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THE STRATEGY-FOCUSED ORGANIZATION

HOW BALANCED SCORECARD COMPANIES THRIVE IN THE NEW BUSINESS ENVIRONMENT

ROBERT S. KAPLAN
DAVID P. NORTON

HARVARD BUSINESS SCHOOL PRESS

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Preface

In the preface to our first book, *The Balanced Scorecard*, we stated, "The book, while as comprehensive and complete as we could make it, is still a progress report. . . .We are confident . . . that innovating companies . . . will expand the structure and use of the scorecard even further. So perhaps in a few years readers can look forward to the sequel."

That forecast was highly accurate on all counts. Since 1996, we have seen the initial set of adopters thrive and prosper by using the Balanced Scorecard as the centerpiece of their management systems and processes. And many other organizations now have adopted the Balanced Scorecard and achieved remarkable results. Adopters throughout the world include large and small, manufacturing and service, mature and rapid-growth, public and private, and for-profit and not-for-profit organizations. As we go to press, *The Balanced Scorecard* has been translated into nineteen languages, attesting to its universal appeal and applicability.

We first developed the Balanced Scorecard in the early 1990s to solve a measurement problem. In knowledge-based competition, the ability of organizations to develop, nurture, and mobilize their intangible assets was critical for success. But financial measurements could not capture the value-creating activities from an organization's intangible assets: the skills, competencies, and motivation of employees; databases and information technologies; efficient and responsive operating processes; innovation in products and services; customer loyalty and relationships; and political, regulatory, and societal approval. We proposed the Balanced Scorecard as the solution to this performance measurement problem.

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But we learned that adopting companies used the Balanced Scorecard to solve a much more important problem than how to measure performance in the information era. That problem, of which we were frankly unaware when first proposing the Balanced Scorecard, was how to implement new strategies. Statistics from various sources documented that organizations encountered major difficulties and often failed when implementing new strategies. In contrast to this general experience, we observed that a high proportion of the early Balanced Scorecard adopters effectively implemented new strategies and realized positive returns within twelve to twenty-four months. We realized that a new organizational form had emerged—the "Strategy-Focused Organization." Executives of adopting organizations were using the Balanced Scorecard to align their business units, shared service units, teams, and individuals around overall organizational goals. They were focusing key management processes—planning, resource allocation, budgeting, periodic reporting, and the management meeting—on the strategy. Vision, strategy, and resource allocation flowed down from the top; implementation, innovation, feedback, and learning flowed back up from the front lines and back offices. With their new focus, alignment, and learning, the organizations enjoyed nonlinear performance breakthroughs. The whole truly became much more than the sum of its parts.

We are indebted to many people for helping us understand how to make an organization strategy focused. We have learned from and been inspired by leaders of exemplary organizations:

Brian Baker and Bob McCool	Mobil North America Marketing and Refining Division
Gerry Isom and Tom Valerio	CIGNA Property & Casualty Division
Robert Gordon	Store 24
Norman Chambers	Halliburton Energy Development
Michael Hegarty and Lee Wilson	Chemical and Chase Banks, now at AXA
Bill Catucci	AT&T Canada, now at Equifax
Larry Brady	FMC Corporation, now at UNOVA
Pam Syfert	City of Charlotte, North Carolina

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Governor Gary Locke and Joe Dear	State of Washington
Dr. Jon Meliones	Duke Children's Hospital
Vanessa Kirsch and Kelly Fitzsimmons	New Profit, Inc.
Tris Chapman	Southern Gardens Citrus
Kathleen Bradley Kapsalis	May Institute
Elaine Brennan	Montefiore Hospital

Many people created change from within their organizations to generate the rich experiences and successful implementations that we describe in the book:

Jay Forbes	Nova Scotia Power
Mike Brown and Doug Schultz	United Parcel Service
Ron Mambu	FMC Corporation
Richard Magnus	Subordinate Courts, Singapore
Guillermo Babatz	Grupo Bal, Mexico
Steve Kirn	Sears, Roebuck and Co.
Cheryl Thomas and William Ehrhorn	Fannie Mae
Steven Relyea	University of California, San Diego
Ted Francavilla	Chemical and Chase Banks
Ed Lewis	Mobil NAM&R
Todd D'Attoma	Mobil NAM&R, Lubricants
Stephen Mournighan	U.S. Department of Energy Procurement
Lori Byrd	U.S. Department of Transportation
Julie Chesley and M. Wenger	National Reconnaissance Office
Dennis Wymore	Shell Oil Company

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Eileen Moser	United Way of Southeastern New England
Lisa Schumacher and Nancy Elliott	City of Charlotte, North Carolina
John Davis	Nationwide Financial Services
Marc de Quervain	ABB Switzerland
Al Derden	Texaco
Wolfgang Schmidt-Soelch	Winterthur International
James Noble and Martin Shotbolt	General Motors
Garrett Walker	GTE Service Corporation
Randy Numbers and Mary Gray	J. P. Morgan

In addition, we learned from the innovative implementations done by our colleagues at the Balanced Scorecard Collaborative: Michael Contrada, Geoffrey Fenwick, Laura Downing, Bill Hodges, Terry Brown, Ann Nevius, Rob Howie, Cynthia Baird, Mario Bognanno, Dave Foster, Randy Russell, and Gaelle Lamotte; and those formerly at Renaissance Worldwide—Francis Gouillart, Sean Hogan, Ryan English, and Timothy Henry.

Our collaborators at Harvard Business School Press—Carol Franco, President; Hollis Heimbouch, Senior Editor; Constance Devanthéry-Lewis, Managing Editor; Barbara Roth, Senior Manuscript Editor; and Laura Noorda, Production Manager—provided inspiration and outstanding support.

We appreciate the assistance of all these many people in helping us create this book.

Robert S. Kaplan and David P. Norton
Boston and Lincoln, Massachusetts, June 2000

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CHAPTER ONE

Creating the Strategy-Focused Organization

THE ABILITY TO EXECUTE STRATEGY. A study of 275 portfolio managers reported that the ability to execute strategy was more important than the quality of the strategy itself.[1] These managers cited strategy implementation as the most important factor shaping management and corporate valuations. This finding seems surprising, as for the past two decades management theorists, consultants, and the business press have focused on how to devise strategies that will generate superior performance. Apparently, strategy formulation has never been more important.

Yet other observers concur with the portfolio managers' opinion that the ability to execute strategy can be more important than the strategy itself. In the early 1980s, a survey of management consultants reported that fewer than 10 percent of effectively formulated strategies were successfully implemented.[2] More recently, a 1999 *Fortune* cover story of prominent CEO failures concluded that the emphasis placed on strategy and vision created a mistaken belief that the right strategy was all that was needed to succeed. "In the majority of cases—we estimate 70 percent—the real problem isn't [bad strategy but] . . . bad execution," asserted the authors.[3] Thus, with failure rates reported in the 70 percent to 90 percent range, we can appreciate why sophisticated investors have come to realize that execution is more important than good vision.

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Why do organizations have difficulty implementing well-formulated strategies? One problem is that strategies—the unique and sustainable ways by which organizations create value—are changing but the tools for measuring strategies have not kept pace. In the industrial economy, companies created value with their tangible assets, by transforming raw materials into finished products. A 1982 Brookings Institute study showed that tangible book values represented 62 percent of industrial organizations' market values. Ten years later, the ratio had dropped to 38 percent.[4] And recent studies estimated that by the end of the twentieth century, the book value of tangible assets accounted for only 10 percent to 15 percent of companies' market values.[5] Clearly, opportunities for creating value are shifting from managing tangible assets to managing knowledge-based strategies that deploy an organization's intangible assets: customer relationships, innovative products and services, high-quality and responsive operating processes, information technology and databases, and employee capabilities, skills, and motivation.

