RECORD, Volume 23, No. 3*

Washington Annual Meeting
October 26–29, 1997

Session 32PD
The Balanced Scorecard: Measuring What Matters

Track: Management
Key words: Management

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Summary: To prosper, an organization must identify and measure the key performance factors that drive success. The Balanced Scorecard is a powerful management reporting system that can channel people's energies toward achieving long-term strategic goals. Too often, insurance companies measure performance on financial measures alone; the Scorecard system measures performance in four critical areas: financial performance, customer perspectives, internal business processes, and learning and growth. Tracking performance on these critical factors will help an organization align its decisions and its actions with its mission.

Mr. James R. Trefz: This session is sponsored by the Committee on Management and Personal Development. This committee's mission is to plan, implement, and actively promote educational programs and resources on management and business skills for SOA members. If you have an interest in any of these areas or in helping further work in any of these areas within the Society, please contact the Society.

In today's increasingly competitive business environment, one of the major challenges that insurance companies face is turning strategy into action effectively. Too often strategic plans gather dust on CEO's shelves. Daily decisions are made to serve short-term goals, but they may not be well-aligned with the strategic plan.

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In recent years, several companies have turned to an approach that has been most commonly labeled the Balanced Scorecard to build the bridge between tactical decisions and long-term strategy. Some well-known companies that have embraced this approach include Fannie Mae, SIGMA Property & Casualty, Hewlett-Packard, Sears, Rockwell International, and the Principal Financial Group.

We're very happy to have two speakers here. R. J. Bannister is a consultant with Towers Perrin. He is a coleader in a value-based management practice area. R.J. will introduce us to the concepts of a Balanced Scorecard approach. He will share his thoughts on some of its strengths and weaknesses and discuss how it can be applied effectively to tie long-term strategy to daily decisions. Dave Neve is Chief Financial Officer (CFO) of the Individual Insurance Division with the Principal Financial Group, where he has been for 20 years. David will talk with us about why the Principal recently undertook a Balanced Scorecard measurement project. He will discuss the implementation process that they have gone through and identify some of the challenges that they have faced and the lessons they have learned. We will have time for questions after our two speakers have made their presentations. We will start with R. J. Bannister.

Mr. R. J. Bannister: What I'd really like to do is to outline the overall concept and to provide an overall survey of the topic area and some information as to how I approach this particular topic and how I've used its tools and frameworks in solving some of my clients' problems and issues.

The Balanced Scorecard concept was developed by David Norton and Robert Kaplan. Because of some of the costs as far as reprinting, we were unable to provide each of you with reprints, but I do have that information as far as articles that Norton and Kaplan wrote as they were developing the concept and also the book that they have written on the particular topic.

The book really generated the work that Robert Kaplan did in the 1980s regarding the concept of activity-based costing. Kaplan was trying to get to the activities involved in the production of making things and the measures associated with those activities. Through that process and his affiliation with Norton (who is a systems individual in his background), Kaplan's intent was to take a company's vision and strategy and to be able to permeate and break that down into four specific measurable areas: financial, customer, internal business process, and learning and growth. For Kaplan, many of the issues through the 1980s as far as increasing shareholder value were extremely important, but he often felt that they were too often financially focused and that not enough time and attention were given to nonfinancial measures. There had been much work in the 1980s in many companies regarding quality, or customer satisfaction, and employee satisfaction.

Attempts as far as focusing and dealing with particular areas were often unsuccessful. Their idea or their intent was to provide an overall framework in which you could house many of these different areas and in a sense look at things from both a financial and a nonfinancial perspective.

If that's the overall concept, the process that they used is essentially a four-step process. The four-step process started with creating or translating the vision, being able to articulate and clarify the vision, seeing what's the company is trying to accomplish, and gaining consensus on that note. From there, the second step is communicating and linking—communicating and educating and setting goals the company wants to accomplish to reach their vision.

The third step is business planning. It's setting our goals, taking those goals and breaking them down as to particular targets that we want to achieve, being able to make sure that we are allowing those strategic targets, and looking at the resources allocated to the company and establishing milestones.

The fourth step is feedback and learning; that is, sharing this articulated vision of the company and what we want to accomplish and then having it as a feedback mechanism to say, these are the measures that we have been able to distill out of this articulated vision and how it's tied to the strategy. Is it working? Is there a feedback loop? If not, are there changes necessary with our strategy?

This process is a way to treat strategy as dynamic as opposed to static. Oftentimes companies have a particular strategy and then develop measurement systems around it. What a Balanced Scorecard can do is to take your strategy and treat it as dynamic and find out, if things aren't working and you're not getting the desired results, what is it in the strategy or what are you trying to prioritize or focus on that's missing?

