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COMMENTARY

Transforming the Balanced Scorecard from Performance Measurement to Strategic Management: Part I

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Several years ago we introduced the Balanced Scorecard (Kaplan and Norton 1992). We began with the premise that an exclusive reliance on financial measures in a management system is insufficient. Financial measures are lag indicators that report on the outcomes from past actions. Exclusive reliance on financial indicators could promote behavior that sacrifices long-term value creation for short-term performance (Porter 1992; AICPA 1994). The Balanced Scorecard approach retains measures of financial performance—the lagging outcome indicators—but supplements these with measures on the drivers, the lead indicators, of future financial performance.

THE BALANCED SCORECARD EMERGES

The limitations of managing solely with financial measures, however, have been known for decades.[1] What is different now? Why has the Balanced Scorecard concept been so widely adopted by manufacturing and service companies, nonprofit organizations, and government entities around the world since its introduction in 1992?

First, previous systems that incorporated nonfinancial measurements used *ad hoc* collections of such measures, more like checklists of measures for managers to keep track of and improve than a comprehensive system of linked measurements. The Balanced Scorecard emphasizes the linkage of measurement to strategy (Kaplan and Norton 1993) and the cause-and-effect linkages that describe the hypotheses of the strategy (Kaplan and Norton 1996b). The tighter connection between the measurement system and strategy elevates the role for nonfinancial measures from an operational checklist to a comprehensive system for strategy implementation (Kaplan and Norton 1996a).

Second, the Balanced Scorecard reflects the changing nature of technology and competitive advantage in the latter decades of the 20th century. In the industrial-age competition of the 19th and much of the 20th centuries, companies achieved competitive advantage from their investment in and management of tangible assets such as

[1] For example, General Electric attempted a system of nonfinancial measurements in the 1950s (Greenwood 1974), and the French developed the Tableaux de Bord decades ago (Lebas 1994; Epstein and Manzoni 1998).

This article is adapted from R. S. Kaplan and D. P. Norton (2001a, 2000).

inventory, property, plant, and equipment (Chandler 1990). In an economy dominated by tangible assets, financial measurements were adequate to record investments 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 by the end of the 20th century, intangible assets became the major source for competitive advantage. In 1982, tangible book values represented 62 percent of industrial organizations' market values; ten years later, the ratio had plummeted to 38 percent (Blair 1995). By the end of the 20th century, the book value of tangible assets accounted for less than 20 percent of companies' market values (Webber 2000, quoting research by Baruch Lev).

Clearly, strategies for creating value shifted from managing tangible assets to knowledge-based strategies that create and deploy an organization's intangible assets. These include customer relationships, innovative products and services, high-quality and responsive operating processes, skills and knowledge of the workforce, the information technology that supports the work force and links the firm to its customers and suppliers, and the organizational climate that encourages innovation, problem-solving, and improvement. But companies were unable to adequately measure their intangible assets (Johnson and Kaplan 1987, 201–202). Anecdotal data from management publications indicated that many companies could not implement their new strategies in this environment (Kiechel 1982; Charan and Colvin 1999). They could not manage what they could not describe or measure.

INTANGIBLE ASSETS: VALUATION VS. VALUE CREATION

Some call for accountants to make an organization's intangible assets more visible to managers and investors by placing them on a company's balance sheet. But several factors prevent valid valuation of intangible assets on balance sheets.

First, the value from intangible assets is indirect. Assets such as knowledge and technology seldom have a direct impact on revenue and profit. Improvements in intangible assets affect financial outcomes through chains of cause-and-effect relationships involving two or three intermediate stages (Huselid 1995; Becker and Huselid 1998). For example, consider the linkages in the service management profit chain (Heskett et al. 1994):

- investments in employee training lead to improvements in service quality
- better service quality leads to higher customer satisfaction
- higher customer satisfaction leads to increased customer loyalty
- increased customer loyalty generates increased revenues and margins

Financial outcomes are separated causally and temporally from improving employees' capabilities. The complex linkages make it difficult, if not impossible, to place a financial value on an asset such as workforce capabilities or employee morale, much less to measure period-to-period changes in that financial value.

Second, the value from intangible assets depends on organizational context and strategy. This value cannot be separated from the organizational processes that transform intangibles into customer and financial outcomes. The balance sheet is a linear, additive model. It records each class of asset separately and calculates the total by adding up each asset's recorded value. The value created from investing in individual intangible assets, however, is neither linear nor additive.

Senior investment bankers in a firm such as Goldman Sachs are immensely valuable because of their knowledge about complex financial products and their capabilities for

managing relationships and developing trust with sophisticated customers. People with the same knowledge, experience, and capabilities, however, are nearly worthless to a financial services company such as etrade.com that emphasizes operational efficiency, low cost, and technology-based trading. The value of an intangible asset depends critically on the context—the organization, the strategy, and other complementary assets—in which the intangible asset is deployed.

Intangible assets seldom have value by themselves.[2] Generally, they must be bundled with other intangible and tangible assets to create value. For example, a new growth-oriented sales strategy could require new knowledge about customers, new training for sales employees, new databases, new information systems, a new organization structure, and a new incentive compensation program. Investing in just one of these capabilities, or in all of them but one, could cause the new sales strategy to fail. The value does not reside in any individual intangible asset. It arises from creating the entire set of assets along with a strategy that links them together. The value-creation process is multiplicative, not additive.

