

The Balanced Scorecard: Issues and Resolution

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The balanced scorecard, as presented by Kaplan and Norton in a 1992 Harvard Business Review article¹, tracks the business in the areas of financial, customer, internal processes, and learning and growth. In this model, each area is to address one of the following questions:

- Financial: To succeed financially, how should we appear to our shareholders?
- Customer: To achieve our vision, how should we appear to our customers?
- Internal business process: To satisfy our shareholders and customers, what business processes must we excel at?
- Learning and growth: To achieve our vision, how will we sustain our ability to change and improve?

These metrics are to align with the business vision and strategy, where each category is to have objectives, measures, targets, and initiatives.

Scorecard balance is important because if you don't have balance you could be giving one metric more focus than another, which can lead to problems. For example, when focus is given to only on-time delivery, product quality could suffer dramatically to meet ship dates. However care needs to be given to how this balance is achieved. A natural balance is much more powerful than forcing balance through the organizational chart using a scorecard structure of financial, customer, internal business process, and learning and growth that may not be directly appropriate to all business areas. In addition, a scorecard structure that is closely tied to the organization chart has an additional disadvantage in that it will need to be changed whenever significant reorganization occurs.

Integrated Enterprise Excellence (IEE) is a sustainable business management governance system, which integrates business scorecards, strategies, and process improvement so that organizations move toward the 3 Rs of business (everyone is doing the Right things and doing them Right at the Right time). IEE provides the framework for innovation and continual improvement, which goes beyond Lean Six Sigma's project-based defect and waste-reduction methods. The existence and excellence of a business depends on more customers and cash; or, $E = MC^2$. As a business way of life, IEE provides the organizational orchestration to achieve more customer and cash.

In Integrated Enterprise Excellence (IEE), natural scorecard balance is achieved throughout the business via the enterprise value chain, noting that overall learning and growth would typically be assigned to HR but, when appropriate, can also be assigned to other functional performance areas. Metrics are assigned an owner who is accountable for the metric's performance. These metrics can be cascaded downward to lower organization functions, where these metrics also are assigned owners who have performance accountability. With this IEE system, whenever there is an organizational change the basic value-chain metrics will not change, only the ownership.

When creating these metrics it is not only important to determine *what to measure* but it is also very important to focus on the *how to report these measures* so that this metric performance tracking leads to the most appropriate action, which maybe to do nothing. The balanced scorecard system is to have a vision and strategy from which functional objectives, measures, targets, and initiatives are to be cascaded throughout the organization chart. I will describe this system and then note some methodology shortcomings which are overcome by an IEE implementation.

Jim Collins describes, in *Good to Great*, a level five leader as someone who is great while leading an organization and whose affect remains after the person is no longer affiliated with the organization. I describe the level-five-leader-created legacy as being a *Level Five System*.

In my workshops, I often ask, "do you think your organization's strategy would change if there were different leadership?" A vast majority give a positive response to this question. Because of this, it seems to me that it would be very difficult for an organization to create a Level Five System when the primary guiding light for the organization is its strategy, which can change with new leadership.

I don't mean to imply that organizational strategies are bad, but I do believe that strategies created without structurally evaluating the overall organizational value chain and its metrics can lead to unhealthy behavior. To illustrate this, consider the following example.

Parameters for a global service corporation's dashboard were defined by the following underlying strategic executive goals for the year:

Grow revenue 25 percent per year, earn minimum of 20 percent net profit, achieve 60 percent of revenue with repeat customers, balance regional growth, fill open positions corresponding with growth, ensure that all employees are competent and high performers, realize projects within time and cost targets, limit ratio of overhead to productive time to 20 percent, and satisfy customers 100 percent.

These objectives, measures, targets, and initiatives were then set up to be monitored, where each metric is to have an owner. Color-coding is used to help clearly identify actual performance versus targets and forecasts. Exclamation marks can indicate red flags, where objectives are not being met and attention is needed.