In an economy dominated by tangible assets, financial measurements were adequate to record investments in inventory, property, plant, and equipment on companies' balance sheets. Income statements could also capture the expenses associated with the use of these tangible assets to produce revenues and profits. But today's economy, where intangible assets have become the major sources of competitive advantage, calls for tools that describe knowledge-based assets and the value-creating strategies that these assets make possible. Lacking such tools, companies have encountered difficulties managing what they could not describe or measure.

Companies also have had problems attempting to implement knowledge-based strategies in organizations designed for industrial-age competition. Many organizations, even until the end of the 1970s, operated under central control, through large functional departments. Strategy could be developed at the top and implemented through a centralized command-and-control culture. Change was incremental, so managers could use slow-reacting and tactical management control systems such as the budget. Such systems, however, were designed for nineteenth- and early twentieth-century industrial companies and are inadequate for today's dynamic, rapidly changing environment. Yet many organizations continue to use them. Is it any surprise that they have difficulty implementing radical new strategies that were designed for knowledge-based competition in the

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twenty-first century? Organizations need a new kind of management system—one explicitly designed to manage strategy, not tactics.

Most of today's organizations operate through decentralized business units and teams that are much closer to the customer than large corporate staffs. These organizations recognize that competitive advantage comes more from the intangible knowledge, capabilities, and relationships created by employees than from investments in physical assets and access to capital. Strategy implementation therefore requires that all business units, support units, and employees be aligned and linked to the strategy. And with the rapid changes in technology, competition, and regulations, the formulation and implementation of strategy must become a continual and participative process. Organizations today need a language for communicating strategy as well as processes and systems that help them to implement strategy and gain feedback about their strategy. Success comes from having strategy become everyone's everyday job.

Several years ago, we introduced the Balanced Scorecard.[6] At the time, we thought the Balanced Scorecard was about measurement, not about strategy. We began with the premise that an exclusive reliance on financial measures in a management system was causing organizations to do the wrong things. Financial measures are lag indicators; they report on outcomes, the consequences of past actions. Exclusive reliance on financial indicators promoted short-term behavior that sacrificed long-term value creation for short-term performance. The Balanced Scorecard approach retained measures of financial performance, the lagging indicators, but supplemented them with measures on the drivers, the lead indicators, of future financial performance.

But what were the appropriate measures of future performance? If financial measures were causing organizations to do the wrong things, what measures would prompt them to do the right things? The answer turned out to be obvious: *Measure the strategy*! Thus all of the objectives and measures on a Balanced Scorecard—financial and nonfinancial—should be derived from the organization's vision and strategy. Although we may not have appreciated the implications at the time, the Balanced Scorecard soon became a tool for managing strategy—a tool for dealing with the 90 percent failure rates.

Several of the first companies that asked us to help them adopt the Balanced Scorecard—Mobil Oil Corporation's North America Marketing and Refining Division, CIGNA Corporation's Property & Casualty Division,

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Chemical Retail Bank, and Brown & Root Energy Services' Rockwater Division—were underperforming; they were losing money and trailing the industry. Each organization had recently brought in a new management team to turn performance around. Each new management team introduced fundamentally new strategies in an effort to make their organizations more customer-driven. The strategies did not simply rely on cost reduction and downsizing; rather, they required repositioning the organization in its competitive market space. More important, the new strategies required that the entire organization adopt a new set of cultural values and priorities. In retrospect, we had been asked to introduce the Balanced Scorecard into four worst-case scenarios: failing, demoralized organizations that needed their workforces of up to 10,000 employees to learn and understand a new strategy and change behavior that had been imbedded for decades.

Mobil North America Marketing and Refining

In 1992, Mobil North America Marketing and Refining Division, a $15 billion per year division of Mobil Oil Corporation,[7] ranked last among its industry peers in profitability, producing an unacceptably low return on investment and requiring a cash infusion of about $500 million from the parent company just to maintain and upgrade facilities. A new management team developed a new customer-focused strategy. The team decentralized the organization into eighteen market-facing business units with P&L accountability and restructured central staff functions into fourteen shared service groups. The Balanced Scorecard was introduced in 1994 to communicate and manage the rollout of the new strategy.

Results came quickly. After years of below-average performance, including ranking at the bottom of its peer group in 1992 and 1993, Mobil moved to the number one position in 1995, with profits 56 percent above the industry average (see Figure 1-1). This turnaround was accomplished within two years of introducing a new strategy, a new organization, and the Balanced Scorecard performance management process. What is more impressive, Mobil maintained industry leadership for the next four consecutive years. Brian Baker, executive vice president of the division in early 1998, commented on the organization's success: "In 1997 we hit the number 1 ranking for our third consecutive year, which is unprecedented for a major oil company. . . . The Scorecard gets the lion's share of the credit. We created a performance mind-set with the Balanced Scorecard."

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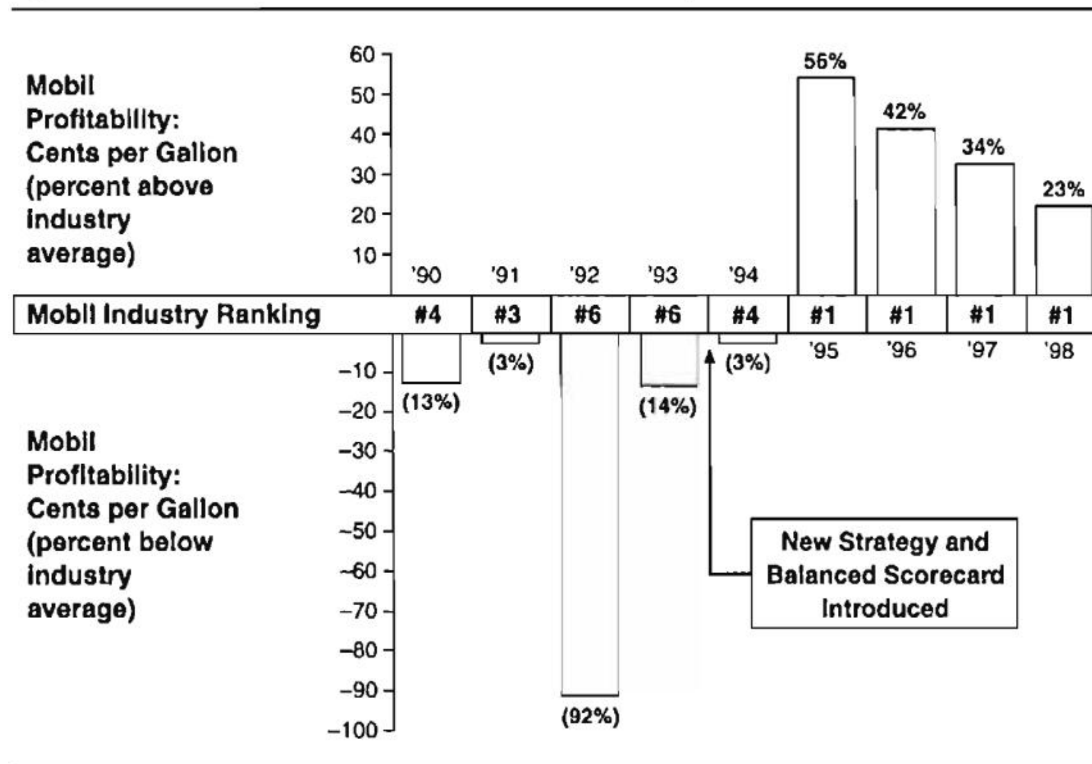
Figure 1-1 Mobil NAM&R's Relative Profitability, 1990–98



CIGNA Property & Casualty Insurance

In 1993, the Property & Casualty Division of CIGNA lost nearly $275 million, making its performance the worst in the industry. The division was near bankruptcy. Although its poor performance was due in part to a few major catastrophes, almost all of its lines of business were marginal. The new turnaround management team developed a new strategy—to become a "specialist"—by focusing on niches in which it had an informational comparative advantage. The management team deployed the new strategy to its twenty-one business units in 1994, using the Balanced Scorecard as the core management process.