THE BALANCED SCORECARD SUPPLEMENTS CONVENTIONAL FINANCIAL REPORTING

Companies' balance sheets report separately on tangible assets, such as raw material, land, and equipment, based on their historic cost—the traditional financial accounting method. This was adequate for industrial-age companies, which succeeded by combining and transforming their tangible resources into products whose value exceeded their acquisition and production costs. Financial accounting conventions relating to depreciation and cost of goods sold enabled an income statement to measure how much value was created beyond the costs incurred to acquire and transform tangible assets into finished products and services.

Some argue that companies should follow the same cost-based convention for their intangible assets—capitalize and subsequently amortize the expenditures on training employees, conducting research and development, purchasing and developing databases, and advertising that creates brand awareness. But such costs are poor approximations of the realizable value created by investing in these intangible assets. Intangible assets can create value for organizations, but that does not imply that they have separable market values. Many internal and linked organizational processes, such as design, delivery, and service, are required to transform the potential value of intangible assets into products and services that have tangible value.

We introduced the Balanced Scorecard to provide a new framework for describing value-creating strategies that link intangible and tangible assets. The scorecard does not attempt to "value" an organization's intangible assets, but it does measure these assets in units other than currency. The Balanced Scorecard describes how intangible assets get mobilized and combined with intangible and tangible assets to create differentiating customer-value propositions and superior financial outcomes.

STRATEGY MAPS

Since introducing the Balanced Scorecard in 1992, we have helped over 200 executive teams design their scorecard programs. Initially we started with a clean sheet of paper, asking, "what is the strategy," and allowed the strategy and the Balanced Scorecard to emerge from interviews and discussions with the senior executives. The

[2] Brand names, which can be sold, are an exception.

scorecard provided a framework for organizing strategic objectives into the four perspectives displayed in Figure 1):

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 that create customer and shareholder satisfaction.
4. *Learning and Growth*—the priorities to create a climate that supports organizational change, innovation, and growth.

From this initial base of experience, we subsequently developed a general framework for describing and implementing strategy that we believe can be as useful as the traditional framework of income statement, balance sheet, and statement of cash flows for financial planning and reporting. The new framework, which we call a "Strategy Map," is a logical and comprehensive architecture for describing strategy, as illustrated in Figure 2. A strategy map specifies the critical elements and their linkages for an organization's strategy.

- Objectives for growth and productivity to enhance shareholder value.
- Market and account share, acquisition, and retention of targeted customers where profitable growth will occur.
- Value propositions that would lead customers to do more higher-margin business with the company.
- Innovation and excellence in products, services, and processes that deliver the value proposition to targeted customer segments, promote operational improvements, and meet community expectations and regulatory requirements.
- Investments required in people and systems to generate and sustain growth.

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 organizational units and employees.

Organizations build strategy maps from the top down, starting with the destination and then charting the routes that lead there. Corporate executives first review their mission statement, why their company exists, and core values, what their company believes in. From that information, they develop their strategic vision, what their company wants to become. This vision creates a clear picture of the company's overall goal, which could be to become a top-quartile performer. The strategy identifies the path intended to reach that destination.

Financial Perspective

The typical destination for profit-seeking enterprises is a significant increase in shareholder value (we will discuss the modifications for nonprofit and government organizations later in the paper). Companies increase economic value through two basic approaches—*revenue growth* and *productivity*.[3] A revenue growth strategy generally has two components: build the franchise with revenue from new markets, new

[3] Shareholder value can also be increased through managing the right-hand side of the balance sheet, such as by repurchasing shares and choosing the low-cost mix among debt and equity instruments to lower the cost of capital. In this paper, we focus only on improved management of the organization's assets (tangible and intangible).

FIGURE 1
The Balanced Scorecard Defines a Strategy's Cause-and-Effect Relationships