What is the appeal of the Balanced Scorecard? It forces senior management to gain some consensus on the operational implications of strategy—what is important, what as a company, do we really want to focus on and prioritize—and take that information, and be able to distill it. Obviously, as managers, there are a number of different areas where we can focus our time and attention. The point is a strategy should do nothing less than prioritize what those things are that we want to work on and need to focus on. The Balanced Scorecard also is a way to help communicate the strategy for employees. If done appropriately and successfully, you are giving your employees a guide map, a road map, on the strategy that you want to achieve and how you as a company want to engage your employees to execute strategy. It also institutionalizes strategic vision in the sense that it forces employees to think outside of the box, not just the financial measures that we need to impact, but the

value drivers underneath that, financial and nonfinancial. It may be in the area of customer satisfaction. It may be in the areas of learning and growth or what we need to do to enhance or develop the competencies within our employees in order to successfully execute the strategy.

It provides a mechanism for this ongoing debate on strategy and for being able to track if you are really executing on the strategy. If not, then what are the things that you need to focus on or how do we need to reprioritize some of these measures or these metrics in order to make sure that we're capitalizing on the strategy? There's one thing that's missing from this piece which I will get to, the shareholder value side of the equation.

This does drive the strategic measurement infrastructure creation. In a sense if done appropriately, this should make your company's financial and operational statistics come to life. It should be interactive. It should be something that you'll be able to manipulate, use on personal computers (PCS), and integrate with whether it's Access or Excel. Treat it as dynamic from which you can run sensitivities off of. You should be able to articulate where are the areas you need to focus on and in a sense where you are going to get the most bang for your buck as far as spending your time and attention.

If those are some of the appeals of the Balanced Scorecard, let's look at some of the conceptual issues. I guess first and foremost, it is an intricate process. To do it right and to do it well does take a lot of time and attention. I think even with that caveat it should help you as managers be able to run your businesses more smoothly and more efficiently. If it's not helping you run your business, then it's an impediment and you shouldn't really go down this path. We'll talk about some of the implementations and roadblocks when Dave presents some real-life client examples and some of the things that you need to pay attention to as you're going down this path.

It requires a lot of financial and operations involvement. There is extensive consensus building because you are looking at priorities. You are taking your strategy and clarifying it. If a company says it wants to be a market leader, it's getting very specific in breaking that down. What do you mean? What does that imply? What are the areas? What are the business processes in order for you to become that market leader? It requires getting involvement and building consensus within a company as far as talking about some of these strategic issues.

There is a limited connection with value creation, or what I would call shareholder value creation. I think that is a major flaw in this, and I'll address it as far as how we have used it at Towers insofar as our consulting in a moment. The other thing is

that there isn't necessarily a prioritization of measures and objectives. As I have seen companies use this, they often have seen these four quadrants, the fact that there are four areas. They must have four or five different measures in each of these areas; they then get caught up in the methodology of filling out the box. The whole intent and purpose of doing this is really to translate the strategy and I think this is where the disconnect comes in as far as not getting focused on filling out the boxes, but rather the interplay in the interconnections. You want those individuals to focus on and prioritize on those measures through which you are going to be able to not only execute your strategy, but improve or increase your overall shareholder value of the company.

As far as within the concept itself, there is what I would call a vague mechanism to translate the vision and strategy into what I would call prioritized activities and measures. That is something that in adapting this or taking this approach that I, in the consulting work that we've done, have had to spend some time doing because the process is not necessarily clear. We as consultants get a company to take an overall strategy and then once clarified, there are the prioritized lists of processes or measures that you need to encounter or take care of. There is also not necessarily a clear process as far as linking activities and measures to accountability. Who is responsible for the particular activities and the measures themselves? That becomes important especially as you try to integrate this within an organization because if done correctly, there are many different applications which we'll speak to in a moment in which you can use the overall concept and framework to help you not only with just an overall measurement framework and program, but also from things ranking from business letters and communication to incentive plan designs and linking the measures to incentives. That gets into the next point as far as the appropriate line of sight and being able to take the overall concepts and touch specific individuals as far as being able to change, affect, and direct them on a day-to-day basis and their impact on the overall strategy of the company.

The last one is somewhat tongue-in-cheek, it is "balanced" and the most appropriate way to go. If a company is truly successful, are they in balance? Do they focus their efforts on one or two areas in which they are extremely strong? Is that how they differentiate themselves in the marketplace? Do you necessarily have to have four or five measures in each of these boxes or can you use this as a tool to understand where your strengths and weaknesses are?

That's a summary of the overall concept, as far as some of the strengths and maybe some of the weaknesses of the Balanced Scorecard. I wanted to introduce another measurement area or concept, which is an area that I work in. It's been popular, growing throughout the 1980s and early 1990s, and that's the area of value-based management. The area of value-based management is the governing objective of

any publicly traded company, which is to optimize long-term shareholder value. The overall management tool has different areas as far as what it encompasses. There are tools that can be used. Economic value added (EVA), which is a measure known by Stern-Stuart. There are a number of financial boutiques that have created financial measures that they believe have a very strong tie to increases in shareholder value. There is a business application side, which looks at utilizing these tools from a financial management application standpoint. Value-based incentive plan designs are one example. It can be used as a communications device as far as incorporating this management philosophy and also as a way to set, prioritize, and orient problem-solving.

