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The balanced scorecard: measuring what matters

by James Trefz

In today's increasingly competitive environment, one key to success is understanding, measuring, and managing the factors that drive one's business. Most traditional financial measures, such as net income or return on equity, are myopic lag indicators that tell us where we have been while saying little about where we are headed. How do we know whether our current actions are creating future value?

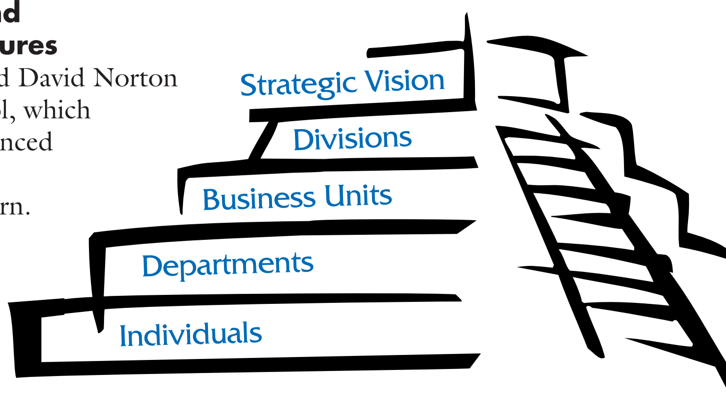
Looking beyond financial measures

Robert Kaplan and David Norton have created a tool, which they call "the balanced scorecard," to address this concern. The balanced scorecard seeks to identify and measure key business drivers by supplementing financial data with measurements from three additional perspectives: customer, internal business processes, and learning and growth.

Following is a brief overview of Kaplan's and Norton's approach. Details are available from their book, *The Balanced Scorecard* (Harvard Business School Press, 1996), and four papers: "The Balanced Scorecard — Measures That Drive Performance," *Harvard Business Review*, January-February 1992; "Putting the Balanced Scorecard to Work," *Harvard Business Review*, September-October 1993; "Using the Balanced Scorecard as a Strategic Management System," *Harvard Business Review*, January-February 1996; and "Aligning Strategy and Performance with the Balanced Scorecard: An Interview with David P. Norton, Ph.D.," *ACA Journal*, autumn 1997.

3 new perspectives

The customer perspective deals with how a firm is perceived by its customers. It seeks to identify what is important to the customer and how the company is performing. An example of a measure that is commonly found within this perspective is "customer retention." Customers can be internal as well as external.



The internal business process perspective addresses how a firm must respond in order to meet customer expectations and accomplish its strategy. An example might be "product development cycle time."

The learning and growth perspective concerns employee competencies, productivity, and job satisfaction. Measures of productivity are often found under this rubric.

These three measures supplement the more traditional financial markers. Together, they indicate not just where the firm has been, say Kaplan and Norton, but where it is going. When a company has invested time in identifying what truly drives results, the balanced scorecard becomes a powerful management tool for tracking performance and predicting success.

Creating the power of alignment

Companies that have implemented the balanced scorecard approach have found that its real potency lies in its ability to force the alignment of behavior at all levels of the organization, say Kaplan and Norton.

One can think of a balanced scorecard as a pyramid. At the top is the strategic vision. Each subsequent level contains measures for divisions, business units, departments, and individuals. Every measure is derived from and supports the levels above it. All four perspectives (e.g., financial, customer, internal business process, and learning and growth) can be represented at each level.

Thus, a well-constructed balanced scorecard is firmly tied to the firm's strategic vision. All measures support that vision, linking long-term strategy to short-term action. Clearly defined measures, designed to reach into all levels of the organization, give guidance to individuals as they make daily decisions.

The exercise of creating a balanced scorecard also forces companies to align their budgeting processes with their strategic planning. Investment decisions are more easily evaluated: if they support the lower-level measures, they also support the longer-term corporate objectives because the lower-level measures feed into the strategic vision.

