Balanced Scorecard (BSC) – Cockpit of your business

"The Balanced Scorecard (BSC) provides managers with the instrumentation they need to navigate to future competitive success."
— Robert S. Kaplan, The Balanced Scorecard: Translating Strategy into Action

Introduction

We are all familiar with the maxim – 'What gets measured, gets done!'. But what should be measured for managing a business effectively. Should one measure profits at the end of a period or should one measure customer satisfaction? Even when profits are being monitored, it is of limited use, if it is a number declared at the end of a period. And entrepreneur would benefit significantly if he/she is provided by a metric(s) which are actionable.

As a driver of any business, an entrepreneur must watch multiple parameters. For example, the entrepreneur must keep a close tab on existing customer orders and concurrently also devote resources for developing new product or service offerings. The entrepreneur must also keep an eye over the operations processes while maintaining the plant and machinery in optimum conditions. And while doing all this, the entrepreneur must ensure that his employees are delivering their best contribution and preparing to learn new skills for future performance. And having done all this the entrepreneur seeks revenue growth and returns better than the cost of capital. Any entrepreneur would wish for a dashboard for managing a business, like the one in an automobile. The BSC is a dashboard and cockpit for managing the business. It presents a curated overview of the health of the business for the entrepreneur and the leadership team.

Proactive business leaders design their own BSC and manage their business for achieving current goals and prepare for future challenges. This article presents an overview of the concept and guides the reader through methodology of designing a BSC.

Genesis

The concept of BSC was first proposed by two professors at Harvard Business School - Prof Robert Kaplan (Harvard) and Prof. David Norton – in 1992. Prior to their proposal, they undertook a study to find out how successful organization monitor business performance. After studying the results of several successful organisations, they found that successful organisations also monitor set of metrics other than Financials. Based on the findings of their study, they proposed the idea of the BSC in the *Harvard Business Review* article, "The Balanced Scorecard: Measures That Drive Performance". Since then, BSC has been globally accepted as a Strategy Management tool.

Features of the BSC

The BSC differs from conventional business metrics on two aspects:

1. It differentiates between Lag and Lead indicators
2. It strikes a balance between Financial and other business indicators

These differences have been explained in the following sections

Lead and Lag Indicators

During their study of successful organisations, Kaplan, and Norton, found that these organisations differentiate between lag and lead indicators. They found that conventional companies focused on measuring 'L**ag indicators'**, which were of limited utility, in terms of early warning and actionability. When a business tracks 'Lag Indicators', the possible action at the disposal of the leader is Diagnostics (or a post-mortem). Some examples of 'Lag Indicators' could be Market Share, Profits, share prices, et al. Successful companies on the other hand, focused on measuring **'Lead Indicators'**, which are both actionable and serve as early warning system, using Predictive Analytics. Acting on the trends of such 'Lead indicators' results into performance that meet the stakeholders' expectations. Some examples of 'Lead Indicators' could be Net Promotor Score, Free Cash Flow, Employee Engagement Score, et al.

Let's understand the difference with an aid of an example. The promoters' expectation of making their business stock as 'Blue-chip stock/ Part of Nifty50' is a 'Lag Indicator'. Whereas monitoring 'Free Cashflow', 'Revenue Growth', 'Asset Turnover' and 'Profit margins', which are all examples of 'Lead Indicators', and improving them could lead to meeting the stakeholder's expectations.

The 'Balance' in the BSC

"The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation. "
Prof. Kaplan and Norton

In a BSC, the financial indicators, which are usually the lag indicators are grouped under the quadrant – Financial perspective. And the lead indicators are grouped under the remaining three quadrants, namely, Customer perspective, Internal processes, and Learning & Growth. Successful companies not only track and work upon the financial indicators; but strike a "balance" by tracking and working upon the indicators pertaining to their Customers, Processes and Learning & Growth capabilities.

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Four quadrants of the BSC

Financial Perspective (Quadrant 1)

In this quadrant, a company tracks its financial indicators. These could be Revenue, Net Profit, Free cashflow, Return on Capital Employed, Savings through Cost reduction projects, Working Capital Cycle, and others.

Customer Perspective (Quadrant 2)

In this quadrant, a company tracks the first set of lead indicators pertaining to customers. These could be increase in market share, revenue from new products, exports revenue, new segments entered, number of innovations launched, customer complaints, product quality, brand standing, customer and industry recognition, and others.

Internal Process Perspective (Quadrant 3)

In this quadrant, a company tracks the process indicators, that design and deliver value. These could be number of customers' irritations addressed in new products, adherence to new product development process by a project, time to launch the product, process capability index, Operational Equipment Efficiency (OEE) index, and others.

Learning & Growth Perspective (Quadrant 4)

In this quadrant, a company tracks the capability building efforts of its employees. These could be employee engagement scores, number of experiments to try out new concepts and business models, training taken to learn new skills, industry academia, and others.