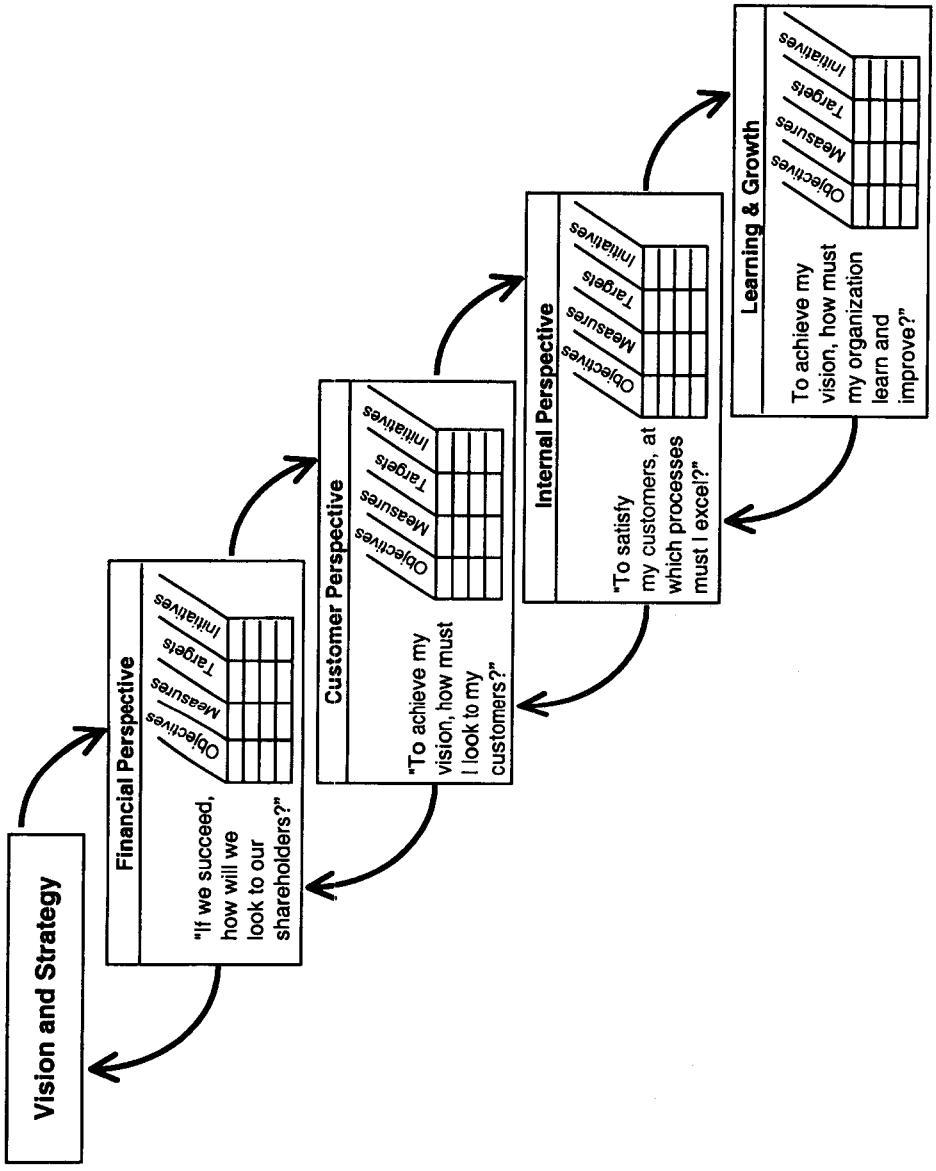
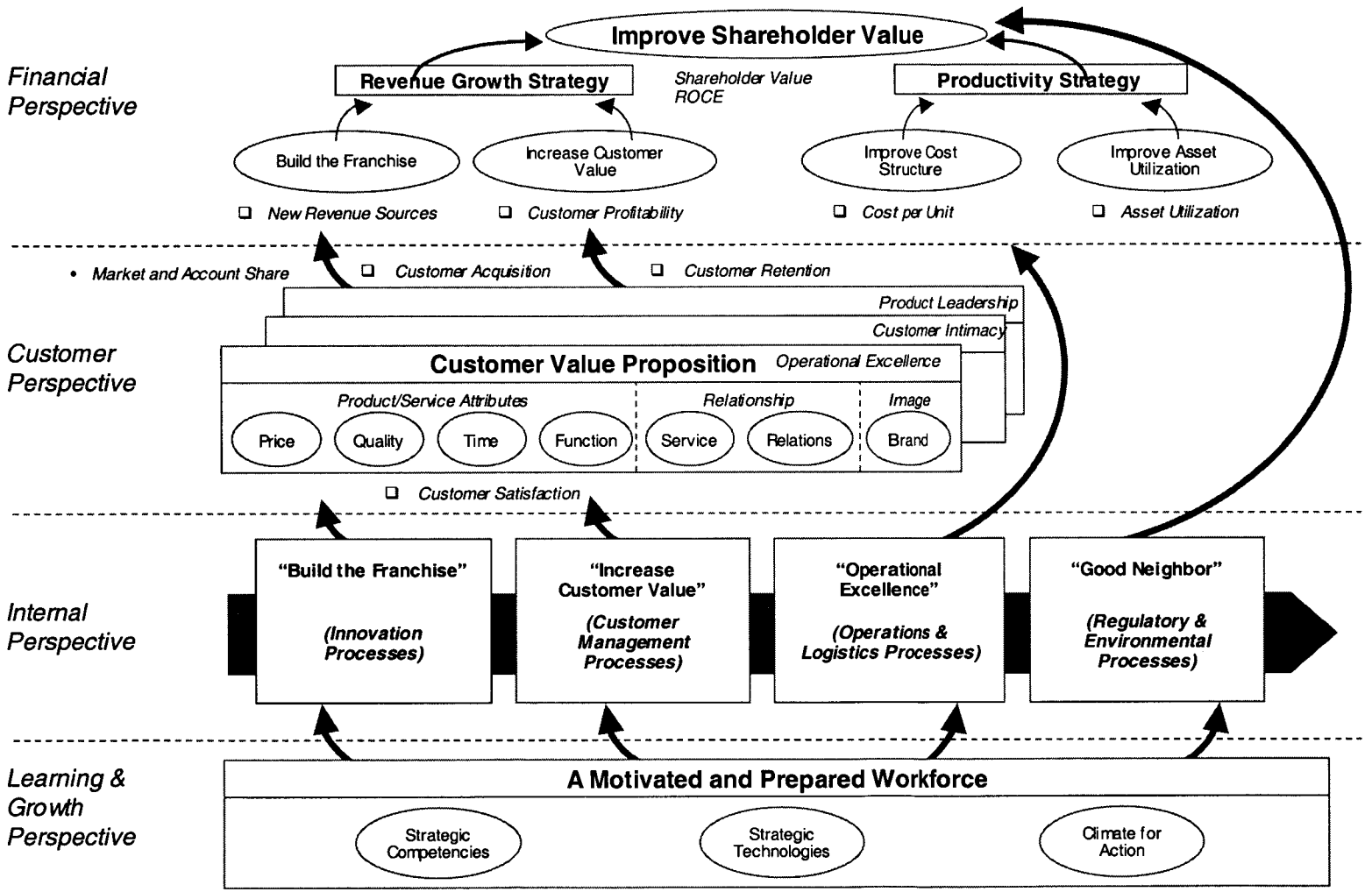


