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Balanced Scorecard Metric Thoughts

"What you measure is what you get. Senior executives understand that their organization's measurement system strongly affects the behavior of managers and employees. Executives also understand that traditional financial accounting measures can give misleading signals for continuous improvement and innovation. The traditional financial performance measures worked well for the industrial era, but they are out of step with the skills and competencies companies are trying to master today." [1]

Managers want a balanced presentation of financial and operational measures. The balanced scorecard was developed to link measures in four perspectives…

- Innovation and learning…what must we do to improve and create value
- Internal processes…what must we excel at?
- Customer…what do customers need and how do they view our performance?
- Financial…are we generating results that satisfy owners/shareholders?

The balanced scorecard represents a cause-effect relationship between the drivers of the business and the results…it's a "do this, get that" perspective. Where most financial measures or outcome measures are "lagging" indicators, they can't be used to predict or improve performance. It's like managing your weight by standing on the scale. Knowing your weight doesn't help you lose weight. Counting calories, carbohydrates, points and how long and hard you exercise are the "leading" indicators that predict weight loss. Actual weight is the "lag" measure or result of other actions.

What makes a good scorecard?

A good scorecard is linked to the strategy of the company. The strategy map is a picture of that strategy. The metrics are how the strategy will be measured.

A good scorecard is balanced. The balance is based on…

- The perspectives…measures of all four perspectives
- Leading/lagging
- Financial/non-financial
- Internal/external…internal process effectiveness and satisfaction in meeting customer needs

A good scorecard represents the vital few measures. An objective is to limit scorecards to 20 measures….that's about 5 per perspective.

A good scorecard cascades throughout the organization. It starts with the top and moves through the organization bringing clarity and focus to all employees. Each employee should see how they directly link to the overall corporate strategy and goals. Each department and/or individual will have specific measures of their performance or task. Their job is to continuously improve their processes to ensure that the metrics are achieved. If everyone achieves their targets, the overall corporation achieves their goals.

What are performance measures?

They are the "vital signs" of an organization. They quantify how well the activities in a process or the outputs of a process meet a goal.

Performance measures tell people how they are doing. They communicate what's important throughout the organization. They are the "in-process" measures…they are what workers can control.

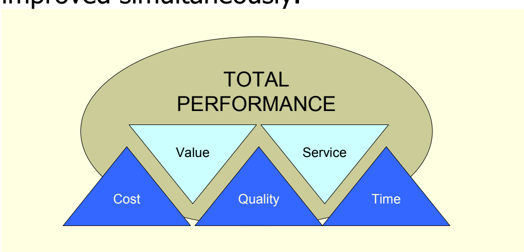
Metrics drive the strategy throughout the organization so that everyone understands how their work and performance is linked to the overall company success.

Process measures: monitor the activities of a process and motivate employees to improve the process.
Output measures: Measure results of a process.

Each organizational unit should support the process of the previous department and the next department. Departments must work together to meet customer needs, internal and external.

Process measures

Performance can be measured in terms of *quality, cost, and time*. The combination of cost and quality is "value." The combination of cost and time is "service." For significant performance improvement, quality, cost, and time must be improved simultaneously.[2]



For performance measures to be effective, people must be able to control the measure.

Lag indicators without leading measures can not predict future performance. Conversely, leading indicators without lag measures may demonstrate short-term improvements but don't show whether these improvements have lead to improved results.

Lead vs. Lag

- Lead indicators= Performance drivers
- Lag indicators= Outcome measures…Results
- Performance drivers (lead indicators) are "early indicators" of results (lag indicators)
- Cause and effect relationship
  - Do "lead"…get "lag"
- Lead and Lag applies to the design of the perspectives, as well as, within each "bubble"

What are the top measurement mistakes?[3]

1. Tracking outcome metrics that can not be controlled
2. Gathering data that tells you what you already know
3. Gathering data for its own sake
4. Relying heavily on customer satisfaction surveys
5. Executives focusing on detailed metrics
6. Measures are not linked to the strategic plan
7. Failing to define practical correlations between key metrics
8. Reporting data that is difficult to read and analyze
9. "Superstitious" process metrics
10. Measures that drive the WRONG performance

Defining metrics

When you identify a measure, it's important to fully define the measure…terms and calculations. Common terms and definitions mean that everyone follows the same rules.

One of the most important aspects in defining metrics is how it will be calculated. Will it be a raw number or a percentage? Will it be per case, per dollar of expense, per dollar of sales, etc.? If it's a per period calculation, will it be per month, per selling day, per hour, etc.? It's important to understand how each measure will be calculated to insure that it accurately reflects process performance.

Once the metric is defined and calculations are determined, you must consider how the data will be collected. Data collection might be from one or several sources. The data may already be collected or you may need to design methods. It might be done via checklists, observations, audits, analysis, other reports, etc.

Consider these things when determining data collection strategies:

- Consider a variety of approaches before settling on one method
- Evaluate the cost (time and dollars) of collecting the data
- Consider collecting the data less frequently or using a sample
- Build in appropriate controls to insure accuracy and integrity of the data
- Build in reliability checks to ensure consistency where judgment is involved

Evaluating performance measures

When considering measures on a scorecard, ask these questions:

- Is the measure controllable?
- What does the metric tell us about the process?
- Is the metric important? Does it drive results?
- How hard/easy is it to collect and report the data? Is it worth it?
- How will the metric vary over time? Will it vary due to changes in the process or will it vary due to seasonality or other uncontrollables?

Setting Targets

An essential part of any scorecard is the targets. It gives an organization something to shoot for. It determines how aggressive the organization needs to be to achieve the goals.

Targets can be expressed as single values, ranges, minimum/maximum levels of performance, or relative to others.

There are many philosophies on setting targets.

- Incremental improvement…slight improvements over previous performance
- Stretch targets…more aggressive goals that challenge the organization beyond incremental improvement
- "Big hairy audacious goals"…no clarification needed here
- Benchmarks…targets could be to achieve the level of performance of a "benchmark" organization
- Competitive performance…targets may also be set on how the organization performs verses competitors

Regardless of the philosophy for setting targets, performance must always improve.

Reviewing scorecards

On a regular frequency, scorecards are reviewed to determine how performance has improved and how effective the organization is at meeting their targets. Due to the nature of the scorecard development, management must devote time and effort to the "leading" indicators vs. sales and financial results. By focusing on the drivers of results, the things employees can control, the organization should achieve overall results.

Summary

Scorecards and metrics evolve over time. They will change. The key is to identify the vital few metrics that drive the company's strategy and results. Focus on improving those metrics and sales and profits will grow. Organizations that can identify key metrics and drive improvements will be successful.

Sources:

[1] *The Balanced Scorecard—Measures that Drive Performance* By Robert S Kaplan and David P Norton, HBR Jan-Feb '92

[2] Vital Signs: Using Quality, Time, and Cost Performance Measurements to Chart your Company's Future, by Steven Hronec, ©1993

[3] Winning Score: How to Design and Implement Organizational Scorecards, Mark Graham Brown, ©2000.