These executive dashboard metrics can then be drilled down further. The strategic objectives described previously set a customer-satisfaction metric goal of 100 percent. Not a bad target; however, meeting this number is not easy. Simply setting this goal will not make it happen, at least not as the team setting the goal would like it to happen. One might wonder how this goal was determined. Do you think this goal is SMART; that is, specific, measurable, actionable, relevant, time-based?

For this metric type, an unachieved goal earns a red exclamation mark, indicating that the metric's owner may need reminding that his or her job-performance rating depends on achievement of this goal. What kind of activity might this type of pressure create, especially when improvement detection is immediately needed? We might initially think that the owner would, as soon as possible, start an investigation into where quality improvements need to be made. But we need to be realistic. Immediate improvements are needed to make this scorecard look better. Might there be other ways to make this happen?

Before we react, let's step back to see the bigger picture. A customer-satisfaction goal is not being met; however, is this level of customer satisfaction really a problem? What were the scores from previous reporting periods? If the scores are better now, this would be good since improvements are being demonstrated—even though the strategic goal is not being met. Without a historical time-dependent reference, could there be disagreements for what is good or bad?

Keeping in mind the type of metric described, consider the following situation:

A few years ago, when my wife and I were buying a new car, negotiating the price of the car with the sales associate got to be a game with me. After we closed the deal, the sales associate pointed to a survey that was facing us under his Plexiglas desktop. This survey had all 5s checked. He told us that we would be getting a survey in the mail. Then he said that he always gets 5s on his survey. He pointed to my wife and said that he wanted her, not me, to fill out the survey.

Consider the following points:

- The salesman said we would receive a survey in the mail.
- He pointed out that he always gets 5s, as noted on the survey form on his desk.
- He wanted my wife, not me, to fill out the survey.

Do you think he might be trying to bias the survey in his favor—perhaps a bonus is riding on these results? Do you think this type of behavior is what the metric should be creating? This is one form of trying to manage the output of the metric process, rather than systematically working to change the process, or the inputs to the process, so that an improved response occurs. Simply setting high-level goals and then managing to those goals, can lead to the wrong behavior. Making true long-lasting gains in customer satisfaction is more involved than working to get satisfactory scores on evaluation sheets. Attaining long-lasting customer satisfaction involves improving the process and the inputs to the process.

Consider a profit scorecard that has the x -axis units of 1 to 12 months, where 1 is the first month after the company's fiscal year. For this type chart tracking is made only against the goal with no indication of what kind of performance has been experienced in the past. Since the goals are annualized, the target line is drawn beginning the first month of the year, but there is no record of performance the previous year, nor whether the goal is reasonable or simply a pie-in-the-sky objective.

If people are really held accountable for achieving this metric objective, very undesirable behavior can result. Since there is an exclamation point, the owner of this metric would need to take immediate action to drive these numbers in the right direction. A high-level metric such as this could lead to the Enron effect, where money could be

simply shifted from one area to the next to make things look better. Or the metric could lead to immediate cost-cutting measures that might significantly damage the company's future outlook. You can cost cut toward achieving increased profitability for only so long. At some point in time you will see diminishing returns and possible increase in fixed costs due to inefficiencies created by a lack of resources. This form of metric reporting can also lead to Krispy Kreme shipping donuts that they knew would be returned so that quarterly expectations would be met.

Metric reporting, where focus is given only to whether output-type goals are met, can cause behavioral problems lower in the organization as well. Consider the following:

A prison representative purchased a commodity item only at the end of the supplier's quarterly financial reporting period. Near the end of every quarter, the salesperson for the supplier called, offering the prison a price incentive for immediate purchase. Because of the type of product sold, there was no reason for this cyclic behavior. Since manufacturing personnel were on overtime and were under pressure to increase production volume, quality problems were more prevalent during this period than others.

This odd behavior was eventually noticed and an investigation conducted. Asked why the prison waited until the end of the quarter to purchase the product, the representative responded that the salesperson called at the end of the quarter with a discounted price.