If I took a look at the strengths and weaknesses or the advantages and disadvantages of the two concepts, I think this was why the Balanced Scorecard was developed. There were many areas, value-based management and the interest in EVA, in which there was a strong, rigorous tie to basic finance and economics that could be tied directly to the stock price of a company. As I talked about the Balanced Scorecard, those were elements that were missing in that area. The idea was that everything wasn't just financially focused, that there was a blend of financial and nonfinancial. However, there was no real tie on the Balanced Scorecard side to a company stock price. If I then looked at some of the disadvantages of value-based management (VBM), they tend to dovetail nicely into some of the advantages of a Balanced Scorecard, in that the disadvantages are typically from the VBM side, that it's typically financially focused and dictated by individuals from the finance department where the Balanced Scorecard was this attempt to focus on financial and nonfinancial, typically driven by line managers and HR and seen as a simpler or easier way to communicate what you would like a company to do.

Once you came up with the Scorecard, the Scorecard in itself wasn't just the end, but a way or a framework to which you could add many different applications. Some of these applications range from not just a measurement framework, which is originally what the Kaplan and Norton philosophy was, but an overall strategic direction as far as looking at benchmark performance standard identification. In a sense, for any measure that you're looking at, there is a range or a distribution of performance and if the intention is to improve the overall long-term shareholder value, you want to identify those areas that you're very strong in and identify those areas that you're weak in. If you can allocate or reallocate your resources appropriately and direct them fully in those areas, then you can perhaps shift resources from some of those strengths to problem areas so you can have the most demonstrable impact on your stock price. This framework would allow you to make those trade-offs. It is a way to establish paper performance alignment especially in the 1980s and the 1990s and particularly in Towers Perrin (the group that I'm associated with), which isn't on a compensation side. This was a very real

issue for them as far as using these types of frameworks in order to push incentives further down the organization but still have some rigorous tie to performance. This framework would allow you the opportunity to do that. It is a way also for things such as competency and skill set identification to be understandable. If you're translating this vision, and you need to focus and prioritize on these specific areas or processes, do you have the work force that has the competencies and skill set to be able to execute them? And, if not, what are ways that you either need to outsource that or develop your training, developing, and mentoring programs within your companies? Those attributes which are necessary to fulfill those areas that you want to prioritize.

Last, which feeds back into full-circle feedback integration, is business literacy, which helps to educate your employees that these are the overall objectives of the company and the strategy. Here's what you do on a day-to-day basis, and here's how you can directly impact the overall value and help us execute the strategy. That is a very powerful concept as far as educating the employees to make sure that everyone is on the same page concerning where the company intends to go.

I'm going to speak briefly on a term and a trademark we call the Integrated Scorecard. This was an area we thought that, given the strengths of both their value-based management philosophy and a Balanced Scorecard type set, that we could blend the two together and be able to come up with potentially a more robust tool. As with any type of tool or framework, I think everyone, all of us as practitioners, needs to be somewhat skeptical and ask, given our particular situation, what's going to make the most sense as far as making practical and real and not just another initiative deemed from corporate but, actually, something that will make work easier? This is an approach that we found that has somewhat been successful for us as far as blending the two. You and your groups may come up with some different path of your own. There's no one right answer. I think the overall concepts make a lot of sense, notwithstanding a lot of give and take.

We came at this with a number of different caveats that I won't review in much detail. If you have clarified your business strategy, then you have essentially prioritized your company's activities and measures as far as what you as a company really want to focus on. That is extremely important because that starts the benchmark as far as creating what we will call value trees prioritizing those activities.

With those caveats, the integrated Scorecard framework occurs in four steps. What's the purpose of the overall measurement framework? Is it just to create a measurement framework? Is the intention to link it to incentive pay, communication and training, competency, and skill sets? As you go on this

corporate initiative, what's the endeavor that you're trying to accomplish or the different management processes that you hope you can weave this into.

The second or third piece is performance information discovery analysis. What are the systems that you currently have in place? The "what gets managed is what's measured" concept is very important here as far as what you are able to track as a company and how fine you are able to break that down. Because without that information it's obviously extremely difficult. This is predicated on the measures that you're able to evaluate people on.