FIGURE 2
The Balanced Scorecard Strategy Map



products, and new customers; and increase sales to existing customers by deepening relationships with them, including cross-selling multiple products and services, and offering complete solutions. A productivity strategy also generally has two components: improve the cost structure by lowering direct and indirect expenses; and utilize assets more efficiently by reducing the working and fixed capital needed to support a given level of business.

Customer Perspective

The core of any business strategy is the *customer-value proposition*, which describes the unique mix of product, price, service, relationship, and image that a company offers. It defines how the organization differentiates itself from competitors to attract, retain, and deepen relationships with targeted customers. The value proposition is crucial because it helps an organization connect its internal processes to improved outcomes with its customers.

Companies differentiate their value proposition by selecting among *operational excellence* (for example, McDonalds and Dell Computer), *customer intimacy* (Home Depot and IBM in the 1960s and 1970s), and *product leadership* (Intel and Sony) (Treacy and Wiersema 1997, 31–45). Sustainable strategies are based on excelling at one of the three while maintaining threshold standards with the other two. After identifying its value proposition, a company knows which classes and types of customers to target.

Specifically, companies that pursue a strategy of operational excellence need to excel at competitive pricing, product quality, product selection, lead time, and on-time delivery. For customer intimacy, an organization must stress the quality of its relationships with customers, including exceptional service, and the completeness and suitability of the solutions it offers individual customers. Companies that pursue a product-leadership strategy must concentrate on the functionality, features, and performance of their products and services.

The customer perspective also identifies the intended outcomes from delivering a differentiated value proposition. These would include market share in targeted customer segments, account share with targeted customers, acquisition and retention of customers in the targeted segments, and customer profitability.[4]

Internal Process Perspective

Once an organization has a clear picture of its customer and financial perspectives, it can determine the means by which it will achieve the differentiated value proposition for customers and the productivity improvements for the financial objectives. The internal business perspective captures these critical organizational activities, which fall into four high-level processes:

1. *Build the franchise* by spurring innovation to develop new products and services and to penetrate new markets and customer segments.
2. *Increase customer value* by expanding and deepening relationships with existing customers.
3. *Achieve operational excellence* by improving supply-chain management, internal processes, asset utilization, resource-capacity management, and other processes.
4. *Become a good corporate citizen* by establishing effective relationships with external stakeholders.

[4] Measurement of customer profitability (Kaplan and Cooper 1998, 181–201) provides one of the connections between the Balanced Scorecard and activity-based costing.

Many companies that espouse a strategy calling for innovation or for developing value-adding customer relationships mistakenly choose to measure their internal business processes by focusing only on the cost and quality of their operations. These companies have a complete disconnect between their strategy and how they measure it. Not surprisingly, organizations encounter great difficulty implementing growth strategies when their primary internal measurements emphasize process improvements, not innovation or enhanced customer relationships.

The financial benefits from improvements to the different business processes typically occur in stages. Cost savings from increases in *operational efficiencies* and process improvements deliver short-term benefits. Revenue growth from enhancing *customer relationships* accrues in the intermediate term. Increased *innovation* generally produces long-term revenue and margin improvements. Thus, a complete strategy should generate returns from all three high-level internal processes.

Learning and Growth Perspective

The final region of a strategy map is the learning and growth perspective, which is the foundation of any strategy. In the learning and growth perspective, managers define the employee capabilities and skills, technology, and corporate climate needed to support a strategy. These objectives enable a company to align its human resources and information technology with the strategic requirements from its critical internal business processes, differentiated value proposition, and customer relationships. After addressing the learning and growth perspective, companies have a complete strategy map with linkages across the four major perspectives.

Strategy maps, beyond providing a common framework for describing and building strategies, also are powerful diagnostic tools, capable of detecting flaws in organizations' Balanced Scorecards. For example, Figure 3 shows the strategy map for the Revenue Growth theme of Mobil North America Marketing & Refining. When senior management compared the scorecards being used by its business units to this template, it found one unit with no objective or measure for dealers, an omission immediately obvious from looking at its strategy map. Had this unit discovered how to bypass dealers and sell gasoline directly to end-use consumers? Were dealer relationships no longer strategic for this unit? The business unit shown in the lower right corner of Figure 3 did not mention quality on its scorecard. Again, had this unit already achieved six sigma quality levels so quality was no longer a strategic priority? Mobil's executive team used its divisional strategy map to identify and remedy gaps in the strategies being implemented at lower levels of the organization.

