. Chances are you'd be told what to do, when to do it, where to do it, and how to do it. Would knowledge of the organization's

Exhibit 1.3 Barriers to Implementing Strategy



Adapted from material developed by Robert S. Kaplan and David P. Norton.

vision and strategy have been the least bit relevant or helpful in your task? Probably not. But today the world is an entirely different place. Value is created largely from intangible assets such as customer knowledge and information-rich networks. If you're going to contribute in a meaningful way you must know where the organization is headed and what the strategy is to get there. Only then can you combine your talents with others from across your agency to create value for your stakeholders and ultimately achieve your mission.

The People Barrier For decades, debate has raged on whether incentive compensation plans really do lead to improved performance. We may never know the answer, but it is probably safe to suggest that an incentive of any kind tends to increase focus—at least temporarily. The danger with incentive plans is the possibility that managers will sacrifice long-term value-creating activities and initiatives in order to reach a short-term financial target and receive a monetary award. Strategy cannot be executed if the focus is continually on the short term. By its very nature, strategy demands a longer-range view of an organization's landscape. Financial incentives can distort or entirely block an organization's strategic view.

The Resource Barrier 60% of organizations don't link budgets to strategy. If that's the case, then what are they linking their budgets to? For many organizations, it's as simple as looking at last year's budget and adding or subtracting a few percentage points as appropriate. This is a particularly damaging blow to the hopes of executing strategy. What is a budget if not a detailed articulation of the priorities of the enterprise for the next fiscal year? If the budget is not linked to some form of strategic plan and goals, then what does that say about the organization's priorities? Do they even possess any, or are they simply spinning their wheels and wasting precious resources in the process. We'll return to the important topic of budgets in Chapter 10.

The Management Barrier Have you ever heard the phrase "management by walking around?" It suggests an approach of staying close to your employees by speaking with them frequently and informally, ensuring communication is two-way and beneficial to all. By contrast, I believe most of us live in the age of "management by firefighting!" We move from one crisis to the next, never taking the time to pause and reflect on our larger objectives, strategies, and mission. A client of mine uses the analogy of "working *in* the business," that is, fighting fires, versus "working *on* the business," that is taking the necessary break to examine things from a larger perspective.

Many would argue there is literally no time to slow down, not even for a minute. Undoubtedly, we live in an era of brutally fast-paced organizations, but virtually all of us attend regular management meetings. In order to have any chance of executing strategy, these meetings must be transformed.