A third step is an intrinsic value analysis. Its intention is to tie back to your overall stock price and what the free cash flows look like from a financial perspective. We've been able to use that as far as intrinsic value analysis or value-based measures as a benchmark to say, if this is how the company looks from a free cash-flow standpoint and built-in assumptions, then these are the metrics or standards that are already built in or implied within your given stock price. That is why one of our first caveats is that the financial markets are rational and that a company's stock price is appropriately priced or valued. You need to understand what the assumptions are that are underlying that stock price.

From there, once you understand what the purpose is and you've gone through what I would call strategy discovery to clarify your strategy, what are you trying to accomplish, and what are the critical success factors? The framework will then break out in two different ways. One is what we would call a value driver analysis, which is to understand the measures associated with these different strategic objectives and critical success factors and the value trees associated with them. Second on the process side, what are the processes that you're trying to prioritize? One of the other caveats that we hold out is that within a given industry, for example the life insurance industry, all of the processes that every company within that industry would have to undergo are finite and known and the measures associated with them are finite and known. What happens is that a company based upon their particular strategy prioritizes different areas. They choose particular processes or particular metrics that they want to hone as far as how they differentiate themselves.

The fourth piece gets to what I would call the driver process linkage, which in a sense is to have some type of Scorecard. There are three components. You need to know the activity that you want to look at, which the process side looks at. You need to know the measure associated with that activity, which is what the value driver piece tries to get at. The third piece is what I would call the accountability. Who is responsible for that particular activity? Is it from corporate? Is it a region, a team, or could you actually break it down to a particular individual?

Once you have determined what the measures on the integrated scorecard are, you can then go through a systematic process which is your benchmarking position and how are you associated with your peers or with your competitors. Next look at what's the root cause, what's driving that positioning. If it's low, what are some of the underlying value drivers that are associated with that? The third step is then a sensitivity analysis, which is understanding the dynamics and the interplay. If there are three or four different value drivers that impact that particular measure, which of those, if I tweak, change, or improve, is going to have the biggest bang for the buck? The fourth is the allocation piece. If I'm a manager and I have a number of different options or opportunities or available to me, which one should I prioritize and which one is going to give me the best return on the particular investment that I have?

I hope you've been able to get a feel for the overall concept of the Balanced Scorecard and some of its advantages and disadvantages. From a controlling side perspective, as far as actually implementing this with companies, I have shown how we've taken the overall concept or framework and then manipulated, changed, or looked at it from a couple of different angles in order to accomplish some of our other objectives which we want to accomplish with our clients. Now I will turn it over to Dave, who will speak about how he has used this with the Principal Financial Group and the processes that they went through.

Mr. David E. Neve: What I would like to do is give you some very practical things that our company has followed and has worked through in trying to implement the Balanced Scorecard, and maybe give you some of the sample measures that we're still working on for the individual division where I work. First, some information about the Principal. It's a $57 billion company. We have six major lines of business—pension, group, and individual life are the big three, and then a number of smaller businesses. We have quite a diverse set of product lines and markets that we operate in, and our goal is to try to bring all these together in some sort of coordinated strategy and then measure the success of achieving our strategic objectives.

Where did we come from? Our history of measurement in the past has emphasized financial goals. I'm sure most of you can relate to this: ROE, premium growth, assets under management, premium persistency, those sorts of things. We had a crude Balanced Scorecard that we developed about ten years ago for incentive pay. By incentive pay I mean all employees from the entry level all the way up to the CEO were involved in this program. We did have nonfinancial measures in there. We have three major categories: financial, customer and productivity, but the major emphasis was still financial. Not a whole lot of emphasis was placed on the nonfinancial measures. We did have some customer surveys and there were a whole group of nonfinancial measures that are going on in each of the different

departments and areas. They weren't really brought into the overall measurement process. Like I said, we had a few nonfinancial measures. Most of our measures were lag, not lead measures and I don't know if those terms mean anything to you, but that's Kaplan and Norton's concept. The lag measures are the ultimate results you're trying to measure. For example, ROE would be a good lag. At the end of the day, what happened? Lead measures would be the success drivers that give you that result at the end—for example, product development cycle time. If you're very good at that and can stay competitive and have state-of-the-art products, it probably will lead to good financial results. But we didn't have many of those lead indicators and felt we needed to have more of them. Also we had a fairly weak connection to our strategic plans. We had these historical measures that we had developed and we had our strategic plan. They were at the corporate and the business unit level, but not necessarily a good link together.

There's a quote I want to include from Kaplan and Norton: "Those companies that can translate their strategy into their measurement system are far better able to execute their strategy because they can communicate their objectives and targets." That summarizes one of the major reasons we wanted to adopt a Balanced Scorecard. There are three key words in this quote that we focused on—translate, getting that strategy down to what people are doing every day; execute, enabling us to execute our strategy so it isn't just words on paper but something that we're doing every day to meet; and communicate, so that employees and the management group are speaking same language.