The results were rapid and dramatic. Within two years, CIGNA Property & Casualty had returned to profitability and sustained and improved its performance during each of the next four years. By 1998, the company's profitability positioned it strongly within the industry with many of its businesses exhibiting top quartile performance. At the end of 1998, the parent company spun off the Property & Casualty Division for $3.45 billion. According to Gerald Isom, president of CIGNA Property & Casualty, the Balanced Scorecard played an important role in this success story:

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"CIGNA used the Balanced Scorecard to manage its transformation from a generalist company to a top-quartile specialist."[8]

Brown & Root Energy Services' Rockwater Division

Rockwater, an undersea construction company of Brown & Root Energy Services (part of the Halliburton Corporation) headquartered in Aberdeen, Scotland, served major offshore oil and gas producers. Rockwater was losing money in 1992. Norm Chambers, the new division president, introduced the Balanced Scorecard to his management team in 1993 to help clarify and gain consensus for a new strategy based on developing customer value-added relationships rather than offering customers the lowest price. By 1996, Rockwater was first in its niche in both growth and profitability. Chambers noted: "The Balanced Scorecard helped us improve our communication and increase our profitability."[9]

Chemical (Chase) Retail Bank

Chemical Retail Bank's implementation started shortly after the merger of Manufacturers Hanover and Chemical Bank in 1992. Michael Hegarty, president of the Retail Bank, deployed the scorecard as part of a new strategy: to diversify the bank's business away from the increasingly commodity-oriented checking and savings accounts delivered through expensive branches in the New York metropolitan area. Chemical, as a newly merged bank, would have to close hundreds of now-redundant branches. By using the scorecard to communicate an intense focus on targeted customers, the retail bank was able to accomplish the cost savings expected from the merger while minimizing the losses of targeted customers, and, in fact, simultaneously expanding its revenue base with the targeted customer base. Chemical's retail profits evolved as shown:

Year	Profits
1993 (base year)	x
1994	8x
1995	13x
1996	19x

The improvement represented hundreds of millions of dollars annually during the bank's first three years of managing with the Balanced Scorecard. Hegarty noted: "The Balanced Scorecard has become an integral part

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of our change management process. The Scorecard has allowed us to look beyond financial measures and concentrate on factors that create economic value."[10]

In contrast with the difficulty most organizations experience in implementing strategy, these four early adopters all used the scorecard to support major strategic and organizational changes. And the "long run" came quite soon. The companies enjoyed substantial benefits from their new strategies early in their implementation activities.

The Balanced Scorecard made the difference. Each organization executed strategies using the same physical and human resources that had previously produced failing performance. The strategies were executed with the same products, the same facilities, the same employees, and the same customers. The difference was a new senior management team using the Balanced Scorecard to focus all organizational resources on a new strategy. The scorecard allowed these successful organizations to build a new kind of management system—one designed to manage strategy. This new management system had three distinct dimensions:

1. Strategy. Make strategy the central organizational agenda. The Balanced Scorecard allowed organizations, for the first time, to describe and communicate their strategy in a way that could be understood and acted on.
2. Focus. Create incredible focus. With the Balanced Scorecard as a "navigation" aide, every resource and activity in the organization was aligned to the strategy.
3. Organization. Mobilize all employees to act in fundamentally different ways. The Balanced Scorecard provided the logic and architecture to establish new organization linkages across business units, shared services, and individual employees.

These organizations used the Balanced Scorecard to create Strategy-Focused Organizations. They beat the long odds against successful strategy execution.

THE PRINCIPLES OF STRATEGY-FOCUSED ORGANIZATIONS

When talking about how they achieved these breakthrough results, the executives continually mention two words: *alignment* and *focus*. How does focus create breakthrough performance? Think of the diffuse light pro-

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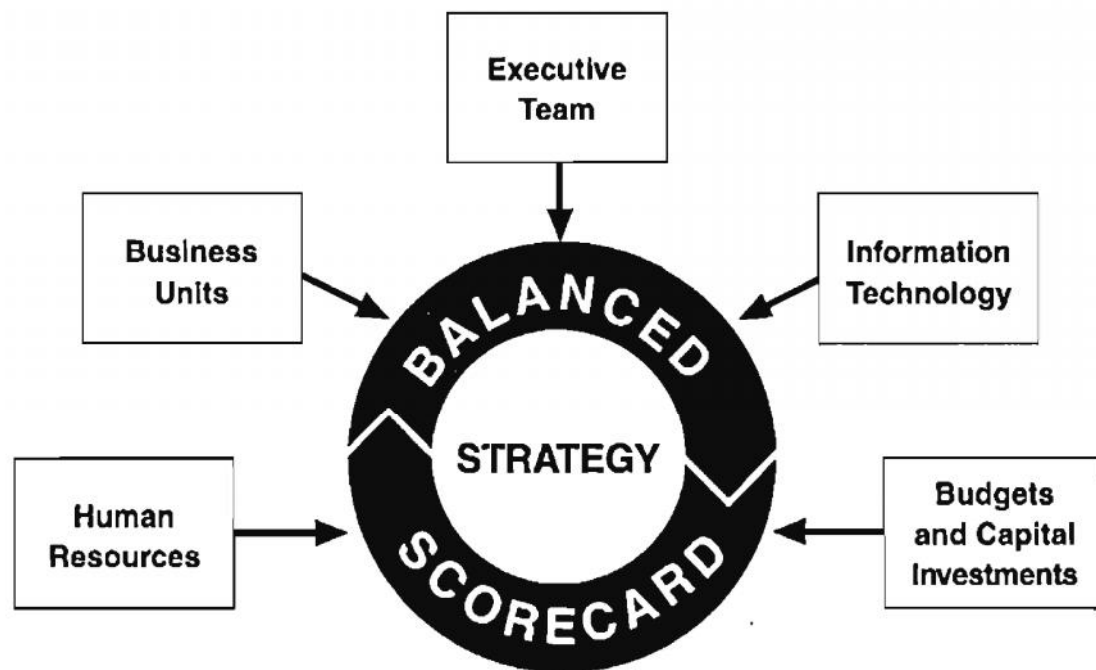
duced in a well-lit room by thousands of watts of incandescent and fluorescent lamps. Compare that warm, diffuse light with the brilliant beam of light that comes from the tiny battery in a handheld laser pointer. Despite its limited resources (two 1.5 volt batteries), the pointer produces a blinding light by emitting all the laser's photons and light waves in phase and coherent. The laser operates nonlinearly; it leverages its limited power source to produce an incredibly bright and focused beam of light. Similarly, a well-crafted and well-understood strategy can, through alignment and coherence of the organization's limited resources, produce a nonlinear performance breakthrough.