Cause and Effect equation of the BSC and Strategy Maps

After understanding the four perspectives of the BSC, one question comes to the mind," How does one evolve such indicators. Ideally, a BSC should be formulated after the strategy of the business is finalised. The ideal sequence of activities in a strategy formulation exercise would be: 1. Core Purpose and Values identification=> 2. Vision statement formulation=> 3. Strategy Analysis=> 4. Mission statement/ long-term roadmap=> 5. BSC formulation=>6. Policy Deployment=> 7. Goal setting for employees.

However, in absence of a formal strategy formulation process, the leadership team could attempt to build their company's BSC, in the following sequence:

1. **Financial Perspective:**

   The team could start by envisaging financial performance that meet or exceed their stakeholders'/shareholders' expectations. They could start by attempting to answer the question: "To succeed financially, how should we appear to our shareholders?". Once they have answered the description of financial performance success, they could

narrow down to the indicators that would report the manifestation of success. These indicators can be imagined as the 'dependent variables (Y) in the equation $Y=f(x)$.

2. **Customer Perspective:**

Manifestation of financial success is possible only by satisfying the customer, who values the products/services. Hence, the team could then attempt to address the question: "To achieve our vision, how should we appear to our customers?" The answers to this question could be summed up in terms of product portfolio, customer access points, cost-savings, differentiation, innovation, brand image, services, and solutions offerings. And subsequently, the team could identify the indicators to track the progress of these customer offerings. These indicators can be imagined as the first set of independent/causal variables (X) in the equation $Y=f(x)$

3. **Internal Processes Perspective:**

The team could then shift the focus to internal processes. They could then attempt to answer the question: "To satisfy our shareholders and customers, what business processes must we excel at?" The answers to these questions could be the set of process-indicators across the value-chain. These indicators can be imagined as the second set of independent/causal variables (X) in the equation $Y=f(x)$.

4. **Learning & Growth Perspective:**

Having drawn the vivid pictures of stakeholders and customer success, the team could then reflect on their employees and the current capabilities. They could pose a question to self: "To achieve our vision, how will we sustain our ability to change and improve?" The answers to these questions could be given by initiatives related to employee engagement, training and development, experimentation, and others. And subsequently the team could identify the indicators to track the progress of these capability building and employee engagement initiatives.

In all, a BSC could have 15-20 indicators divided over the 4 quadrants. Many companies apportion weightages to objectives and quadrants for driving their Performance Management Systems.

Strategy Map

To help companies in evolving the BSC, Prof. Kaplan and Norton, proposed the use of 'Strategy Map'. A strategy map is an abstract tool to evolve the BSC and communicate the strategy of the company. One start building a strategy map by starting from Financial Perspective and working backwards up to Learning initiatives. A generic strategy map is shown below.

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4
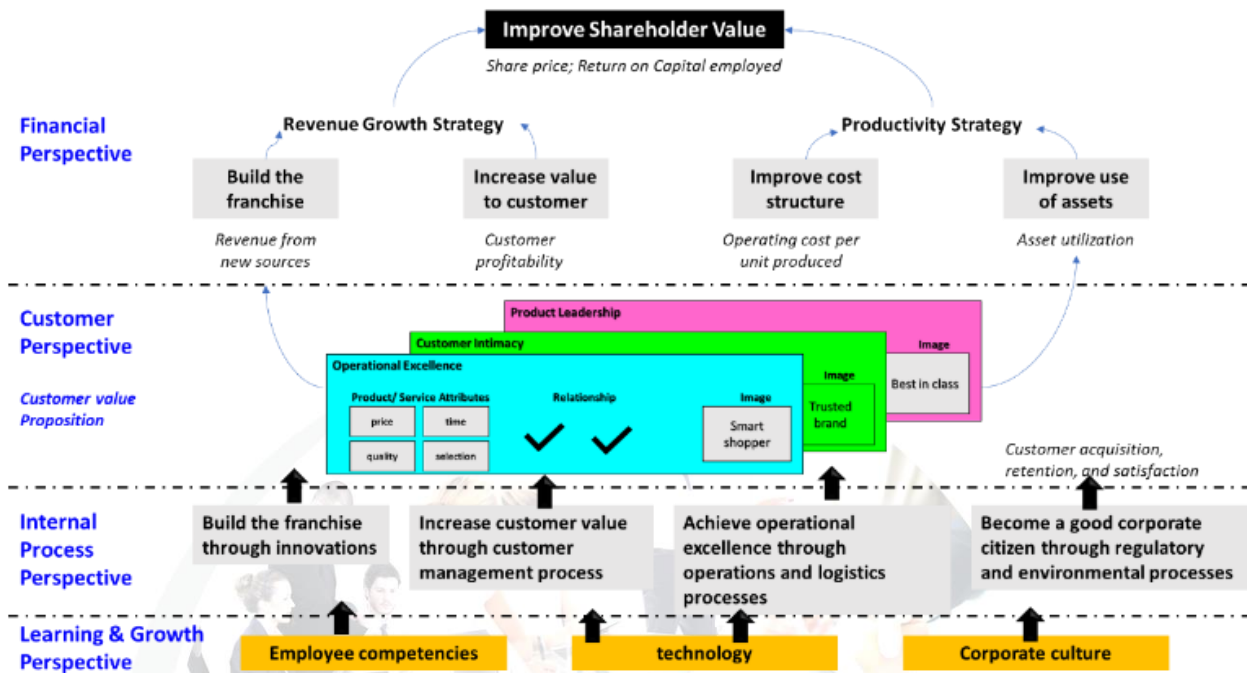
Uses of BSC