The scorecard approach began with a desire on the part of corporate management at the top to rejuvenate our strategic planning process. We developed a new methodology both at the corporate level and at the business unit level. We wanted as we were developing this improved process, to translate those strategies into results. We wanted to have a framework so that we could have a common language between business units and corporate. We wanted to improve communication not only within the management group, but throughout the organization to unify employees around strategies. Now we did have, as I mentioned, an incentive compensation plan for every employee, but, again, there wasn't a strong link to the measures that were driving the incentive compensation results to what people were doing on a day-to-day basis.

About three years ago we finalized our new strategic planning methodology to articulate our strategy, to estimate our market attractiveness and the competitive position of our company in that market, and to assess our strategy. We launched that in 1995. We began the process of articulating Balanced Scorecards for each of the business units. We selected two of our businesses, group medical and residential mortgage, to go through and develop a Scorecard in 1996. This year,

those two business units are actually implementing their measures and using them in their incentive compensation and other businesses. I'm in that category, and we're still developing our scorecards with the idea that next year it's going to be full implementation. It takes a lot of effort, and linking them to your strategy is a very difficult exercise. Hopefully you'll get a flavor for that as I get into how we did that.

The key elements that we felt we had to put into place were communication, education, and training programs. These were driven by corporate. The corporate CFO took on the role of the project champion for this effort, and this was a major part of his responsibility over the last several years. Informal discussions were set up between executive management and then communicated down. It wasn't mandated that you had to follow these particular measures, but there was an attempt to explain the purpose and the value of it and to establish pilots, as I mentioned. There were meetings with the V.P. group and the officer group to start rolling this off, and explain why we're doing this. There were specific business unit training sections that were set up by corporate with each of the business units to explain the concept and it's implementation. We then developed a formal communication plan to communicate this throughout the organizations.

I would like to give you more specifics within the individual insurance division of how we went about developing a Balanced Scorecard. We adopted the term "Strategic Performance Measures." We thought that was a more descriptive term than Balanced Scorecard, but it's basically the same thing. (We call them SPM or SAM for short.) One of the main questions that we were struggling with throughout this effort was, are we doing the right things? Are employees doing the right things? Everybody is very busy; there's no lack of effort on the part of people. They come in and put in a hard day's work, but are the activities really supporting the strategy? And are there some things that we should not be doing? We had three primary objectives? In the individual division, we wanted to improve the linkage between the measures that we have and our strategy. We felt that we had a winning strategy and it had been articulated, but the problem was in executing it and measuring it to see if it was really accomplishing what we wanted to say. In many ways it was a nice thing on paper, but was it really meeting its objective? Second, we wanted to improve our ability to track. Our short-term actions were moving us toward achieving our long-term strategies, and we also wanted to improve our whole management information system. We felt this was the starting point that would serve as the foundation for all kinds of management information, from high-level down to detail.

What did we do in the individual area? We formed a small core team to oversee the implementation. This was about three to four people. None of them were working on this full time; they were working it into their other duties. We attended

the small core group, and all the corporate training sessions that had been set up. We formed functional teams of an individual within the client services, the markets, and the distribution area to develop these high-level measures and also to develop these lower-level operational measures that would not be part of the Balanced Scorecard or strategic performance measures, but were built on each other. We then asked the core team to develop recommended measures. It was then the role of senior management within individual to review the measures, to insure that the linkage was there to the strategy and there was a consistency with the corporate measures, and to communicate that to the organization. This was our plan. We thought it made sense and we could go through all these steps and at the end of the day have this neat Balanced Scorecard, and everybody would understand it and everything would be hunky-dory. One of the problems we had was when we formed these functional teams, the basic thing we told them was, tell us what the success drivers in your particular area are, and what kind of information or measures you need to manage your operations better so that you know that you're successful or not. We didn't really ask them to develop measures that were consistent with the strategy. There was a missing link there because there was a tendency to say, "I think I know what I'm supposed to be doing and I have these historical measures and I'm going to try to define those better so that I can know whether I'm successful or not." However, what they were being successful at wasn't necessarily what we wanted to have in place to meet our strategy, so that was a mistake on our part as we went through this implementation.

We looked at four categories on the Balanced Scorecard: financial, customer, internal process, and employee learning and growth. We felt that they built on each other. The starting point was employee learning and growth, so we felt that if we had that in place, that would lead to good processes. If we had good processes, that would lead to satisfied customers and if all three of those were in place, we would have good financial results.

We tried to articulate the strategic objectives in each of these categories. I'll discuss two of them. The first one is cost of personal development and satisfaction of employees. The second strategy is that new employees understand the strategy of our business unit, SBU, the percentage of employees who understand our strategy. We try to articulate a strategic objective and measures underneath them.

The next one, internal business processes, is the second of the four categories. We have three strategic objectives: improved service and support capabilities, improved product competitiveness, and strength in field technology. I'm not going to dwell on any of them. I think it gives you a feel for what we came up with. The third category is the customer. Again, three strategic objectives: we were trying to

measure improved customer satisfaction, improved target market focus, and increased marketing efforts to existing customers.

