Scorecards 10 Years On – Fading Fad or Maturing Management?

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SCORECARDS AS EMERGING BEST PRACTICE IN MANAGEMENT CONTROL?

The concept of the balanced scorecard (BSC) was first presented in the early 1990s. By 2000 some surveys indicated that a majority of firms in the United States, the United Kingdom and Scandinavia used scorecards – or at least intended to do so soon. Others, like Bain's management tools survey,[2] indicated a slight drop in usage to 36%, but with a high average satisfaction with the tool. The number of software packages for scorecards on the market is growing and now exceeds 100. In only 10 years, the idea of the BSC has certainly made its mark.

At the same time there are reports of high failure rates. We have seen firms abandon their scorecard efforts. Others are struggling against the perception of the BSC as 'just another three-letter fad' propagated by consultants such as TQM, BPR, and ABC.[3] But were these failures? There are probably fewer BPR or ABC projects started now than 10 or 15 years ago. Still, important parts of their philosophy have been integrated into standard practices in modern management.

There is also another danger. Many such projects were not for 'real'. Managers used the terms because it was the current thing to do, but did not give the concepts a chance by applying them as intended. The same may be happening to the BSC: the ideas are rejected because they are not applied properly.

There are indications that the literature about scorecards has 'peaked' (Figure 1.1). Even after 10 years of the BSC we are aware of very few companies with more than a few years of successful and ongoing scorecard use. Some may see Figure 1.1 as a 'hype curve', indicating inflated expectations

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among those who take an interest in methods of management. To have lasting effects, the hype has to be followed by action. Organizations introducing scorecards need to work patiently for several years before they can claim to have reformed their control systems. With diminishing hype, the BSC will need to start producing tangible effects – at a time when it is still in need of continued support and experimentation.

Yet during our research for this book we found that several important corporations are only now launching major BSC initiatives. We met enthusiastic managers convinced that they will avoid the pitfalls encountered by companies who have discontinued their projects. They usually claim that others have laid too much emphasis on performance measurement, and too little on strategic control. Maybe after a period of trial-and-error the BSC is now emerging as a natural and necessary part of management?

So it seems time to make up our minds about the BSC. What can we learn from the past 10 years of the BSC? What should organizations using scorecards take note of in order to make their projects successful? These are the questions that prompted the present book. We build on the experiences reported in our previous book *Performance Drivers* (1999). But here we

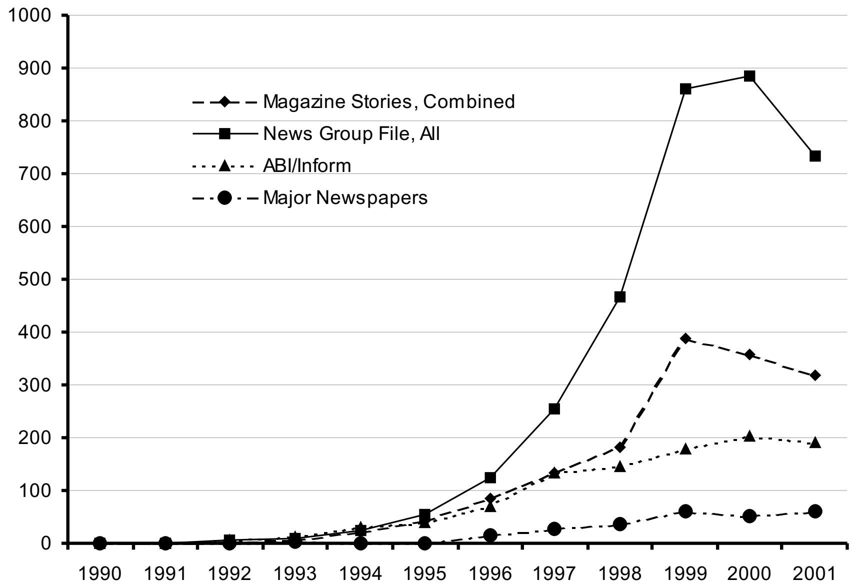

Figure 1.1 Articles about the BSC in the Nexis database.