The Balanced Scorecard enabled the early-adopting companies to focus and align their executive teams, business units, human resources, information technology, and financial resources to their organization's strategy (see Figure 1-2).

Our research of successful Balanced Scorecard companies has revealed a consistent pattern of achieving such strategic focus and alignment. Although each organization approached the challenge in different ways, at different paces, and in different sequences, we observed five common prin-

Figure 1-2 Aligning and Focusing Resources on Strategy



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ciples at work. We refer to these as the principles of a Strategy-Focused Organization (see Figure 1-3).

Principle 1: Translate the Strategy to Operational Terms

The speed with which the new strategies delivered results indicates that the companies' successes were not due to a major new product or service launch, major new capital investments, or even the development of new intangible or "intellectual" assets. The companies were, of course, developing new products and services and investing in both hard, tangible assets

Figure 1-3 The Principles of a Strategy-Focused Organization

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and softer, intangible assets. But they could not have benefited much in two years from such investments. To achieve the results we have just described, the companies capitalized on capabilities and assets—tangible and intangible—that existed already within their organizations. The companies' new strategies and the Balanced Scorecard had unleashed the capabilities and assets that were hidden (or frozen) within the old organization.

In effect, the scorecard provided the "recipe" that enabled ingredients already existing in the organization to be combined for long-term value creation. Think how making a meal requires a combination of raw materials (the ingredients), tangible capital and assets (cooking implements, an oven, and a stove), and intangible, human capital (the chef). But a great meal requires a recipe to take advantage of all these tangible and intangible assets. The recipe is the critical soft asset. It transforms the raw ingredients, physical assets, and intangible assets—each with little stand-alone value—into a great meal, with considerable value. The recipe corresponds to a company strategy that combines internal resources and capabilities to create unique value propositions for targeted customers and market segments. The companies in our sample were successful with the Balanced Scorecard because they engaged all employees, not just the lead chef, to implement and improve the recipe.[11]

The Balanced Scorecard provides a framework to describe and communicate strategy in a consistent and insightful way. We can't expect to implement strategy if we can't describe it. Unlike in the financial domain, where standard frameworks such as general ledgers, income statements, and balance sheets exist to document a financial plan, no generally accepted frameworks exist for describing strategy. There are as many ways of describing a strategy as there are strategy theorists and methodologies.

Since introducing the Balanced Scorecard in 1992, we have worked with more than two hundred executive teams in their design of scorecard programs. We always started the design by asking, "What is the strategy?" From this base of experience, we developed a general framework for describing and implementing strategy that we believe can be as useful as the framework—income statement, balance sheet, statement of cash flows—used by financial managers for financial planning and reporting. The new framework, which we call a "strategy map," is a logical and comprehensive architecture for describing strategy. It provides the foundation for designing a Balanced Scorecard that is the cornerstone of a new "strategic management system."

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Strategy maps and Balanced Scorecards address the shortcomings of the industrial age's tangible asset measurement systems. The measurement linkages of cause-and-effect relationships in strategy maps show how the intangible assets are transformed into tangible (financial) outcomes. Financial measurement systems record the stand-alone book values of tangible assets—cash, accounts receivable, inventory, land, plant, and equipment. These types of assets have values largely independent of who owns them. Intangible assets, in contrast, usually have little stand-alone value; their value arises from being embedded in coherent, linked strategies. The scorecard's use of quantitative, but nonfinancial, measures—such as cycle time, market share, innovation, satisfaction, and competencies—allows the value-creating process to be described and measured, rather than inferred. The customer value proposition describes the context in which intangible assets such as skilled, motivated employees and customer information systems become transformed into tangible outcomes such as customer retention, revenues from new products and services, and, ultimately, profits. The strategy map and its corresponding Balanced Scorecard measurement program provide a tool to describe how shareholder value is created from intangible assets. Strategy maps and Balanced Scorecards constitute the measurement technology for managing in a knowledge-based economy.

By translating their strategy into the logical architecture of a strategy map and Balanced Scorecard, organizations create a common and understandable point of reference for all their units and employees.

Principle 2: Align the Organization to the Strategy

Synergy is the overarching goal of organization design. Organizations consist of numerous sectors, business units, and specialized departments, each with its own strategy. For organizational performance to become more than the sum of its parts, individual strategies must be linked and integrated. The corporation defines the linkages expected to create synergy and ensures that those linkages actually occur—a task, however, that is easier said than done.

Organizations are traditionally designed around functional specialties such as finance, manufacturing, marketing, sales, engineering, and purchasing. Each function has its own body of knowledge, language, and culture. Functional silos arise and become a major barrier to strategy

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implementation, as most organizations have great difficulty communicating and coordinating across these specialty functions.

Strategy-Focused Organizations, however, break through this barrier. Executives replace formal reporting structures with strategic themes and priorities that enable a consistent message and consistent set of priorities to be used across diverse and dispersed organizational units. New organization charts are not necessary. Business units and shared service units become linked to the strategy through the common themes and objectives that permeate their scorecards. Often, ad hoc organizations emerge to focus on scorecard strategic themes. In all cases, successful companies use the Balanced Scorecards in a coordinated manner across their organizations to ensure that the whole exceeds the sum of the parts.

Principle 3: Make Strategy Everyone's Everyday Job

The CEO and senior leadership team of the adopting organizations we studied could not implement the new strategy by themselves. They required the active contributions of everyone in the organization. We refer to this as the movement of strategy from the 10 (the senior executive team) to the 10,000 (everyone in the company). How do you move strategy from the boardroom to the backroom and thus to the front lines of daily operations and customer service?

Strategy-Focused Organizations require that all employees understand the strategy and conduct their day-to-day business in a way that contributes to the success of that strategy. This is not top-down direction. This is top-down communication. Individuals far from corporate and regional headquarters—at the oil refinery in Texas, at the gasoline station in New Hampshire, and at the claims desk in Des Moines—are the ones who will find improved ways of doing business that will contribute to achieving the organization's strategic objectives.

Executives use the Balanced Scorecard to help *communicate* and *educate* the organization about the new strategy. Some observers are skeptical about communicating strategy to the entire organization, fearing that valuable information could be leaked to competitors. To this criticism, Mobil's Brian Baker responds: "Knowing our strategy will do them little good unless they can execute it. On the other hand, we have no chance of executing our strategy unless our people know it. It's a chance we'll have to take."

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Companies can educate their employees about surprisingly sophisticated business concepts. To understand the scorecard, employees had to learn about customer segmentation, variable costing, and database marketing. Instead of assuming that the workforce was incapable of understanding these ideas, the companies made concerted efforts to educate employees at all levels of the organization about these key strategic components.

The companies then cascaded the high-level corporate and business unit scorecards to lower levels of the organization; in many cases personal scorecards were used to set *personal objectives*. The strategy and scorecard were communicated *holistically*. Instead of cascading objectives through the chain of command, as is normally done, the complete strategy was communicated in a top-down fashion. Individuals and departments at lower levels could develop their own objectives in light of the broader priorities. Many pleasant surprises resulted from this process, as individuals identified areas outside their functional responsibility in which they could contribute.

