

Aligning Strategic and Operational Planning With Balanced Scorecard Techniques

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Background

The ability of an organization to execute its strategy is directly proportional to its ability to understand and communicate the strategy. The most successful tool for articulating, implementing, and managing the overall business strategy is the Balanced Scorecard. The Balanced Scorecard (scorecard for short), developed in 1992 by Drs. David Norton and Robert Kaplan, has gained global acceptance as a powerful framework to help leaders define and rapidly implement strategy. This is accomplished by translating the corporate vision and strategy into a set of strategic objectives that drive behavior and performance.

Elements of Scorecard Models

The scorecard concept is built upon the premise that measurement motivates and that measurement must start with a clearly described strategy. There are two primary views of a scorecard design. The first is the **strategy map view**, which articulates the strategy in a series of linked objectives representing the most important priorities for the organization. The second is the **scorecard view**, which holds the specific measures, and targets that represent the yardstick and expected level of success as well as the strategic initiatives or action programs that are the ways to achieve targets outside of current capabilities.

Strategic initiatives in the context of marketing can be marketing investments, with specific ROI targets, and eventually, ROI results.

Strategic objectives are numerical measurements that are commonly referred to as Key Performance Indicators or “KPIs”. In the case of Balanced Scorecard, the founders, Kaplan and Norton recommend the name strategic objective to highlight the importance of naming the measurement with the goal in mind, e.g. “Increase Market Share”, “Reduce Cost of Sales”.

The creation of a *strategy map* and scorecard for each major organizational unit allows the goals of the organization to be explicitly and visually aligned. Cause and effect arrows link the upstream measurements across time to the downstream measurements. These key measurements are used to represent strategic objectives that highlight specific goals that lead to increased shareholder value. The strategic objectives are color-coded green, red, or yellow to indicate their relative success or failure when actual values are compared against target values within the balanced scorecard tool. [1]

Data Sources and Decision processes for Scorecard Models

Rather than becoming a laundry list of performance measurements, scorecards should reflect a very selective choice of measurements which span business units and a long planning horizon to narrow the scorecard to less than 25 strategic objectives for the entire firm. Each strategic objective will typically have historical (actual) values and target values for comparison of achievement. Ideally they will also have forecast values (especially in the case of sales for revenue planning). The forecast values come from planning systems when updating the balanced scorecard. This could include CRM, financial planning and budgeting or workforce (headcount) planning applications.

There are five categories of data used when creating a scorecard model:

- 1) historical internal (company) data (from operational systems)
- 2) historical external data (from third parties)
- 3) forecast external data (from third parties)
- 4) forecast company internal data (financial and non-financial)
- 5) target values (e.g. EPS targets, Sales Quotas, etc)

Strategic objectives will have actual historical data pulled from internal IT databases typically. Some will be from external data sets, pulled from service and data providers, or government statistics. The color coding of the strategic objective (or KPI) will be red, green, yellow, determined by numerical thresholds derived from the difference between the current actual value and the target value set during the planning stage. A typical example is sales quota for year end. That is the target value, whereas the actual value of sales maybe more or less than that target value. This target value can have different origins but is usually entered by the scorecard owner or administrator, or integrated from the planning source. The target values for each strategic objective can be:

- 1) Decreed by executive management
- 2) Negotiated between the operational and line management
- 3) Selected from an industry benchmark
- 4) Selected from competitors known (or assumed) values
- 5) Selected as % change over last years historical value

Each of these target-value origins will have different effects on the commitment and reaction to the use that target and the reward or punishment according to its achievement. These choices are a key link into the culture of decision making within any one particular firm. Methodology experts, such as those at Balanced Scorecard Collaborative www.BSCOL.com, are very valuable in managing the political ramifications of the choice of strategic objectives, target value and cause-and-effect linkage that make up a scorecard design. The target values are goals for specific strategic objectives, sometimes called “plan values”. Forecast values by contrast are what we expect to happen, regardless of the target value. Typically, every

strategic objective will have a target value to allow the color alarm to appear. Only certain strategic objectives will have forecast value, the best example being sales volume and sales revenue.

One common source of confusion is the different interpretations and use of actual data, vs. forecast data, vs. target data. There are different ways to drive the color alert combinations for a strategic objective (R/G/Y): the variances between (actual, forecast), (actual, target), and (target, forecast). Depending on the recency of the forecast data amongst other factors, the use of each variance is an import choice when designing the scorecard and achieving acceptance from the user community.

The scorecard strategy map illustrated below articulates and communicates these strategic goals and performance targets to employees through the four scorecard perspectives of financial, customer, internal, and organization and learning. The information reported from the scorecard on a periodic basis provides management with a clear representation of progress on executing the strategy, and ideally includes the same forecast values from the planning and budgeting process.