Regarding internal business processes, we felt it was very important that we didn't just get business coming in the door, which is good, but we wanted to make sure that we were targeting a certain customer and a certain market. Or is all our business coming from some other segment that we aren't even focusing on? We haven't really measured that kind of growth or had that kind of focus in our measures, so the number of customers and the premium growth is surely within our targeted market.

Finally, the financial measures we came up with are categorized by three strategic objectives: improved profitability, growth first-year return in premium, and strengthening our distribution system.

We came up with these measures and we presented them to our management team in individual and they basically approved them without extensive review. We sent them up to corporate and had a meeting with corporate, but that didn't go real well. They thought that we hadn't done a very good job of coming up with these measures. Part of the reason was, we really didn't have a very well-articulated strategy. It is difficult to come up with measures if you don't have a precise strategy. We had a strategy but it was general, not specific. It was hard to quantify the measures that we need to fulfill for strategy because they weren't very specific. In fact, we found that we were actually creating strategic objectives because we had these measures and we had to find the strategy so that we could justify using them. One of the best examples was in employee learning and development—developing satisfied employees and empowered employees, etc. We didn't have anything like that in our strategy. Our strategy was all market- and product-driven. We thought we had to go back and do a better job of articulating our strategy.

There was also a tendency to use the old traditional measures: ROE, premium growth, asset growth, and customer satisfaction. We didn't spend the time to qualify the real success drivers. Not that those are bad, but there are probably other things that we need to think about and put into place. We also spent a lot of time trying to sort measures between lag and lead because we wanted to have both, but we found that exercise to be sometimes counterproductive, because a measure could be both, for example, premium persistency. You could view that as a lead indicator for ROE because it's critical that you have good persistency, but some felt that was an end result or flag indicator by itself, so in retrospect that distinction was probably not as critical as we thought it was going in. We also had too many measures. I had listed 26 even after dropping some off. You have to narrow it down and give some focus to the organization. As I mentioned, there was a

tendency to fill in the four boxes to make sure we had enough measures in each one to achieve a balance. Do all four of the categories have to be of equal importance? Probably not. We need to make sure that we're not putting in measures so that we have a balance. That isn't always the objective of the scorecard; that is, we need to come up with measures that are meaningful.

There were also two other challenges that we ran into. One is that for many of the measures, we simply didn't have the available data to give us the measure. For example, some of these growth measures in our targeted markets just didn't have the systems in place to capture that. It takes a significant systems commitment to get those kinds of measures in place. If we're committed to that measure, it's going to take some resources to track it.

Another very important challenge is the management time that it takes to discuss and evaluate the measures and to come up with good ones. In our case when we came up with these preliminary measures, we really didn't get the management team within the individual division together enough to really discuss them. They were rubber-stamped and even though management felt that this was a very important exercise, we had a hard time just logistically getting them together because they're traveling and there are many other important things that they're working on. In order for this really to be effective, you must get the time commitment to really work together as a team and make sure that these are the measures that you want.

You need to make sure that your strategy is specific and clearly articulated. You need the support of senior management, not just in concept but their actual time. It takes time and effort to do this. You need to know your company's culture. Are you a company that is strong on strategy but weak on execution? Or perhaps vice versa? Is your company able to make change effectively or easily? It's important you know your company's culture as you go into this process. You can't do too much educating and communicating. In corporate we've set up many training and communication activities and efforts, which you can never do too much of.

We have incentive measures in place and we have developed new strategic performance measures. There's a tendency to keep them on separate tracks, but we really need to blend them together so we don't have too different sets of management measures or performance measures. It's not easy and it takes time. It isn't something that you can do in a month or two. You can do it probably in that time frame, but it's been our experience that it really won't give you the results that you're looking for.

Mr. John E. Ragan: I was wondering if anyone could speak from the standpoint of accountability. It seems as if we've always developed these corporate plans that look nice and are designed to implement all these things, but what do you plan on doing, specifically in your company, from an accountability standpoint of meeting those objectives?

Mr. Neve: One of the purposes of the strategic performance measures is to provide that accountability because it will become the basis of incentive compensation to the extent that you have some of your pay at risk because these are the measures, then you accomplish that at least in theory. It underscores the importance of having that link to strategy because if you just have measures that people can fulfill or work toward and hopefully meet, if they're not linked to your strategy you may be meeting those objectives, but you may not be meeting your true strategic goal. That linkage is really important, and it's something that we struggled with quite frankly. It's not easy to accomplish, but we're working on it.