Finally, each of the successful organizations linked *incentive compensation* to the Balanced Scorecard. Most executives opted for a team-based, rather than an individual based, system for rewarding performance. They used the business unit and division scorecards as the basis for rewards, an approach that stressed the importance of teamwork in executing strategy. Compensation could be based on up to twenty-five strategic measures. Instead of promoting confusion, as many feared, the scorecard compensation systems heightened the employees' interest in all components of the strategy and furthered their demand for knowledge and information about scorecard measures. Strategy indeed became everyone's everyday job, because everyone understood it and was motivated to execute it.

Principle 4: Make Strategy a Continual Process

For most organizations, the management process is built around the budget and operating plan. The monthly management meeting is devoted to a review of performance versus plan, an analysis of variances of past performance, and an action plan for dealing with those variances. There is nothing wrong with this approach per se. Tactical management is necessary. But for most organizations, that's all there is. There are no meetings at which managers discuss strategy. Our research indicates that 85 percent of management teams spend less than one hour per month discussing strat-

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egy. Is it any wonder that strategies fail to be implemented when strategy discussions don't even appear on the executive agenda and calendar? Strategy-Focused Organizations use a different approach.

The successful Balanced Scorecard companies introduced a process to manage strategy. We refer to this as a "double-loop process"—one that integrates the management of tactics (financial budgets and monthly reviews) and the management of strategy into a seamless and continual process. Because a process for managing strategy hadn't previously existed, each organization developed its own new approach. Three important themes emerged in the implementations.

First, organizations began to *link strategy to the budgeting process*. The Balanced Scorecard provided the yardstick for evaluating potential investments and initiatives. Chemical Retail Bank's initial motivation for using the scorecard was to provide a strategic rationale for screening investments. More than seventy different requests for funding had been submitted. The bank found that more than 50 percent of these requests had no impact on the scorecard. These were discarded as " nonstrategic." It also found that around 20 percent of the measures on the scorecard had no initiatives associated with them. So it developed a process for managing strategic initiatives. While this process took place within the annual budget process, the strategic initiatives were treated differently. Companies have discovered that they need two kinds of budgets: a *strategy budget* and an *operational budget*. This distinction is essential. Just as the Balanced Scorecard attempts to protect long-term initiatives from short-term suboptimization, the budgeting process must also protect the long-term initiatives from the pressures to deliver short-term financial performance.

The second and most significant step was the introduction of a *simple management meeting* to review strategy. As obvious as this policy sounds, such meetings didn't exist in the past. Now, management meetings were scheduled on a monthly or quarterly basis to discuss the Balanced Scorecard so that a broad spectrum of managers could have a say in the strategy. A new kind of energy stirred. People used terms such as *exciting* to describe the events. Information feedback systems had to be designed to support the process. Initially, these systems were designed for the needs of the executive team. But several of the organizations went a step further. They created *open reporting*, making the performance results available to everyone in the organization. Building on the principle that "strategy is everyone's job," they empowered "everyone" by giving each employee the

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knowledge needed to do his or her job. At CIGNA, a first-line underwriter could learn about performance reports before a direct-line executive if she happened to be monitoring the feedback system. This created a set of cultural issues that revolutionized traditional approaches to power and performance.

Finally, a *process for learning and adapting the strategy* evolved. The initial Balanced Scorecards represented hypotheses about the strategy; they were the best estimate, at time of formulation, of the actions that would engender long-term financial success. The scorecard design process helped to make the cause-and-effect linkages in the strategic hypotheses explicit. As the scorecard was put into action and feedback systems began reporting progress, the organizations could test the strategy's hypotheses. Some, such as Brown & Root, did the testing formally, using statistical correlations between measures on the scorecard to determine if, for example, employee empowerment programs were increasing customer satisfaction and improving processes. Others, such as Chemical Retail Bank, tested the hypotheses more qualitatively during meetings at which managers validated and refined the programs being used to drive service quality and customer retention. Still others used the meetings to determine if new strategic opportunities had emerged that weren't currently on their scorecard. In each case, ideas and learning emerged continually from within the organization. Rather than waiting for next year's budget cycle, the priorities and the scorecards could be updated immediately. Much like a navigator guiding a vessel on a long-term journey, always sensing the shifting winds and currents and adapting the course, the executives of the successful companies used the ideas and knowledge generated by their organization to constantly fine-tune their strategies. Instead of being an annual event, strategy became a continual process.

Principle 5: Mobilize Change through Executive Leadership

The first four principles focus on the Balanced Scorecard tool, framework, and supporting processes. It is important to stress that you need more than processes and tools to create a Strategy-Focused Organization. Experience has repeatedly shown that the single most important condition for success is the ownership and active involvement of the executive team. Strategy requires change from virtually every part of the organization. Strategy requires teamwork to coordinate these changes. And strategy implementation

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requires continual attention and focus on the change initiatives and performance against targeted outcomes. If those at the top are not energetic leaders of the process, change will not take place, strategy will not be implemented, and the opportunity for breakthrough performance will be missed.

A successful Balanced Scorecard program starts with the recognition that it is not a "metrics" project; it's a change project. Initially, the focus is on *mobilization* and creating momentum, to get the process launched. Once the organization is mobilized, the focus shifts to *governance*, with emphasis on fluid, team-based approaches to deal with the unstructured nature of the transition to a new performance model. Finally, and gradually over time, a new management system evolves—a *strategic management system* that institutionalizes the new cultural values and new structures into a new system for managing. The various phases can evolve over two to three years.

The first phase, *mobilization*, must make clear to the organization why change is needed; the organization must be unfrozen. John Kotter describes how transformational change begins at the top, with three discrete actions by the leaders: (1) establishing a sense of urgency, (2) creating the guiding coalition, and (3) developing a vision and a strategy.[12] The leaders of successful Balanced Scorecard organizations clearly followed this mode. Several of the adopting companies were experiencing difficult times. The obvious threat of failure and job loss was a motivating factor that created receptivity for change. But the role of the Balanced Scorecard in driving change and breakthrough performance should not be limited to distressed or failing companies. Often, executives at companies that are already doing well create stretch targets to ensure the organization does not become complacent. They use the scorecard to communicate a vision for future performance that is dramatically better than the present. The first job for executive leadership at a Strategy-Focused Organization is to make the need for change obvious to all.

Once the change process is launched, executives establish a *governance process* to guide the transition. This process defines, demonstrates, and reinforces the new cultural values to the organization. Breaking with traditional power-based structures is important. The creation of strategy teams, town hall meetings, and open communications are all components of this transition governance.

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As the process evolves, executives modify their existing management system to consolidate progress and reinforce the changes. The patterns were different in each organization we studied. For example, CIGNA linked executive compensation to the scorecard in the first year, whereas Mobil waited until the second year. CIGNA and Mobil cascaded the scorecard to the very bottom of the organization, whereas Chemical Retail Bank went only halfway. Each organization linked the Balanced Scorecard to its formal planning/budgeting process at the first available cycle. Regardless of the sequence, though, each organization gradually built a new management system that ended up looking very similar to one another's. By linking traditional processes such as compensation and resource allocation to a Balanced Scorecard that described the strategy, they created a *strategic management system*. The scorecard described the strategy while the management system wired every part of the organization to the strategy scorecard.

For good executives, of course, there is no "steady state." By embedding the new strategy and new culture into a management system, however, companies can create a barrier to future progress. The competitive landscape is constantly changing, so strategies must constantly evolve to reflect shifts in opportunities and threats. Strategy must be a continual process. The art of leadership is to delicately balance the tension between stability and change.