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take a much more careful look at the experiences people have had in introducing and using scorecards. We do this through cases from business and government. A few of them are told in some detail, because we believe that success with scorecards hinges on how they enter into the everyday life of organizations. Others are used as building blocks for a discussion of challenges and issues facing firms using the BSC. But first this chapter and the next provide a brief introduction to the range of different varieties of BSCs, and how they are used.

WHAT A SCORECARD IS, AND WHY

A BSC is a format for describing the activities of an organization through a number of measures for each of (usually) four perspectives. A simplified BSC may resemble Figure 1.2. Some business activity is described from four different perspectives, using a small number of measures for each. The description may refer to the business's current performance, or to its goals for the next period.

Some would say that this is just another performance report, combining financial and non-financial metrics. But there is more to the scorecard than immediately meets the eye:

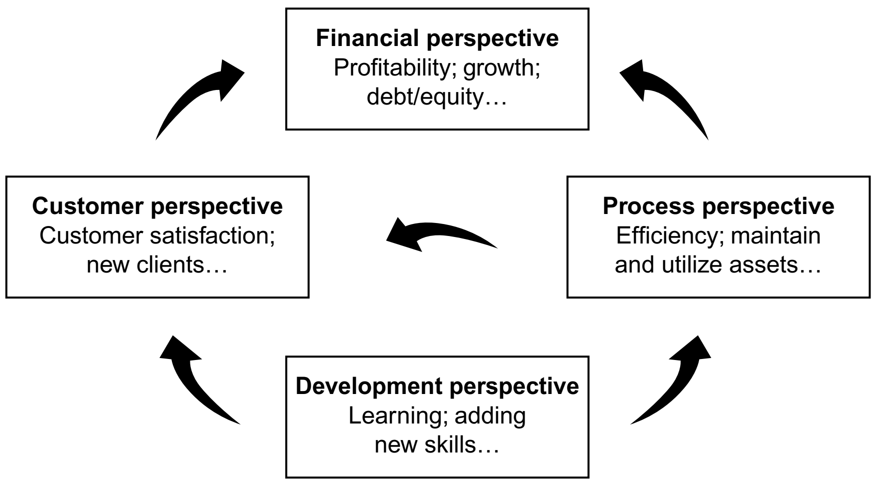

Figure 1.2 A basic BSC, with examples of typical contents for each of the four perspectives.

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- The scorecard is balanced: the four perspectives aim for a complete description of what you need to know about the business. First, there is a *time dimension* going from bottom to top. Current profitability, etc. may largely be a consequence of what was done last quarter or last year; if new skills are added now it should have consequences for next year's efficiency and finance.
- The scorecard is balanced in another way also: it shows *both internal and external* aspects of the business. It is obvious that a 'well-oiled machinery' of internal processes is important in any business, and may not always correlate with external perceptions. On the other hand, customers' views and the contacts that have been established in the market-place are obviously important too. The scorecard shows both.
- Finally, the scorecard is *linked* through cause-and-effect assumptions. Among its most important uses is to reflect on how strong these linkages are, what time delays they involve, and how certain we can be about them in the face of external competition and change. In Figure 1.2, links are indicated just between perspectives; it is, of course, advisable to discuss links also between individual measures.

In Figure 1.2 we use four perspectives, as originally proposed by Robert S. Kaplan and David P. Norton in their initial article, published in 1992 in the *Harvard Business Review* (Kaplan and Norton, 1992). In practice, the names and identities of these perspectives have come to vary. The 'development' perspective was Innovation and Learning in Kaplan and Norton's first article, and became Learning and Growth in their later writings. The 'process' perspective is sometimes called Internal Business Processes. We tend mainly to use 'development' and 'process' for their brevity, but readers will find that the organizations we have studied have introduced their own names for these.