Mr. Bannister: I would say that as far as linking it to the incentive plans, if you want accountability that's where you're going to get it because you will grab someone's attention immediately as far as what they are going to be focusing on. That could be a blessing and a hindrance. If you give short shrift, as David said, and you jam it into a month or two, don't get consensus from all of your employees as far as what they need to focus on, and create these elaborate scorecards, you may get exactly what you intended and they will focus on the things that you have put in that scorecard. If not done appropriately, they may be focusing on things that they don't need to or they shouldn't be focusing on. Make sure that everyone's on the same page and if they feel some confusion or some apprehension, they have to rely on their own intuition and do what they think is appropriate. The problem is that if you get 5,000 individuals all at the same level doing what they think is most appropriate, chances are not everyone is going to be doing exactly the same thing or the strategy that you want.

From the Floor: Would you say you need to drive the tie to performance-based compensation down to the lowest levels in the organization for this to work?

Mr. Bannister: I would say yes. Ideally what you would love to do is touch the individual so they understand what they do on a day-to-day basis and how it links to the strategy that you're trying to execute and how it links to increases in overall shareholder value. The trick is though, as David rightly pointed out, it does not happen overnight. If you're moving along this process, it's evolutionary not revolutionary. To think that you're going to do it in a month or two is giving it short shrift because ideally senior management has to understand it, believe it, live with it, and be comfortable with the process and understand that it's just not financial.

From the Floor: David, and possibly R.J., could you comment on a clearly articulated strategy? What are the components to it? What are the elements to make it specific? Rather than spending too long making it absolutely right the first time, what you might have done differently based on your experience? I might have argued that at least having an organization recognize the power of measures, whether they may not be exactly the right ones, is part of this evolutionary aspect that R.J. talks about—at least getting something out there, measuring it, and talking about it somewhat.

Mr. Neve: What does it mean to have a clearly articulated strategy? If I had a clearly articulated response to that I'd probably go into consulting and make a lot of money. What we're trying to do on the individual and also the corporate level is two basic elements: clearly define who you are going after as far as who you're marketing to and how you're going to do that. What markets? What consumers? Who are you targeting? Make that very clear. How are you going to do that? Are you going to do it fundamentally through a pricing strategy of having the lowest price? Are you going to do it through a value-added, maybe not the lowest price but a very high value added given the price? Are you going to try to do it through a customer intimacy approach?

Mr. Bannister: Obviously in consulting, you can't get away from a process or a framework in which you would actually meet with a group of senior management and walk them through. Get a group of individuals together and look at their particular business; look at a number of different criteria, whether it's markets, technology, or the types of customers you are looking for, to be able to gain some consensus on where you want this company to go.

A second approach that we've taken is from a process side. There is an organization in Dallas called the International Quality and Productivity Center (IQPC). Given a lot of business process reengineering, they have actually come up with a definite list of different processes that companies have to go through. There are 13 metaprocesses, including understanding your markets and your customers, and understanding your human resources implications. And there are subprocesses underneath that. That approach has been extremely useful for articulating strategy. That's just the beginning, though, because then you have to break down those processes, and those measures to see then where you are going to get the most bang for your buck, so I think that answers the first question.

Mr. Neve: Your second question was about the evolutionary nature of this activity. That's a very good point. We didn't get it right the first, time and we didn't end up after a year or so going through this with the perfect response. I think there is a tendency to say, "I want to conquer this mountain and I want to get it done and

then move to other things." You cannot do this. It will change over time as your strategy changes. I'm not exactly sure if I'm responding to your question, but it is true that this is an evolutionary process and as you go through it, don't be too hard on yourself if you don't get it right the first time because if you do you'll probably be in the vast minority. It certainly is true in our case.

Mr. Bannister: I would say as far as from an evolutionary process, do not get hung up on trying to solve the third number to the right of the decimal point. As far as I know I'm speaking in front of a bunch of actuaries. I myself am not an actuary, but I work with them at Towers Perrin. I think the way to start the evolutionary road is utilized technology. There are a number of things you can do with systems that we've used with companies. This is not a multimillion dollar system. You can use Excel or Access to automate the process that you send things out. People can push. If things are in their hands and people can see the power of understanding, it can be amazing. Once they have the tool in their hand, we ought to add this piece into it or we ought to look at it from this perspective. I think the leveraging of technology helps considerably as far as insuring at least that it is an evolutionary process and not just a six-month initiative that somehow loses steam and gets lost with all of the other initiatives that come down the road.

Mr. Godfrey Perrott: First of all, I have a response to that precision question. I am an actuary. I work very hard to explain to my staff that the second significant digit is usually insignificant; the third almost always. In implementing this, you're replacing the incentive compensation paradigm and I'm presuming that the old paradigm and the new paradigm are tangential so that it happens that everyone gets the same bonus under the old and new. What transition approaches have you used or will you use particularly for senior managers who receive a substantially lower bonus?