STAKEHOLDER AND KEY PERFORMANCE INDICATOR SCORECARDS

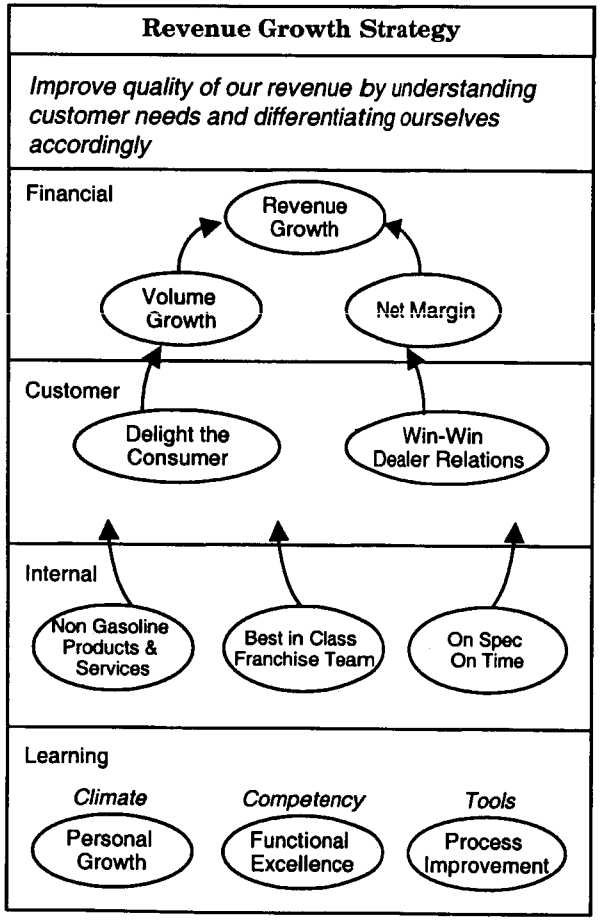
Many organizations claim to have a Balanced Scorecard because they use a mixture of financial and nonfinancial measures. Such measurement systems are certainly more "balanced" than ones that use financial measures alone. Yet, the assumptions and philosophies underlying these scorecards are quite different from those underlying the strategy scorecards and maps described above. We observe two other scorecard types frequently used in practice: the *stakeholder scorecard* and the *key performance indicator scorecard.*

Stakeholder Scorecards

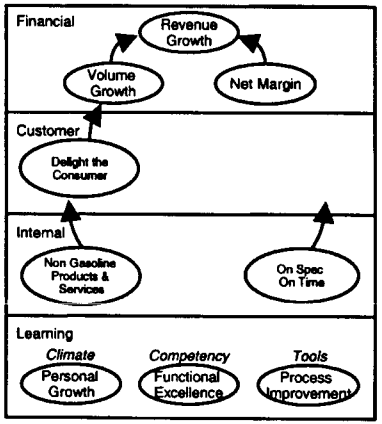
The *stakeholder scorecard* identifies the major constituents of the organization—shareholders, customers, and employees—and frequently other constituents such as

FIGURE 3
Mobil Uses Reverse Engineering of a Strategy Map as a Strategy Diagnostic

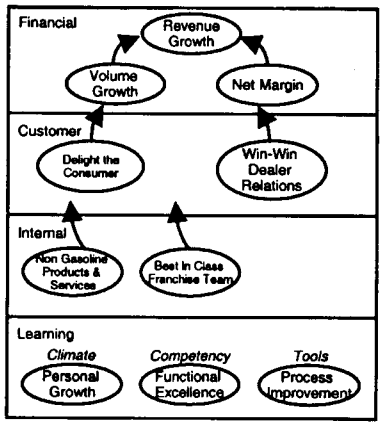
The Template (Strategy Map: Partial)



SBU A: "Did we eliminate the dealer?"



SBU B: "Have we achieved perfection?"



suppliers and the community. The scorecard defines the organization's goals for these different constituents, or stakeholders, and develops an appropriate scorecard of measures and targets for them (Atkinson and Waterhouse 1997). For example, Sears built its initial scorecard around three themes:

- "a compelling place to shop"
- "a compelling place to work"
- "a compelling place to invest"

Citicorp used a similar structure for its initial scorecard—"a good place to work, to bank, and to invest." AT&T developed an elaborate internal measurement system based on financial value-added, customer value-added, and people value-added.

All these companies built their measurements around their three dominant constituents—customers, shareholders, and employees—emphasizing satisfaction measures for customers and employees, to ensure that these constituents felt well served by the company. In this sense, they were apparently *balanced*. Comparing these scorecards to the strategy map template in Figure 2 we can easily detect what is missing from such scorecards: no objectives or measures for *how* these balanced goals are to be achieved. A vision describes a desired outcome; a strategy, however, must describe *how* the outcome will be achieved, how employees, customers, and shareholders will be satisfied. Thus, a stakeholder scorecard is not adequate to describe the strategy of an organization and, therefore, is not an adequate foundation on which to build a management system.

Missing from the stakeholder card are the drivers to achieve the goals. Such drivers include an explicit value proposition such as innovation that generates new products and services or enhanced customer management processes, the deployment of technology, and the specific skills and competencies of employees required to implement the strategy. In a well-constructed *strategy scorecard*, the value proposition in the customer perspective, all the processes in the internal perspective, and the learning and growth perspective components of the scorecard define the "how" that is as fundamental to strategy as the outcomes that the strategy is expected to achieve.

Stakeholder scorecards are often a first step on the road to a strategy scorecard. But as organizations begin to work with stakeholder cards, they inevitably confront the question of "how." This leads to the next level of strategic thinking and scorecard design. Both Sears and Citicorp quickly moved beyond their stakeholder scorecards, developing an insightful set of internal process objectives to complete the description of their strategy and, ultimately, achieving a strategy Balanced Scorecard. The stakeholder scorecard can also be useful in organizations that do not have internal synergies across business units. Since each business has a different set of internal drivers, this "corporate" scorecard need only focus on the desired outcomes for the corporation's constituencies, including the community and suppliers. Each business unit then defines how it will achieve those goals with its business unit strategy scorecard and strategy map.