Organizations whose long-term goals are not financial may prefer to reorder the perspectives, and regard the financial perspective not as an objective but as a means to providing customer services. Or they can change it into the fulfilment of the organization's goal. We will discuss this in Chapter 2.

Since its first appearance, the concept of the BSC has been widely adopted as a new approach to management control both in business and government. A scorecard is an easy-to-understand generic format for describing

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the ambitions and achievements of an organization. It has proved useful for:

- Communicating strategic intentions, enabling managers and employees to realize intended strategies.[4]
- Discussing activities that are motivated by strategic aims rather than current necessities, such as the development of competencies, customer relationships, and IT, and how these will pay off in the future.
- Monitoring and rewarding such activities.

These aims are equally important in business firms pursuing long-term profitability and in non-profit organizations such as government agencies. Some of the most enthusiastic advocates of scorecards are to be found in public administration. Behind them is one important common theme: essential qualities of modern organizations – their resources as well as their performance – are poorly reflected in traditional accounting and control. Managers need tools to communicate about intangible or immaterial assets: to agree on targets for, and to monitor, their organization's performance in dimensions other than the traditional monetary ones.

GETTING A GRIP ON INTANGIBLES

In *Performance Drivers*, we argued that the interest in scorecards reflects the increasing dependence of both business and government on their intangible assets, *and* the need to engage employees in the pursuit of strategies where the long-term development of such assets is a key to business success. This need will be most apparent in organizations where many employees have customer contacts, and where long-term success is highly dependent on the interaction with customers and other external contacts. Such organizations need to spend time and effort learning about their environment, improving databases and systems, and creating positive attitudes towards the organization among all stakeholders. Scorecards will guide and focus these activities.

The idea of a BSC for business emerged from consultations with companies to identify a planning and performance control process suitable for the 1990s. Increased dependence on immaterial resources was a major reason why a quest for control tools using metrics other than traditional,

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financial ones seemed necessary. The time was ripe for a concept integrating several ideas that had gained importance during the 1970s and 1980s, and would develop in parallel with the BSC:

- Customer satisfaction indices, and the general idea that value as perceived by customers was important to monitor.
- 'Network' ideas of customer and supplier relationships as assets that a company should maintain and develop over time, important for future earnings and consequently an important part of the value of a business. Terms such as customer base, partnerships, alliances, virtual and imaginary organizations, emerged at about the same time.
- Process orientation and quality as critical for business success were promoted through acronyms such as TQM and BPR.
- Human resource accounting provided the roots for other types of 'intellectual capital' reporting, with ambitions to provide both internal and external parties with an improved understanding of the most important assets of a company.

These ideas could be integrated into the customer and process perspectives. For the development (learning and growth) perspective, there were comparatively fewer suggestions.

Using non-financial measures, of course, had a history going much further back. Local information systems (in a production unit or a sales department) attracted the attention of accounting research in the 1980s, but had, of course, always existed. Large corporations have used non-financial numbers in a systematic way for at least 50 years. And, as Kaplan and Norton have pointed out, there will always be hundred of numbers which are used in a company that should not be included in scorecards. The scorecard idea was essentially to articulate strategy through a particular format, integrating a highly restrictive selection of metrics.

Brand recognition, competences, processes, etc. are all part of an organization's intangible assets. The benefits of scorecards will be greatest in organizations where these are especially important, and particularly when many organization members are involved in maintaining and utilizing them. Assets such as customer relations, procedures, brand names, databases, etc. used to show up only as costs in planning documents and reports. Gradually, new metrics have been introduced such as customer satisfaction, cycle times, and brand recognition. A well-designed scorecard provides a unifying perspective for these, showing the intended relation between them and future revenues.