OTHER EXAMPLES

While we have the most sustained experience with the four organizations described earlier in the chapter, the application and performance breakthroughs are by no means limited to these examples, these industries, or even the companies for which we served as consultants. Many companies in every industry worldwide have realized successes from use of the Balanced Scorecard to create Strategy-Focused Organization. We briefly describe several examples here and provide more details in chapters throughout the book.

AT&T Canada, Inc.

In 1995, AT&T Canada, Inc. (then known as Unitel Communications, Inc.) had more than C$300 million in operating losses and was close to default-

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ing on its debt. In a 1995 survey of employee satisfaction in 500 North American companies, AT&T Canada had placed far below the median. In December 1995, AT&T and the banks brought in Bill Catucci as CEO to rescue the company. Catucci turned the company around by focusing on process improvements and a new strategy, guided by a Balanced Scorecard strategic management system.

By the end of 1998, AT&T Canada had virtually eliminated its losses and was generating positive cash flow, a considerable accomplishment during a period when the price of a long-distance phone call from Toronto to Vancouver had dropped by a factor of 10. The customer base expanded from 350,000 to more than 700,000 when growth of the telecommunications market was only 4 percent. Revenue per employee increased from $273,000 in 1995 to more than $370,000 in 1998. The $250 million in new equity invested three years earlier now had an estimated market value of $1.2 to $1.5 billion—a substantial turnaround from the company's near-death experience of just three years earlier. The 1998 survey of 500 North American companies showed that AT&T Canada's employee satisfaction scores were 50 percent higher than the average performance of the top 10 percent of companies in the sample. The improved performance provided the basis for a merger in 1999 with MetroNet Communications Corporation, Canada's largest competitive local exchange carrier, in a transaction valued at approximately $7 billion.

Zeneca Ag Products North America

Zeneca Ag Products North America, a $1 billion business employing 1,800 people, developed, manufactured, and sold products for the agricultural industry. Zeneca was one of the world's top three suppliers of crop protection products and also at the leading edge in applying biotechnology to improve food quality.

The catalyst for the development of a Balanced Scorecard was poor financial performance in 1992, the worst in the company's history. Few new products were in the pipeline, inventory was out of control, and customers viewed the company as lacking in innovation. The product range was too broad for efficient management and included many unprofitable products. There was an urgent need to focus the company. The president and the executive team of Zeneca, aided by consultants, formed the guiding coalition for the change.

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They used the Balanced Scorecard to make a new mission and strategy a reality, and to link incentive pay to strategic performance. Zeneca deployed the scorecard to the entire organization in early 1995. Since that time, the growth of sales has been double the industry average and the profit margin exceeded competitors' average each year. Customer survey results were positive, and all critical success factors continued to improve. The Balanced Scorecard also provided an excellent mechanism for securing the support of the parent company for agreement on performance goals at the beginning of each year.

Southern Gardens Citrus

Even small companies have benefited from using the Balanced Scorecard to implement strategy. Southern Gardens Citrus, a Florida-based citrus processor and subsidiary of U.S. Sugar Corp., with 175 employees, developed its Balanced Scorecard in 1995. The company wanted to create a high-performance, collaborative environment. Vice President/General Manager Tristan Chapman used his equipment supplier FMC Corporation (another early Balanced Scorecard adopter) to assist in delivering the new strategy of operational excellence.

Chapman's management team introduced the first Balanced Scorecard in the summer of 1995, with plantwide measures, accompanied with a pay-for-performance process. The results of the program were dramatic. At a time when many small agricultural processors were failing and leaving the business, Southern Gardens survived and enjoyed significant performance improvements:

Performance Area	**94/95**	**97/98**	**% Improvement**
Shipments out of spec.	30.0	1.2%	96
On-time delivery	89.0	98.0	82
Extractor utilization*	100.0	134.0	34
Yield*	100.0	106.4	6
Rework	6.2	1.9	69
Employee absenteeism	10.0	1.0	90
Employee turnover*	100.0	31.0	69
Cost per pound (¢)	28.8	19.7	32

* Indexed: 94/95 = 100

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Southern Gardens was the most efficient citrus processor in the world for the 1996 through 1999 seasons. It received The Kroger Co. Supplier of the Year Award in 1996, 1998, and 1999.

University of California, San Diego

The Balanced Scorecard also has been successfully applied to government, nonprofit, and educational institutions, as we discuss in Chapters 5 and 7. As one leading example, the University of California, San Diego, was looking for ways to improve productivity and customer satisfaction among its administrative service units, such as the bookstore, housing office, police force, and travel office. Vice Chancellor Steven Relyea introduced the Balanced Scorecard approach to the 27 service units in 1994.[13] The results were far reaching. The payroll department reduced errors by 80 percent. The financial office reduced the time to process expense reimbursement checks from six weeks to as little as three days. The innovative program has received wide recognition, including winning the 1999 Rochester Institute of Technology/*USA Today* Quality Cup for Education.[14]

Duke Children's Hospital

Duke Children's Hospital (DCH), an academic children's hospital within the Duke University Health System in Durham, North Carolina, was experiencing increases in cost per case of 35 percent from 1994 to 1995. Its eight-day average length of stay was 15 percent over target. It was losing money, its staff was dissatisfied, and its recent process improvement initiatives were unsuccessful. Yet it was asking the medical center for an additional $40 million for expansion programs. Dr. Jon Meliones at DCH led a Balanced Scorecard program that eventually reached all of DCH's pediatric facilities, including two large hospitals in the region that DCH acquired as the program was rolling out. Dr. Meliones used the Balanced Scorecard method as a call to action to begin "practicing smarter" medicine.

The near-term results from the scorecard, initiatives, and process improvements were dramatic (see Figure 1-4). These efforts resulted in nearly a $30 million reduction in cost and a $50 million increase in net margin. All results were achieved while improving clinical outcomes and staff satisfaction. Through the use of the Balanced Scorecard to focus and align the clinical, academic, and administrative staffs to a new strategy, DCH im-

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Figure 1-4 Duke Children's Hospital's Balanced Scorecard

	Measure	Before	After	% Improvement
Financial Perspective	▪ Operating Margin	–$50m	+$10m	
	▪ Cost per Case	$14,889	$11,146	–25%
Customer Perspective	▪ Family Satisfaction	4.3	4.7	+11%
	▪ Would Recommend	4.3	4.7	+11%
	▪ Discharge Timeliness	50%	60%	+20%
	▪ Medical Plan Awareness	47%	94%	+100%
Internal Perspective	▪ Length of Stay	8 days	6 days	–25%
	▪ Readmission Rate			
	- Intensive Care Unit	11%	4%	–63%
	- Intermediate Care	11%	7%	–36%

proved patient and physician satisfaction and loyalty while achieving dramatic 25 percent reductions in cost per case and length of stay. And the results came quickly, within two to three years.

United Parcel Service

What about an organization that was not in financial difficulty? Is the Balanced Scorecard only for companies experiencing declining performance? Consider the experience of UPS. In 1994, the company was enjoying record profits. But CEO Oz Nelson understood that the market was changing and the company would be in danger within five years unless it made dramatic changes. Many new opportunities were arising from e-commerce and global expansion, and UPS had to become a more customer-focused company, one that understood its customers better and could deliver what they wanted.