The Balanced Scorecard provides a framework to translate the vision and strategy into operational terms

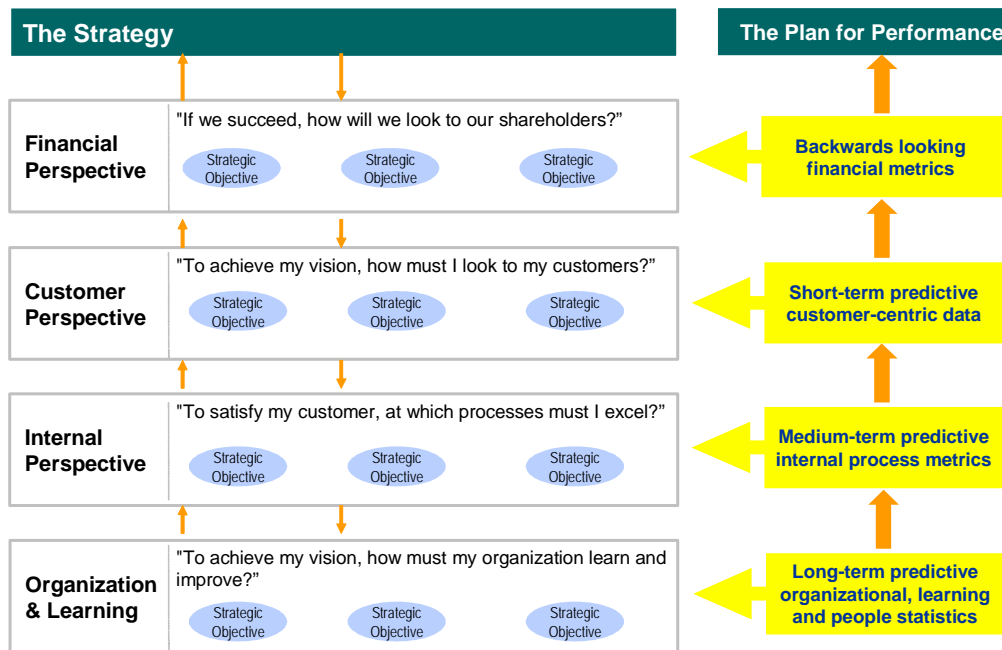


Figure 1. Depiction of Strategy Map and related time horizons for planning. The planning illustrates the data sources used for forecasting future values of each strategic objective.

The four perspectives of strategic objectives from “Most upstream” (far in advance of shareholder value) to “most downstream” (at the point of shareholder value) are as follows:

- 1) **Organization & Learning:** People, Teams, training and recruiting
- 2) **Internal Process:** business process, automation, technology & plant infrastructure
- 3) **Customer:** Marketing, Value Proposition, and Product/service in the eyes of the customer
- 4) **Financial:** revenue, growth, earnings, corporate governance, shareholder value

These four perspectives are *related* to functional departments, but the correspondence is not always 1-1. In large companies many departments will contribute to the performance of a single strategic objective, and will influence more than one of these perspectives.

The “Balance” in the Scorecard

The scorecard method allows development of explicit targets relating to financial targets as well as non-financial targets, such as customer satisfaction levels, share of wallet (cross selling services), and share of voice and brand awareness (advertising).

The word “balanced” derives from the balance financial and non financial metrics for a more holistic approach to measuring company performance. The use of a balanced set of measures gives not only a view of the current state of strategy execution, but a predictive outlook on strategic success. In a sense the scorecard “balances” historical performance with forecasted performance as well.

The financial perspective measures financial performance for a past period (last quarter, last year, etc). The customer perspective measures the value delivered to and the overall satisfaction of the customers that will have a short-term future impact on the financial performance. The internal perspective measures the ability of the organization to execute its processes that will have a short-term future impact on customer value and a medium-term impact on financial performance. The “organization and learning” perspective measures the development of organizational capabilities that will have a short-term impact on operational execution, a medium-term impact on customer satisfaction, and a long-term impact on financial performance. *So different time horizons play a role within a single scorecard design.* The scorecard is a tool to represent and communicate strategy.

Cause-and-Effect thinking

Another source of confusion is selecting the right cause-and-effect relationships in the scorecard Strategy map. Leading indicators are similar, but different than

causes. Its useful to contrast Cause-and-effect, leading indicators, and correlation to give some perspective. Examples:

- 1) New customer acquisition (Customer/Marketing KPI) is a **cause** of Increased Revenue (Financial KPI)
- 2) Higher gas prices **cause** of inflation
- 3) Higher fuel prices are a **leading indicator** of higher airline ticket prices
- 4) Lower interest rates are a **leading indicator** increased home prices, but not a cause

Furthermore, correlation is not causation: be aware that things can occur simultaneously *without* cause and effect relationships: The morning sunrise does not cause people to eat breakfast, it is correlated however. Time series data that usually move together are termed “correlated”. They may or may not be any causal relation. There may or may not have one series be a leading indicator of the other series of data. In the context of a scorecard, cause and effect relationships should be intuitively testable and deterministic, *but do not need to be measurable*, unless you require a statistical test for evidence. The following example shows two deterministic causal relationships, Example A is statistically significant, and was measured by a statistical test:

Example A: Use of packaging #1 causes a 23% failure rate
(Statistical regression analysis results)

Example B: Use of lighter packaging reduces shipping expense.