During the 1990s, interest in intangibles grew. Research in the European Union and the United States focused on how companies could manage and report immaterial assets, and the title of a Brookings Institute report (2001) summarizes the hopes attached to these efforts: *Unseen Wealth*. Through most of the decade, stock markets did see wealth in intangible assets. In the United States, the ratio between share prices and book values for large companies on average rose from a little more than 2 in 1990 to a high of more than 7 at the end of the decade.[5] It then declined, but not to its previous low. Obviously, this development was partly about asset-less 'new economy' firms. But also 'bricks and mortar' companies are increasingly focusing on their 'intellectual capital', rather than the material assets that are visible in their balance sheets. With the current emphasis on shareholder value, few will find it sufficient to base internal controls only on Return on Investment (RoI) or similar concepts which reflect traditional accounting concepts.

The link we see between intangibles and scorecard use may also explain why the idea seems to have attracted interest especially in industries and countries where 'knowledge-based' companies are common. But also other types of firms can benefit. A recent report[6] describes scorecard use in a carpet company in Mongolia!

USES OF SCORECARDS

Scorecards are tools for communication. They can be used in many different dialogues about almost any kind of activity. All organizations strive to please their customers, clients, or recipients in general; we all have our internal processes and routines; we all reap rewards from what we did earlier, at the same time as we need to prepare for the future; and we all have to think about causation over time. Introducing BSCs, however, also means *designing a customized management control system.* Scorecards are used to align business activities to the vision and strategies of a firm, monitoring performance in the dimensions used in the scorecards, and taking action appropriate for realizing the intended strategy.

Compared with other ways of describing what an organization does or should do, BSCs have two distinguishing features. One is the almost

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simplistic format of the scorecard itself, where a restricted number of measures are used for each of four perspectives on a business activity: its *financial* performance; its *customer interface*; its *internal processes*; and its *learning and development*.

The other is the insistence that perspectives and measures should be 'linked'. A good scorecard documents a strategic logic: cause-and-effect relationships between current activities and long-term success. Scorecards aim to *change behaviour* through *communication* in order to *realize the intended strategy*. The particular efforts an organization makes in order to learn, or improve its processes, or make its customers happier, must be based on its conviction that these efforts constitute the best path to future success. The links in a good scorecard will visualize a 'business logic': how doing the right things now is expected to produce long-term rewards. In this way, scorecards translate strategy into terms that are meaningful for organization members in their everyday activities.

A difficulty in judging the penetration of scorecards is to decide what we mean by 'using' BSCs. There are studies where half the respondents claim that their companies use scorecards or soon will. We believe that companies where management control is really based on scorecards are much fewer. The fact that most respondents believe that they (should) use scorecards is interesting by itself, as are the difficulties also reported. In fact, there are very many different variants to be found among the applications we have learnt about:

- A number of firms use scorecards as a format for discussing strategies only, and have not really introduced them as a tool for ongoing management control.
- Some companies structure their plans and reports into four or five perspectives derived from the BSC. However, they use these only for sorting existing measures to provide an overview. The resulting 'scorecard' does not really derive from any coherent strategic discussion. While this shows that the scorecard format is generally accepted and attractive, we do not expect companies who just use it for sorting preexisting measures to realize its potential benefits.
- In some cases, scorecards were introduced as a substitute for budgets, while in other cases budgets and scorecards coexist. A fairly common ambition currently seems to be to combine scorecards with rolling

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forecasts of cash flow. This is because budgets are perceived to have a dual role: providing performance targets, and foreseeing cash needs. The former role is taken over by scorecards, while the latter is handled through rolling forecasts.