Key Performance Indicator Scorecards

Key Performance Indicator (KPI) scorecards are also common. The total quality management approach and variants such as the Malcolm Baldrige and European Foundation for Quality Management (EFQM) awards generate many measures to monitor

internal processes. When migrating to a "Balanced Scorecard," organizations often build on the base already established by classifying their existing measurements into the four BSC categories. KPI scorecards also emerge when the organization's information technology group, which likes to put the company database at the heart of any change program, triggers the scorecard design. Consulting organizations that sell and install large systems, especially so-called executive information systems, also offer KPI scorecards.

As a simple example of a KPI scorecard, a financial service organization articulated the 4Ps for its "balanced scorecard:"

1. Profits
2. Portfolio (size of loan volume)
3. Process (percent processes ISO certified)
4. People (meeting diversity goals in hiring)

Although this scorecard is more balanced than one using financial measures alone, comparing the 4P measures to a strategy map like that in Figure 2 reveals the major gaps in the measurement set. The company has no customer measures and only a single internal-process measure, which focuses on an initiative not an outcome. This KPI scorecard has no role for information technology (strange for a financial service organization), no linkages from the internal measure (ISO process certification) to a customer-value proposition or to a customer outcome, and no linkage from the learning and growth measure (diverse work force) to improving an internal process, a customer outcome, or a financial outcome.

KPI scorecards are most helpful for departments and teams when a strategic program already exists at a higher level. In this way, the diverse indicators enable individuals and teams to define what they must do well to contribute to higher level goals. Unless, however, the link to strategy is clearly established, the KPI scorecard will lead to local but not global or strategic improvements.

Balanced Scorecards should not just be collections of financial and nonfinancial measures, organized into three to five perspectives. The best Balanced Scorecards reflect the strategy of the organization. A good test is whether you can understand the strategy by looking only at the scorecard and its strategy map. Many organizations fail this test, especially those that create stakeholder scorecards or key performance indicator scorecards.

Strategy scorecards along with their graphical representations on strategy maps provide a logical and comprehensive way to describe strategy. They communicate clearly the organization's desired outcomes and its hypotheses about how these outcomes can be achieved. For example, *if* we improve on-time delivery, *then* customer satisfaction will improve; *if* customer satisfaction improves, *then* customers will purchase more. The scorecards enable all organizational units and employees to understand the strategy and identify how they can contribute by becoming aligned to the strategy.

APPLYING THE BSC TO NONPROFITS AND GOVERNMENT ORGANIZATIONS

During the past five years, the Balanced Scorecard has also been applied by nonprofit and government organizations (NPGOs). One of the barriers to applying the scorecard to these sectors is the considerable difficulty NPGOs have in clearly defining their strategy. We reviewed "strategy" documents of more than 50 pages. Most of the

documents, once the mission and vision are articulated, consist of lists of programs and initiatives, not the outcomes the organization is trying to achieve. These organizations must understand Porter's (1996, 77) admonition that strategy is not only what the organization intends to do, but also what it decides *not* to do, a message that is particularly relevant for NPGOs.

Most of the initial scorecards of NPGOs feature an operational excellence strategy. The organizations take their current mission as a given and try to do their work more efficiently—at lower cost, with fewer defects, and faster. Often the project builds off of a recently introduced quality initiative that emphasizes process improvements. It is unusual to find nonprofit organizations focusing on a strategy that can be thought of as product leadership or customer intimacy. As a consequence, their scorecards tend to be closer to the KPI scorecards than true strategy scorecards.

The City of Charlotte, North Carolina, however, followed a customer-based strategy by selecting an interrelated set of strategic themes to create distinct value for its citizens (Kaplan 1998). United Way of Southeastern New England also articulated a customer (donor) intimacy strategy (Kaplan and Kaplan 1996). Other nonprofits—the May Institute and New Profit Inc.—selected a clear product-leadership position (Kaplan and Elias 1999). The May Institute uses partnerships with universities and researchers to deliver the best behavioral and rehabilitation care delivery. New Profit Inc. introduces a new selection, monitoring, and governing process unique among nonprofit organizations. Montefiore Hospital uses a combination of product leadership in its centers of excellence, and excellent customer relationships—through its new patient-oriented care centers—to build market share in its local area (Kaplan 2001). These examples demonstrate that NPGOs can be strategic and build competitive advantage in ways other than pure operational excellence. But it takes vision and leadership to move from continuous improvement of existing processes to thinking strategically about which processes and activities are most important for fulfilling the organization's mission.

Modifying the Architecture of the Balanced Scorecard

Most NPGOs had difficulty with the original architecture of the Balanced Scorecard that placed the financial perspective at the top of the hierarchy. Given that achieving financial success is not the primary objective for most of these organizations, many rearrange the scorecard to place customers or constituents at the top of the hierarchy.

In a private-sector transaction, the customer plays two distinct roles—paying for the service and receiving the service—that are so complementary most people don't even think about them separately. But in a nonprofit organization, donors provide the financial resources—they pay for the service—while another group, the constituents, receives the service. Who is the customer—the one paying or the one receiving? Rather than have to make such a Solomonic decision, organizations place both the donor perspective and the recipient perspective, in parallel, at the top of their Balanced Scorecards. They develop objectives for both donors and recipients, and then identify the internal processes that deliver desired value propositions for both groups of "customers."