The balanced scorecard fosters cause-and-effect learning by providing feedback on whether success or failure on a particular set of measures has the predicted result on one or more of the other measures. This forces a firm to consistently review its business model, clarify its strategy and objectives, and refine its understanding of key drivers.

The final and most difficult step in aligning goals and performance is tying incentive compensation and employee appraisals to balanced scorecard results. Great care needs to be taken in designing such programs to ensure they link the proper incentives to the right balanced scorecard factors. When a program is well designed, such a linking can provide a powerful alignment of individual and corporate motivations.

Scoring the scorecard

A growing number of companies — such as FMC Corporation, Mobil Oil, Sears, The Principal Financial Group, and Nationwide Financial Services — have implemented various aspects of the balanced scorecard. Kaplan and Norton say that as companies broadened their perspectives beyond the merely financial and strived to measure key business drivers, they clarified their strategic vision and have more closely aligned divisional, departmental, and individual performance with that vision. Implementing the balanced scorecard is an evolutionary process, which will take its own path within each company. To do it well, a company should plan on a significant investment of time and resources. The payoff may be worth it.

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Bancassurers no more (continued from page 3)

Integrate or specialize?

Historically, Australian banks' insurance operations have grown up as individual, specialized divisions of a bank. Over the years, there have been a number of pushes to integrate bank and insurance operations. The potential advantages of such integration could be great. Most notably, integration is seen as a way to overcome perceived cultural differences that may have a material impact on sales. Integration is seen as particularly attractive on the distribution and marketing side. Commonwealth Bank recently implemented sweeping organizational changes aimed at integrating the various areas of the bank.

Full integration may have a downside. In particular, a product can become lost in a large bank without a champion to support it. Further, specialized skills related to insurance and investment products need to be maintained. ANZ Bank is known to believe in the importance of maintaining a separate team focused on insurance and investment products.

Consistent scorekeeping

The issues related to pricing approaches are clear. Less obvious are those related to risk management and capital allocation, which also impact pricing and scorekeeping. Multiservice providers are only just beginning to address these issues in Australia. The traditional approaches to risk management in banks, fund managers, and insurance companies are very different, reflecting the range of risks faced. This was never much of an issue before the rise of the multiservice providers, but now it has become critical to be able to assess risks of varying nature on an even-handed basis.

Without being underpinned by a coherent approach to risk management and capital allocation, attempts to price consistently and operate consistent scorekeeping may not be successful.

It is plain that many executives from a banking background find insurance risks, such as AIDS and sales compliance risks, hard to assess and rather unnerving. Insurance executives might find similar discomfort with banking risks if they aimed to run a banking operation.

Is 'bancassurance' the right term?

The debates set out above all seem to be heading toward a different sort of institution than might be characterized as a bancassurer. Australian companies now regard themselves as financial services providers rather than banks, insurance companies, mutual funds, or, indeed, bancassurers.

With this mindset in place, it may be clearer to see how the above debates might be settled. Here are some speculations on possible resolutions.

In regard to the product model and the adviser model, a true financial services provider may be driven towards the product model. The critical deciding factor may be the need to develop a consistent value proposition to put to the customer. It is difficult to sustain a position where product pricing is inconsistent among products which may be seen as substitutes for each other. The future focus may be on customer needs rather than products.

On the issue of customer management, it seems inevitable that the present trends will lead to a single coordinated marketing effort focused on the customer rather than on product segments.

On the issue of integration, I believe that further integration will occur, but the need for product champions and experts will remain. Financial services providers are likely to operate a variety of distributions supported by an integrated marketing approach.

On the issue of the consistent scorecard, I see the development of common risk management and capital allocation standards as being one of the critical areas yet to be faced — and one that will be faced now that the financial services mentality prevails.

As a final thought, I should warn those in the United States who look to Australia for interesting bancassurance models that they are looking at a moving target. The industry is reinventing itself rapidly at this very moment. Exciting times are ahead.

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