- The scope of scorecard use within companies varies widely: just one scorecard (for the entire firm, or for some part of it); scorecards at one or two levels of the hierarchy; scorecards throughout the organization, sometimes including personal scorecards for individual members. So does the way different scorecards are linked. In some corporations, similar metrics are prescribed for everyone; in others, design is up to each scorecard 'owner'.
- This is closely linked to how measures[7] are meant to relate. Some companies (and, incidentally, most software vendors) expect numbers to be aggregated throughout the organization, while in others it is the logic rather than the numbers that matters. Some examples: certain measures obviously are easy to combine (like adding profits). But is it meaningful to calculate an average of market shares or employee scores? Has a division necessarily met its targets if the sum of its subunits fulfils expectations, but this hides large discrepancies among them?
- Some companies have used scorecards for projects. 'Learning and development' may then be for the project itself, if its life span is long, or for the rest of the corporation.
- Scorecards for corporate functions such as IT or human resources (HR) have been suggested and tried. This introduces the need to distinguish between a scorecard for, say, an IT *department* and for IT as a *business resource* for the entire firm.
- Scorecards for government and other non-profit organizations are gaining in popularity.

These applications show that the BSC is an attractive format for discussing human activities whenever there is a need to communicate ideas about causes and effects and priorities, or to check what has been achieved so far. There is no single best way of using scorecards. This makes it urgent, before starting a scorecard project, to consider what part or aspect of an organization and its activities is in need of such discussions, and who is to take part in them. This should determine the scope of the project, in terms of how much and which parts of the organization should be included, who

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should be involved, and at what stages: as a planning tool; for monitoring activities; and for reviewing achievements.

SCORECARDS AND INFORMATION DISCLOSURE TO THE PUBLIC

In this book we are concerned with the use of scorecards in running an organization. However, it seems appropriate to comment briefly here on scorecards as tools also for external communication.

Reporting performance in scorecard terms to the outside public, for instance, in annual reports, has been very rare. However, current suggestions for richer reporting using terms such as intellectual capital often show the influence of BSC thinking.[8] Recent events are having a huge impact on public trust in any information disclosed by corporations. It is hard to guess how this will influence the debate about adding more non-financial information to the facts that corporations are publishing, or are required to publish.

On the one hand, when even long-established accounting numbers are difficult to trust, who will believe a company's non-financial reports about its customers, its processes, and its development efforts? Can they be audited? Is not any claim about such assets too contingent on other external and internal conditions that are impossible to verify?

On the other hand, misleading or fraudulent use of accounting numbers may partly happen because modern business cannot be described in as simple terms as earlier. Translating emerging new business deals, partnerships, and competencies in monetary terms involves assumptions that are better left to the market. According to this way of thinking, scorecard-like information as a *complement* to external accounts is needed now more than ever.

In our interviews for this book we came across a related, but different issue. A few of the corporations we talked to saw insider-trading rules as a limitation on their *internal* disclosure of scorecard information. Public corporations have to obey strict rules about how information with a potential impact on share prices is disseminated. Top-level managers who have access to such information are registered as insiders to prevent them from buying and selling stock based on it. The companies we talked to would have liked to let many more employees have access to scorecard information such as trends in different customer segments, quality measures, etc. They

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told us that they could not do this, and had to restrict access to measures for just the local unit where employees work. 'Otherwise we would have to register several hundred employees as insiders!'

We found this interesting, because it seems an obvious but little-discussed consequence of the greater openness that many corporations now aim for. It also shows that this type of information really is strategically sensitive. Of course, it should be if a scorecard really 'tells the story of our strategy', as is the intention. But it may also indicate that in the longer run it will be necessary to disclose more such information to the general public – because it has to be handled daily by too many employees to be kept secret. Scorecards will be a natural format for this.

FAD OR EMERGING STANDARD?

The previous sections showed that the *aims and scope* of scorecard projects have varied. Early projects focused on performance management.[9] The BSC was soon promoted as a strategic control tool, to be used throughout a corporation and based on its over-arching strategic aims. This was probably attempted in only a minority of cases. Multi-business corporations find it hard to articulate a corporate strategy, and financial measures are usually more acceptable and even sufficient at this level, especially in more differentiated groups. Much scorecard work therefore started at division or business unit level, or even lower down in organizations, where non-financial metrics and concrete assumptions about cause-and-effect relationships were found to be more attractive than traditional controls. Some companies even argued that scorecards should be built bottom-up rather than mandated from the top. One such company, Skandia, is described in Chapter 3. As we will see, after some years they partly changed their philosophy.