UPS had long had an operational-excellence focus. Ninety percent of its measurements were financial, usually reported with lags of forty-five days or more. Employees said that they had little understanding of how their day-to-day work affected company performance. Nelson wanted the company and its employees to refocus on quality measures of key processes. So the company defined four key point-of-arrival (POA) metrics—customer satisfaction, employee relations, competitive position, and time in transit—and created the corporate Balanced Scorecard with the four per-

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spectives containing measures and goals aligned to these metrics.[15] The scorecard became the measurement vehicle to align all eleven UPS regions, sixty districts, and more than 300,000 employees worldwide. The goal was to have a clear line of sight from every employee's everyday job to the company's overall business objectives.

In 1999, within five years of launching the project, UPS executives believed they had succeeded in transforming the company into a more nimble, customer-focused, and solutions-oriented business that was at the leading edge of technology and e-commerce opportunities. UPS revenues were growing at nearly 10 percent annually, in an industry with 3 percent to 4 percent growth. Profitability had improved by 30 and 40 percent in 1998 and 1999. In 1999 *Forbes* named UPS "Company of the Year," and *Business Week* described UPS's delivery people as "the foot soldiers of the dot.com revolution." Along with initiatives in technology and marketing, the Balanced Scorecard helped drive this performance. In the words of one UPS executive, "The Balanced Scorecard provided a road map—the shared vision of our future goals–with action elements that let everyone contribute to our success."

We discuss the UPS Balanced Scorecard process more comprehensively in Chapter 9. We mention it here to indicate that becoming a Strategy-Focused Organization is best done before a division or company has encountered the financial difficulties experienced by Mobil, CIGNA, AT&T Canada, and Zeneca Ag. Ideally, the scorecard should be used by organizations that are about to embark on an aggressive growth strategy—to guide the journey, to develop the management system for rapid growth, and to align existing and soon-to-be-hired employees to the strategy for acquiring, retaining, and deepening relationships with targeted customers.

A NEW APPROACH TO MANAGING

The Balanced Scorecard has evolved since we first developed and introduced the concept as a new framework for measuring organization performance. It was originally proposed to overcome the limitations of managing only with financial measures. Financial measures reported on outcomes, lagging indicators, but did not communicate the drivers of future performance, the indicators of how to create new value through investments in customers, suppliers, employees, technology, and innovation. The Bal-

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anced Scorecard provided a framework to look at the strategy used for value creation from four different perspectives:

1. Financial. The strategy for growth, profitability, and risk viewed from the perspective of the shareholder.
2. Customer. The strategy for creating value and differentiation from the perspective of the customer.
3. Internal business processes. The strategic priorities for various business processes, which create customer and shareholder satisfaction.
4. Learning and growth. The priorities to create a climate that supports organizational change, innovation, and growth.

With the Balanced Scorecard, corporate executives could now measure how their business units created value for current and future customers. While retaining an interest in financial performance, the Balanced Scorecard clearly revealed the drivers of superior, long-term value and competitive performance.

We quickly learned that *measurement* has consequences beyond just reporting on the past. Measurement creates focus for the future because the measures chosen by managers communicate to the organization what is important. To take full advantage of this power, measurement should be integrated into a *management system*. Thus we refined the Balanced Scorecard concept and showed how it could move beyond a performance measurement system to become the organizing framework for a strategic management system (see Figure 1-5).[16] A strategy scorecard replaced the budget as the center for management processes. In effect, the Balanced Scorecard became the operating system for a new strategic management process.

As organizations managed with the scorecard, they made further discoveries. The speed and magnitude of the results achieved by the early adopters revealed the power of the Balanced Scorecard management system to focus the entire organization on strategy. To achieve such intense strategic focus the organizations had instituted comprehensive, transformational change. They redefined their relationships with the customer, reengineered fundamental business processes, taught their workforces new skills, and deployed a new technology infrastructure. Also, a new culture

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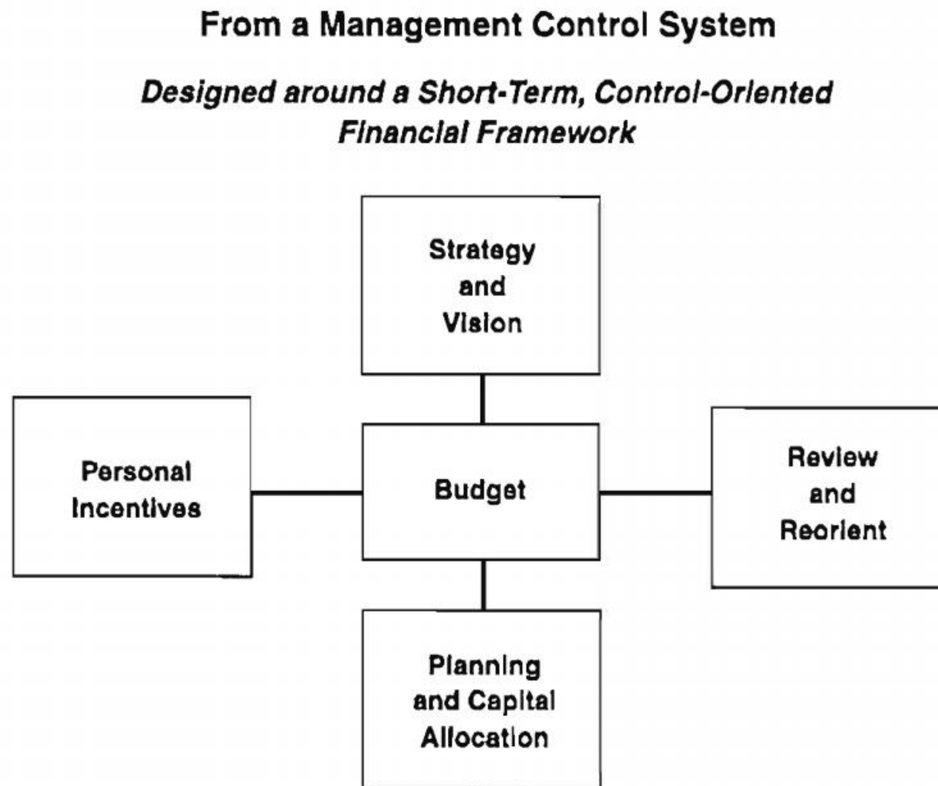
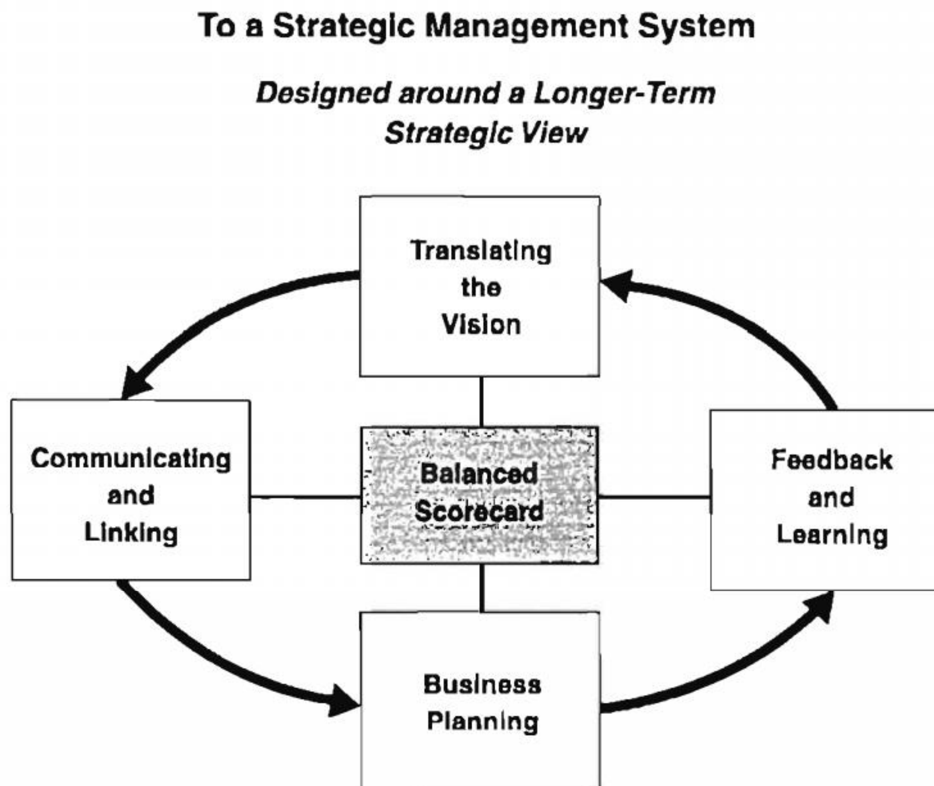
Figure 1-5 Starting from a New Premise