Mr. Neve: We have two incentive programs. We do have a program for the executive group, which is somewhat by itself and then we have our other incentive compensation that relates to every employee. I think the answer to your question relates to this evolutionary element too. It isn't like you flip a switch and suddenly you go from one paradigm to the other. We have had an incentive compensation and I'm referring now to the employee-wide one. We've had that in place for about ten years and it has not changed much. When they finalize these Balanced Scorecard measures they will then become the measures to use for incentive compensation and it will just happen in an evolutionary manner, SBU by SBU. In some cases it may be kind of a drastic set of changes, but in most cases there will be a continuation of many of the measures that have been used in the past. It will, however, be that evolutionary thing again.

From the Floor: I have a question for both of you. How do you actually zero in on those key measures and how do you build learning into the system so that if you get it wrong or the world changes that you actually adapt the measures to fit the business appropriately?

Mr. Bannister: My answer to that is lots of analysis even in the approach that we've taken as far as starting out from looking at whether you're looking at it from an intrinsic value analysis or trying to break down the company's stock price into the financial metrics and then working your way down. There is a way of being able to determine and articulate at least in some analytical fashion what seemed to be the drivers of your overall shareholder value. How does that dovetail with the drivers of your strategy? That is where there is a metric component and an activity component. Typically the activity is coming from the strategy side as far as what you want to articulate. A metric value driver approach is looking at it from the shareholder value perspective. I think running through a lot of analysis and sensitivity analyses is a way for you to determine as you move down through your financial value tree the areas that you ought to zero in and impact because every measure, no matter what it is, has some type of distribution and being at either end isn't necessarily a good thing. I often reference two companies in 1990 and 1991 who won the Malcolm Baldridge award for quality that were mid-size companies between 100–500 million. Each went bankrupt three years after they won it. Why? Because they zeroed in so much on a particular measure that they allocated too many resources and didn't understand or realize that they were already doing considerably well in this area and that the customer was not going to pay incrementally more for the product knowing that it was that much more of a higher standard or higher caliber. They should have reallocated their resources elsewhere. That I think is a key thing as far as the scorecard goes. It ought to help you prioritize.

Mr. Neve: Analysis is spending the time to understand what is it that's going to make us successful to meet our strategy. That is not a generic thing that runs through for every company. Maybe there are some things that are success drivers, but what is it that's unique about your strategy that you have to be successful at in order to accomplish that strategy? What is it, and how do you measure it? It could be different for every company. Again, there are some common things but don't try to look at some industry-wide success measure. Study what makes your company and your strategy unique, analyze it, and try to define that success driver.

Mr. Bannister: I'll just make one other point. Eventually when you have a framework or scorecard like this your strategy goes from being static to being dynamic and you get a lot of clear signals. If you feel that you have the connections and the value drivers right and you are not achieving the shareholder value that you

have and the expectations that you've set out for yourself, then your strategy is incorrect. This can act as a feedback loop of saying that we really ought to revisit our strategy and are we really doing what we set out to do and do we need to focus our attention elsewhere, which I think is a dynamic piece of strategy which typically doesn't happen. It's usually static and if we don't achieve what we're trying to accomplish, it's because we didn't execute our strategy. This is a methodology of test. If you are executing your strategy and you're not getting the stock price appreciation results, then there may be a flaw in the strategy.

From the Floor: My question really ties into what you were talking about. Dave, you said that you had tried to implement too many measures. It would seem that you would want to have a very small number of measures that employees could keep in their heads in order to really guide them in their day-to-day work. On the other hand, with an insufficient number of measures, you won't really get to your strategic objective. R.J., could you comment briefly on how you get to the right number of measures?

Mr. Bannister: I think that it is important because if there are 20 or 25 measures, that's probably too much for a particular individual to handle or comprehend. Ideally you want to get to that point where the individual has a direct impact on that measure and has the authority to impact that measure and isn't necessarily being held accountable for something that he or she can't change. I think even though there may be many metrics within the system within what I would call an organized framework, a value tree, I think you can use that as a way to organize your measurement framework. When it gets to an individual level, that individual person may be only evaluated on a very few metrics because other individuals are being held accountable for other things.

Mr. Neve: Yes, and therein lies one of the real struggles that we have trying to get the right number because the fewer number of measures that you have, the higher level they are and the less line of sight there is to the individual employee. If you want to have a measure that every employee in the organization can relate to that deals with what they do every day, you're going to have thousands of measures, so again, it is hard to strike a balance. I think it points out the need for employee education because the more that employees understand the success drivers and how they can contribute to ROE the more they can support that kind of high-level measure, even if it isn't a direct line of sight to them. They need to understand the dynamics of that, and that's a challenge.

If you're able to link this process into other different management processes, I think that's a much better road to take. It's a great tool to leverage in many different areas.

Mr. Bannister: Communication and business literacy within the company is extremely important.