The proponents – Kaplan and Norton – developed BSC as a business cockpit. Over the years, the BSC has evolved in terms of its utility. Some of the uses of BSC are:

1. Communicate what the organisation is trying to accomplish

2. Align the day-to-day work that everyone is doing with strategy

3. Prioritize projects, products, and services

4. Measure and monitor progress towards strategic targets

BSC of a Forgings Company (Sample)

To illustrate how companies use the BSC, we have created a BSC for a **hypothetical** forgings company. This company from India, supplies forging predominantly to Automotive OEMs. It has drafted a strategy to grow through diversifying into other market segments. The company has identified Railways and Defence as target segments. It also wants to reduce dependence on domestic market by focusing on exports, particularly Africa.

To manifest the diversification and growth options, it seeks to improve on its Operational Excellence and build new capabilities for tomorrow. After studying their strategy, the following BSC is proposed for the forgings company.

Perspective	#	Objective	Metric	Units	FY21 Target	Weightage
Finance	1	Grow revenue	Net Revenue	Rs Cr	1200	15%
	2	Improve Profits	PAT	Rs Cr	120	10%
	3	Generate cash for future expansion	FCF	Rs Cr	50	10%
Customer	4	Develop Non-auto business - Railway	Revenue from Railway segments	Rs Cr	60	5%
	5	New product introduction	No. of applications	#	4	5%
	6	Defence Tie-up	Approval of partnership by GOI	Timeline	by Q4	5%
	7	Offer design capabilities to customer	No. of products with >25% GC margin	#	4	5%
Internal Business Process	8	Develop capability to process Maraging steel	Complete the development project along with IIT	Timeline	by Q2	5%
	9	Offer Non-auto customers small lead-time	lead-time for Non-auto	Time (weeks)	2	5%
	10	Get quality right first time, every time for Auto products	FTR ratio	%	80%	5%
	11	Improve yield through use of Computational	Yield improvement in Al-forgings for Auto	%	90%	5%

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Perspective	#	Objective	Metric	Units	FY21 Target	Weightage
		Fluid Dynamics (CFD) analysis				
Learning & Growth	12	Drive the Digitalisation journey	Executive of digital transformation projects	#	10	10%
	13	Create Forging design experts with help of IIT	No. of experts developed	#	10	5%
	14	Strive to foster gender diversity	% Of women engineers in pool	%	20%	5%
	15	Work on findings of employee survey	FY20 action plan execution	Timeline	by Q3	5%
						100%

Deployment of BSC using Policy Deployment

Progressive companies build upon the BSC and cascade the objectives to the targets for functions and employees, using the approach of Policy Deployment (also known as X-matrix and 'Hoshin-Kanri' (Japanese)). To illustrate the Policy Deployment exercise, we have taken one objective from the BSC of the forgings company. Here the objective of 'Developing Non-auto Business – Railway' would happen only when all functions come together and contribute. www.definetraining.com

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7

Objective	Metric	Unit	Target	Weight	Guidelines/Initiatives	Target	Function	Engineering	Purchase	Production	Quality Assurance	Business	Marketing
Develop Non-auto Business	Railway segment revenue	Rs. Cr	60	5%	Operational excellence for existing orders (OTIF)	90%			**	**			*
					Develop new products by Q2 (no. of products)	4		**	*	*	*	**	
					Entry into Africa market -revenue from African countries from Q4	Rs. 10 Cr		**				**	**
					Establish our name in global rail equipment industry	Execute promotion plan		*				**	**

Note: ** - indicate main responsibility and * - supporting role

Maturity levels in use of BSC

Businesses can start using BSC and then mature in terms of its deployment. We have projected three levels of maturity in use of BSC

Maturity level	Walk	Run	Fly
Status	Set of Indicators organised in 4 quadrants	Objectives and metrics evolved using strategy map	Objectives of the organisation converted into goals for functions and employees

BSC is the most effective way of communicating the company's strategy to employees and other stakeholders. It also helps in aligning employees and partners with the company's vision and mission.