

Measuring Value Creation With The Balanced Scorecard

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There are no generally accepted frameworks for describing strategy or for describing the intangible assets on which strategy is based. Executives are still using measurement frameworks designed for "industrial economy" organizations, which emphasize measurements of tangible assets. Clearly, if we are to successfully manage in a new economy dominated by intangible assets, new management systems are needed.

Intangible assets include such things as the skills and knowledge of the workforce, the information technology available to support the workforce, and the climate that encourages innovation. Each of these assets can potentially create value for the organization - but which assets and how?

This is the essence of strategy: defining the outcomes that are desired and identifying the assets and activities required to achieve them. There are several features of these intangible assets that make them incompatible with traditional management systems:

1. Value is indirect.

Intangible assets like knowledge or technology seldom have a direct impact on tangible outcomes like revenue or profit. Typically, they have a third-order impact. For example, an investment in workforce training might improve service quality that, in turn, will impact customer confidence and retention, which might finally result in increased revenue. The tangible outcomes are separated in logic and in time from the intangible drivers. These relationships make it difficult to measure the value of an asset like "workforce knowledge."

2. Value is contextual.

All intangible assets are not equal. Some knowledge is strategic, some is tactical, and some is irrelevant. For example, competencies in customer relationship management are far more important in a firm like Goldman Sachs than they are at ebay.com, where the emphasis is on operational

efficiency, cost, and reliability. The value of an intangible asset can only be determined in the context of the strategy that creates the value.

3. Value is potential.

Tangible assets such as raw materials can be valued based on their cost, market value, etc. But the real value is created when these raw materials are transformed through processes like manufacturing into higher order products. The value of a television set far exceeds the cost of the screws, wires, and tubes of which it consists. Intangible assets are similar, except they cannot be measured based on their cost or market value, at least not in a meaningful and useful way. Such intangible assets have potential value, but the value is not real until it is transformed into tangible value. Organizational processes such as design, delivery, and service are the way that intangible assets are transformed.

4. Assets are bundled.

Intangible assets seldom create value by themselves. They must be bundled with other assets, generally other intangible assets, to create value. For example, a new sales strategy might require new knowledge, new computer systems, reorganization, and a new incentive program. Investing in any one of these assets without the others would result in failure. No value would be created.

Measurement Tools and Their Limitations

Measurement systems and related performance management systems were not designed to deal with the sophistication and complexity presented by assets that are intangible. The primary measurement systems used by organizations today fall into two categories:

Valuation systems. The balance sheet approach values the assets, liabilities, and net worth of the organization at finite points in time. Newer approaches such as EVA™ and Knowledge Capital Scorecards attempt to create more contemporary valuation approaches.

Value creation systems. The income statement approach that defines the resources consumed in a time period and the outcomes achieved. The Balanced Scorecard is a contemporary adaptation of such a system.

Because the value of an intangible asset is contextual, valuation systems have difficulty creating a "granular" view of assets. Most approaches to measuring

intangible value look at macro-measures such as market-to-book ratios but do not focus on the value of specific assets. Value creation systems are limited in a number of ways as well. Because they monetize all parameters, they are unable to describe value creating factors like cycle times, experience levels, turnover, etc. Timing presents a major limitation. While accrual accounting attempts to match resource consumption with outcomes, these approaches degenerate into ways to manage earnings instead of managing value. Clearly, the tools of performance measurement must adapt to meet the needs of the knowledge economy.

Measuring Value Creation - The Balanced Scorecard

The Balanced Scorecard was developed to address these problems. The approach was based on the simple premise that (1) the creation of value consistent with the mission is the overarching purpose of organizations and (2) strategy defines the unique organizational approach to creating value. Thus, a measurement system designed to influence behavior should describe the strategy, instead of describing pieces of the strategy (e.g., financial, customers, quality, etc.). The measurements are derived from a description of the strategy that we call a strategy map. This combination of measurement and mapping provides tools that have been used in numerous organizations to successfully execute strategy.

Cause-and-Effect Relationships

Strategy is a hypothesis. Strategy implies the movement of an organization from its present position to a desirable but uncertain future position. Since the organization has never been to this future position, the pathway of how it intends to get there involves a series of linked hypotheses. The Balanced Scorecard enables the strategic hypotheses to be described as a set of cause-and-effect relationships that are explicit and testable. Further, the strategic hypotheses require identifying the activities that are the drivers (or lead indicators) of the desired outcomes (lag indicators).

Through this logical architecture, we are able to describe the indirect linkage between the intangible assets - the drivers of strategy - and the tangible results, which are outcomes.

Value-Creating Processes

Strategy is almost always decomposed into several focused themes that allow the organization to deal simultaneously with the conflicting priorities of long-term and short-term. The themes relate to the way that value is created over

different time horizons through different internal processes. Strategic themes can be segmented into the following categories.

- Build the franchise. The long-wave of value creation; developing new products and services, and penetrating new markets and customer segments.
- Increase customer value. Expand, deepen, or redefine relationships with existing customers (e.g., cross-sell services, become trusted advisor) through multiple sales cycles.
- Operational excellence. The short wave of value creation through internal productivity and supply chain management that enables production and delivery of existing products and services.
- Good corporate citizen. Manage relationships with external, legitimizing stakeholders, especially in industries subject to regulation (e.g., utilities), and/or environmental risk (e.g., petrochemicals).

Each of the four strategic themes provides a "pillar" for the strategy and contains its own strategic hypothesis, its own set of cause-and-effect relationships, and occasionally, even its own scorecard. Each of these themes is related to a process that transforms the potential value of intangible assets into tangible shareholder value.

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ABOUT THE BALANCED SCORECARD

The Balanced Scorecard (BSC) concept—created by Drs. Robert S. Kaplan and David P. Norton in 1992—has been implemented in thousands of corporations, organizations, and government agencies worldwide. Based on the simple premise that “measurement motivates,” the BSC puts strategy at the center of the management process, allowing organizations to implement strategies rapidly and reliably.

The Balanced Scorecard Hall of Fame™, awarded to organizations that have achieved breakthrough results through the use of the Balanced Scorecard, includes notable companies such as CIGNA P&C, National Reconnaissance

Office, Wells Fargo Bank, Mobil USM&R, Hilton Hotels, City of Charlotte, and UPS.

The BSC has been the subject of four articles in the Harvard Business Review (HBR); two best-selling business books that have been translated into 19 languages and numerous case studies and public conferences worldwide. The editors of HBR identified the BSC as one of the most significant management ideas of the past 75 years.

ABOUT BALANCED SCORECARD COLLABORATIVE, INC.

Led by Balanced Scorecard creators Drs. Robert S. Kaplan and David P. Norton, Balanced Scorecard Collaborative, Inc. (BSCol) is a new kind of professional services firm dedicated to the worldwide awareness, use, enhancement, and integrity of the Balanced Scorecard as a value-added management process.

We help organizations successfully execute strategy to create breakthrough results. As long-term partners in our client's success, we build the capability to execute strategy and accelerate time to results. BSCol offers a wide variety of services for organizations at any stage of developing and using the Balanced Scorecard -- our educational, coaching, consulting, training, and online services can be tailored to develop solutions for organizations small and large throughout the world.

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