But there are also large differences in the *realization* of the intended aims. We have seen scorecard projects that never went beyond an initial scorecard, although this was the aspiration. Management engaged enthusiastically in articulating their strategy, but the resulting scorecard was never turned into control.

At the same time, other corporations pushed systematic measurement and reporting as the essential part of their scorecard projects, almost to the exclusion of strategic discussions or top-management involvement.

A consequence was that scorecards in some corporations were a set of overhead slides in the CEO's presentations, in others elaborate performance measurement routines without much contact with strategy. In some, the scorecard project became synonymous with a new software package for reporting numbers that already existed in data warehouses. As we will argue in later chapters, to get widespread and connected use of scorecards without lapsing into meaningless rituals may be the real challenge in scorecard projects. Popular books and articles, including our own, are partly to blame for the failures. Too little attention has been given to the problems of 'living with scorecards', an imbalance we intend to redress in this book.

Scorecards also tend to look very different in different organizations. Kaplan and Norton in their later writings (e.g. Kaplan and Norton, 2001) stress the use of the *strategy map*, a tool which we find highly useful and will discuss extensively in later chapters. This should be regarded as a different way of *representing* the scorecard, and we include it when we talk of the BSC. On the other hand, many companies have redesigned the original, four-perspective scorecard. We have given some examples already in *Performance Drivers*: Volvo using one short-term and one long-term scorecard, or Xerox reformulating their previous measurement framework into a sort of scorecard. In Scandinavia, a standard change has been to introduce a fifth perspective for employees or HR. This sometimes leads to a reformulation of the entire scorecard in terms of stakeholder groups.

Although such 'scorecards' are interesting reactions to the same needs that led to the BSC, we believe that they may have harmed the basic concept. The BSC is a flexible tool, but its usefulness cannot be judged from the reactions people have from using 'scorecards' that are very different from the original intention, or from failing to use them properly. One of our case companies told us that their scorecard project had encountered difficulties mainly in one division. This had run a local scorecard project a couple of years previously, which the present project leader believed was not handled properly. In a similar way, we were told by a group having operations both in Sweden and in one of the Baltic states that it was easier to introduce scorecards in the latter. They had less preconceived opinions and a greater expectation of change.

Reports that 55% of firms are now using the BSC need therefore to be viewed with a healthy dose of scepticism. What kind of scorecards do they have in mind, and how are they used?

What these findings do indicate is a lack of satisfaction with traditional controls. This is also the unifying theme in the cases we report in this volume. Our intention in this book is to take a critical look at why companies introduce scorecards, how they do it, and what challenges and important design issues they encounter. The selection of companies is largely based on access, with an eye to a mixture of large and small, private and public, local (Swedish) and international. These are introduced in Chapter 4. We find one story, Skandia, so interesting that we devote an entire chapter, Chapter 3, to it. It provides food for thought on many of the issues that we discuss later, and allows us to give an 'inside' perspective that adds new depth to the descriptions of Skandia's project in earlier books.[10]

Following these chapters, we proceed by using our cases and other experiences for a thematic exposition which we have organized into 'challenges' and 'issues'. These are introduced at the beginning of these sections. Challenges are the difficulties many organizations face as they implement and use scorecards. Issues refer to the most important design choices when an organization introduces the BSC and starts relying on it as an important tool for realizing strategies.

So is our conclusion that the BSC is a 'fad', or 'emerging best practice'? We think it all depends on how it is done. The scorecard idea is flexible. It needs to be adapted to one's own situation, and a number of design issues need to be addressed. That is why we have written this book. By digesting the experiences from our case organizations and our own practice working with scorecards in many organizations, we believe that readers who are managing scorecard projects, leading firms where such projects are attempted, starting new projects – or salvaging old ones – should get an awareness of the pitfalls and critical choices to be made. This should make it possible for them to make their own use of scorecards successful.

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