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emerged, centered not on traditional functional silos but on the team effort required to support the strategy. The management system provided the mechanism to mobilize and guide the process of change. But this new culture involved even more than a management system. Companies created a new kind of organization based on the requirements of their strategy—hence the term *Strategy-Focused Organization.* For the companies we studied, creating a Strategy-Focused Organization was not a homogeneous approach similar to, for example, qualifying for ISO 9000 or submitting an application for the Baldrige Award, processes by which a standard set of requirements can be applied. Strategies differed so that the organizational changes differed from company to company. The common feature, however, was that every Strategy-Focused Organization put strategy at the center of its change and management processes. By clearly defining the strategy, communicating it consistently, and linking it to the drivers of change, a performance-based culture emerged that linked everyone and every unit to the unique features of the strategy.

Companies are moving away from performance management systems linked exclusively to financial frameworks. In the early decades of the twentieth century, Dupont Corporation and General Motors Corporation developed the return-on-investment metric as an integrating device for the multidivisional firm.[17] By the mid-twentieth century, multidivisional firms were using the budget as the centerpiece of their management systems. In the 1990s, companies had extended the financial framework to embrace financial metrics that correlated better with shareholder value, leading to economic value added (EVA) and value-based management metrics. But even today's best financial frameworks do not capture all the dynamics of performance in today's knowledge-based competition.

Recognizing the limitations of managing only with financial numbers, many companies adopted quality as their central rallying cry and organizing framework during the 1980s and 1990s. Companies strove to win national quality awards—Malcolm Baldrige in the United States, the Deming Prize in Japan, and EFQM in Europe—and to emulate Motorola, Inc., and General Electric by adopting six sigma programs. But quality alone was insufficient, as were the pure financial measures the quality programs hoped to replace. Several companies that won national quality awards soon found themselves in financial distress.

Beyond financial and quality measures, some companies have emphasized customer focus, implementing programs to build market-focused or-

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ganization and establishing customer relationship management systems. Others have opted for core competencies or reengineering of fundamental business processes. Still others have emphasized strategic human resources management, showing how motivated, skilled employees can create economic value, or have deployed information technology for competitive advantage. Each of these perspectives—financial, quality, customers, capabilities, processes, people, and systems—is important and can play a role in creating value in organizations. But each represents only one component in the network of management activities and processes that must be performed to generate superior, sustainable performance. To focus on and manage only one of these perspectives encourages suboptimization at the expense of broader organizational goals. Companies have to replace any narrow or specific focus with a comprehensive view in which strategy is at the heart of the management systems.

Strategy-Focused Organizations use the Balanced Scorecard to place strategy at the center of their management processes. The Balanced Scorecard makes a unique contribution by describing strategy in a consistent and insightful way. Before the development of strategy scorecards, managers had no generally accepted framework for describing strategy: They could not implement something that they couldn't describe well. So the simple act of describing strategy via strategy maps and scorecards is an enormous breakthrough.

Having the scorecard, however, may be necessary but not sufficient to beat the odds against successful strategy implementation. From working with the world-class executives on whom this book is based, we have learned that they succeeded by using the Balanced Scorecard as the central framework for a new performance management process. This process produced significant performance improvements rapidly, reliably, and in a sustainable manner. The approach, while building on solid historical foundations, was tailored to the needs of the new economy. This book provides a roadmap for those who wish to create their own Strategy-Focused Organization.

NOTES

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CHAPTER TWO

How Mobil Became a Strategy-Focused Organization

MOBIL NORTH AMERICA MARKETING AND REFINING (NAM&R) is perhaps our best example of putting the five principles of a Strategy-Focused Organization into practice. Bob McCool became chief executive of NAM&R in 1992; his executive vice president, Brian Baker, succeeded him in 1996. Together they transformed an underperforming organization that was inwardly focused, bureaucratic, and inefficient into the leader in its industry—a turnaround that improved operating cash flow by more than $1 billion per year. Mobil NAM&R successfully implemented a strategy that required a significant marketplace repositioning concomitant with substantial cost reductions and operational improvements. Even more impressive, however, Mobil created an organization capable of sustaining competitive advantage in a mature, commodity, and fiercely competitive industry. Placing the Balanced Scorecard at the center of its management processes, Mobil achieved industrywide profit leadership from 1995 up through its merger into ExxonMobil Corporation in late 1999. Its experience illustrates well the power of the five principles of a Strategy-Focused Organization.

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TRANSLATE THE STRATEGY TO OPERATIONAL TERMS

The process starts by building a Balanced Scorecard that describes and communicates the strategy. Therefore, management must have a clear understanding of its strategy.

Historically, Mobil attempted to differentiate its commodity product (gasoline) through a product leadership strategy that stressed brand image and unique product characteristics. Its major competitors, however, pursued a similar strategy, and largely neutralized Mobil's attempt at product differentiation. Most competition still took place around price and location. Because of the nature of the industry—capital intensive, a high cost of raw materials, a commodity product—Mobil and its competitors devoted much of their energies to cost reduction and productivity.

As McCool and Baker contemplated a new strategy, they wanted to do more than just lower costs and become more efficient across its value chain. Some of Mobil's competitors had access to low-cost crude, so that a pure cost leadership strategy would be difficult to sustain in the long run. Mobil wanted a strategy for growth and differentiation. It wanted to find ways to attract customers who purchased more gasoline than average, purchased more premium than regular-blend products, were willing to pay higher prices for a better buying experience, and would purchase products other than gasoline at a retail station. Mobil's strategy, therefore, was two-pronged: (1) reduce costs and improve productivity across its value chain, and (2) generate higher volume on premium-priced products and services. If successful, Mobil's margins would improve through both components.

Financial Perspective

Mobil started its scorecard by defining its high-level financial objective: to increase *return on capital employed* (ROCE) from its current level of 7 percent (below the cost of capital) to 12 percent within three years.[1] The executives believed that an increase of this magnitude—in a mature, slow-growth, commodity industry with at least a half-dozen major competitors and many smaller players—was indeed a stretch target.

Mobil planned to improve its high-level ROCE measure by using two financial themes: *productivity* and *growth*. The productivity theme consisted of two components: cost reduction and asset intensity. Cost reduction would be measured by operating cash expenses versus the industry (using