In fact, nonprofit and government agencies should consider placing an over-arching objective at the top of their scorecard that represents their long-term objective such as a reduction in poverty or illiteracy, or improvements in the environment. Then the objectives within the scorecard can be oriented toward improving such a high-level objective. High-level financial measures provide private sector companies with an accountability measure to their owners, the shareholders. For a nonprofit or government agency, however, the financial measures are not the relevant indicators of whether the

agency is delivering on its mission. The agency's mission should be featured and measured at the highest level of its scorecard. Placing an over-arching objective on the BSC for a nonprofit or government agency communicates clearly the long-term mission of the organization as portrayed in Figure 4.

Even the financial and customer objectives, however, may need to be re-examined for governmental organizations. Take the case of regulatory and enforcement agencies that monitor and punish violations of environmental, safety, and health regulations. These agencies, which detect transgressions, and fine or arrest those who violate the laws and regulations, cannot look to their "immediate customers" for satisfaction and loyalty measures. Clearly not; the true "customers" for such organizations are the citizens at large who benefit from effective but not harsh or idiosyncratic enforcement of laws and regulations. Figure 5 shows a modified framework in which a government agency has three high-level perspectives:

1. *Cost Incurred*: This perspective emphasizes the importance of operational efficiency. The measured cost should include both the expenses of the agency and the social cost it imposes on citizens and other organizations through its operations. For example, an environmental agency imposes remediation costs on private-sector organizations. These are part of the costs of having the agency carry out its mission. The agency should minimize the direct and social costs required to achieve the benefits called for by its mission.
2. *Value Created*: This perspective identifies the benefits being created by the agency to citizens and is the most problematic and difficult to measure. It is usually difficult to financially quantify the benefits from improved education, reduced pollution, better health, less congestion, and safer neighborhoods. But the balanced scorecard still enables organizations to identify the outputs, if not the outcomes, from its activities, and to measure these outputs. Surrogates for value created could include percentage of students acquiring specific skills and knowledge; density of pollutants in water, air, or land; improved morbidity and mortality in targeted populations; crime rates and perception of public safety; and transportation times. In general, public-sector organizations may find they use more output than outcome measures. The citizens and their representatives—elected officials and legislators—will eventually make the judgments about the benefits from these outputs vs. their costs.
3. *Legitimizing Support:* An important "customer" for any government agency will be its "donor," the organization—typically the legislature—that provides the funding for the agency. In order to assure continued funding for its activities, the agency must strive to meet the objectives of its funding source—the legislature and, ultimately, citizens and taxpayers.

After defining these three high-level perspectives, a public-sector agency can identify its objectives for internal processes, learning, and growth that enable objectives in the three high-level perspectives to be achieved.

BEYOND MEASUREMENT TO MANAGEMENT

Originally, we thought the Balanced Scorecard was about performance measurement (Kaplan and Norton 1992). Once organizations developed their basic system for measuring strategy, however, we quickly learned that *measurement* has consequences