A Marketing Scorecard Example

Below we show an example scorecard, with four perspectives each holding strategic objectives which serve to illustrate marketing strategy. The slight complication is that the initiatives (sometimes thought of as external to the scorecard) are overlaid into the definition of the strategic objectives. Ideally, the initiatives are separate and external, and their implementation success yields visible results in the scorecard itself. This form of integrating the initiatives into the scorecard design will soon affect the software tools on the market to implement broad based scorecard solutions. As you review your own organization you will find subtle differences in interpretation between objectives and initiatives especially across departments, teams and owners of the data. Scorecards can be focused at the departmental, divisional or overall corporate level, with specific themes in mind. For example “Increase Market Penetration” may have ramifications across all four perspectives and choice of operational metrics and the strategic objectives they support.

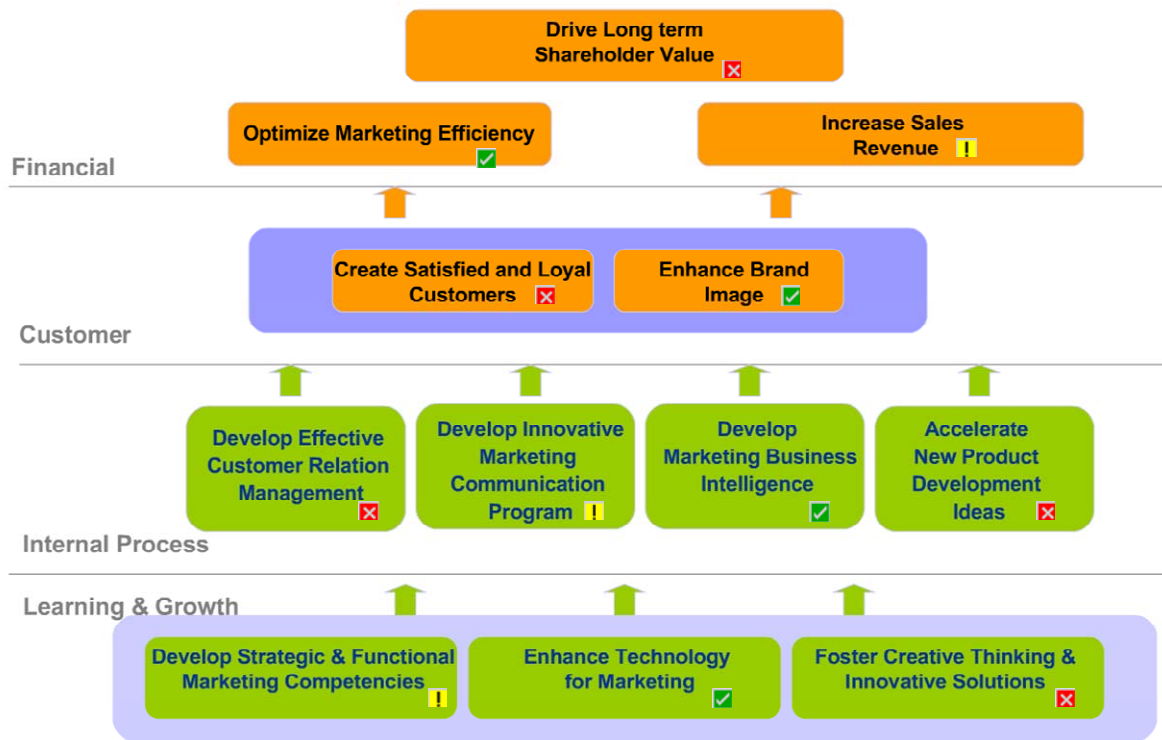


Figure 2. A generic marketing-focused scorecard, with strategic objective style of naming conventions. Example from www.exploreHR.org. Note the Red/Green/Yellow Alert Colors which measure the threshold difference between current actual value and target (sometimes called plan) value.

Conclusion

Balanced scorecard designs can be implemented as a methodology, a software tool, a spreadsheet, or a full blown enterprise application shared across one, many or all departments within a firm. Using strategy maps, strategic objectives, strategic initiatives, and cause and effect they illustrate the power of strategic planning whereby individual departments and operational performance metrics are linked to an overall plan for achieving shareholder value. Scorecards allow a visual way to show adherence to a specific strategy and allow selective access to monitoring the progress over time. Scorecards can reveal organizations execution weaknesses and strengths, and their design will be impacted by the politics and culture of decision making and control within the firm. The monitoring bias is the change in behavior achieved with individuals know the performance is being measured and monitored. The benefits of the scorecard are derived from several distinct aspects:

1. consolidating disparate data sources into a common view
2. negotiated agreement in representing strategic objectives (KPIs)
3. negotiated agreement in strategy map with cause-and-effect linkages
4. negotiated agreement in choice of target values.

In a sense, the scorecard represents a “dynamic visual contract” that represents the historical performance, future outlook, and negotiated priorities across departments consistent with the business plan.

[1] Excerpt from the 2004 paper “Strategy Focused Business Planning” joint publication of BSCOL.com and Oracle Corporation.

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