FIGURE 4
Adapting the Balanced Scorecard Framework to Nonprofit Organizations

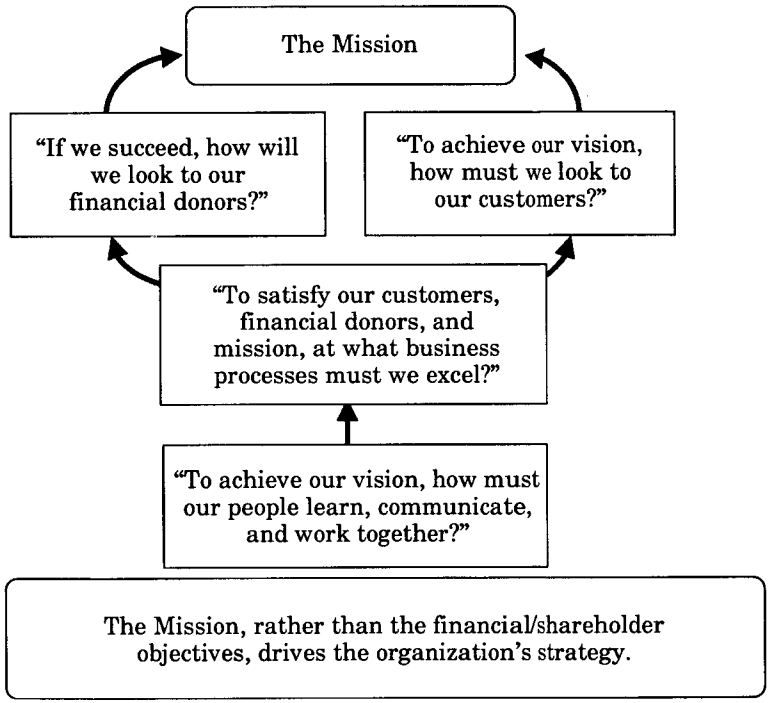
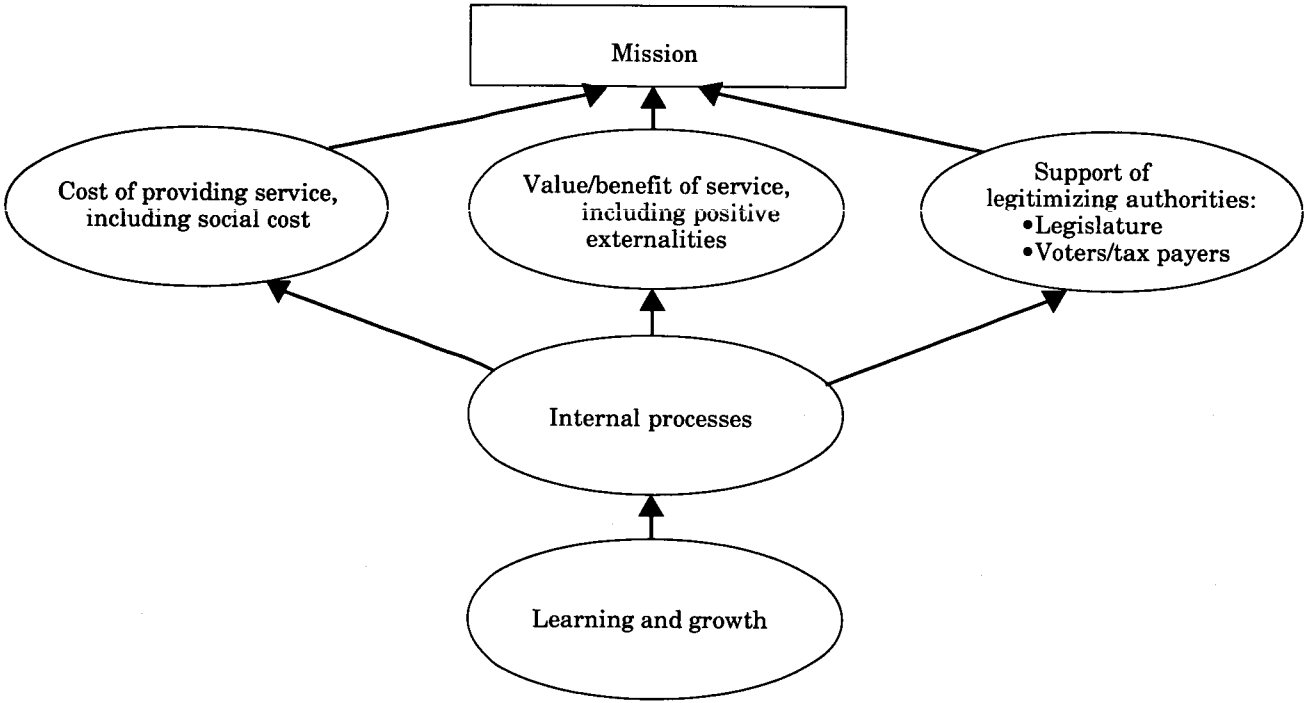


FIGURE 5
The Financial/Customer Objectives for Public Sector Agencies May Require Three Different Perspectives



Professor Dutch Leonard, Kennedy School of Government, Harvard University, collaborated to develop this diagram.

far beyond reporting on the past. Measurement creates focus for the future. The measures chosen by managers communicate important messages to all organizational units and employees. To take full advantage of this power, companies soon integrated their new measures into a *management system*. Thus the Balanced Scorecard concept evolved from a performance measurement system to become the organizing framework, the operating system, for a new strategic management system (Kaplan and Norton 1996c, Part II). The academic literature, rooted in the original performance measurement aspects of the scorecard, focuses on the BSC as a measurement system (Ittner et al. 1997; Ittner and Larcker 1998; Banker et al. 2000; Lipe and Salterio 2000) but has yet to examine its role as a management system.

Using this new strategic management system, we observed several organizations achieving performance breakthroughs within two to three years of implementation (Kaplan and Norton 2001a, 4–6, 17–22). The magnitude of the results achieved by the early adopters reveals the power of the Balanced Scorecard management system to focus the entire organization on strategy. The speed with which the new strategies deliver results indicates that the companies' successes are 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, of course, develop new products and services, and invest in both hard, tangible assets, as well as softer, intangible assets. But they cannot benefit much in two years from such investments. To achieve their breakthrough performance, the companies capitalize on capabilities and assets—both tangible and intangible—that already exist within their organizations.[5] The companies' new strategies and the Balanced Scorecard unleash the capabilities and assets previously hidden (or frozen) within the old organization. In effect, the Balanced Scorecard provides the "recipe" that enables ingredients already existing in the organization to be combined for long-term value creation.

Part II of our commentary on the Balanced Scorecard (Kaplan and Norton 2001b) will describe how organizations use Balanced Scorecards and strategy maps to accomplish comprehensive and integrated transformations. These organizations redefine their relationships with customers, reengineer fundamental business processes, reskill the work force, and deploy new technology infrastructures. A new culture emerges, centered not on traditional functional silos, but on the team effort required to implement the strategy. By clearly defining the strategy, communicating it consistently, and linking it to the drivers of change, a performance-based culture emerges to link everyone and every unit to the unique features of the strategy. The simple act of describing strategy via strategy maps and scorecards makes a major contribution to the success of the transformation program.

[5] These observations indicate why attempts to "value" individual intangible assets almost surely is a quixotic search. The companies achieved breakthrough performance with essentially the same people, services, and technology that previously delivered dismal performance. The value creation came not from any individual asset—tangible or intangible. It came from the coherent combination and alignment of existing organizational resources.

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