Additional company investigation revealed that the salesperson typically had difficulty meeting his quarterly target objective. Near the end of every quarter, the salesperson would ask his manager for approval to give customer discounts, which would help their department meet its targeted goals. If these goals were not met, there would be no personal or departmental bonuses. The manager routinely complied.

What makes this situation even worse is that the salesperson was getting paid off the top line (total products sold), while the company was taking a significant impact at the bottom line. That is, the salesperson was getting rewarded for total products sold, while the company's true profit from the transaction was reduced by the sales commission as well as additional overtime costs due to demand spike.

All these negative corporate-profitability behaviors originated with the company's salesperson commission policy. Rather than someone noticing and investigating, this type of situation could be readily identified in an IEE Enterprise process Define-Measure-Analyze-Improve-Control (E-DMAIC) structure during the analyze phase. In this structure, a project could have been created that later resolved the undesirable behavior of the sales department through changing either the reward policy or discounting policy so that these demand spikes would no longer occur.

The shortcomings of many traditional performance metrics are that they often reflect only fiscal year metrics, make comparisons to a point estimate from a previous month or year, and don't have a procedure for improving the process so that gains occur and are maintained. These traditional methods don't view the enterprise process as a system of processes, where the performance metric is the result of these processes along with the

variability that occurs within them. Long-lasting change is a result of systematic improvements to these processes.

This form of metric reporting is always after-the-fact reporting and not predictive. Imagine if a customer said, “Based on past experience, our products will have a consumer half-life of only years. If innovations and improvements are not sustained, our revenues will decline by X percent over the next Y years.” This type of data-driven statement, which is available in an IEE system, leads to long-term thinking that can have long-lasting results.

The Integrated Enterprise Excellence four book series^{2,3,4,5} provides the framework for blending innovative thoughts with analytics so that in the end the organization as a whole benefits. IEE provides a guiding light system for creating a healthy no-nonsense 21st Century Business Governance System for policy creation/deployment that integrates scorecards, strategic planning, business improvement, and control.

The American Management Association (AMA) describes the IEE system in a 2008 winter issue article⁶. The system that is described in this article can become a guiding light for management to make good, healthy decisions for their organization.

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In a professional career spanning over a quarter century, Forrest Breyfogle has established himself as a leading edge thinker, a prolific author, an innovative consultant, a world-class educator, and a successful business executive. His work is documented in eleven books and over ninety articles on the topic of quality improvement.

A professional engineer, Forrest is also a member of the board of advisors for the University of Texas Center for Performance Excellence. He is the founder and CEO of Smarter Solutions, Inc., an Austin, Texas based consulting firm offering business measurement and improvement consultation and education to a distinguished list of clients worldwide, including BAMA, CIGNA, Dell, HP, IBM, Oracle Packaging, Sherwin Williams, Cameron, TIMET, and TATA. He served his country on active

duty in the US Army for 2 years, and has played an active leadership role in professional and educational organizations. Forrest received the prestigious Crosby Medal from the American Society for Quality (ASQ) in 2004 for his book, *Implementing Six Sigma* (second edition). This award is presented annually by the American Society for Quality to the individual who has authored a distinguished book contributing significantly to the extension of the philosophy and application of the principles, methods, or techniques of quality management

He is a widely recognized authority in the field of management improvement and is a frequent speaker before professional associations and businesses. His earlier work in the field of management science has been widely acclaimed. A previous book, *Implementing Six Sigma*, sold over 40,000 copies and still ranks among the top Amazon books in Applied Mathematics/Engineering Statistics and Industrial Engineering /Quality Control.

He founded Smarter Solutions in 1992 after a 24-year career at IBM. The associates of Smarter Solutions specialize in helping companies throughout the world improve their bottom line and customer satisfaction through the implementation of techniques that are beyond traditional Lean Six Sigma and the balanced scorecard methodologies. His latest and most extensive work has been in the documentation of a new system of enterprise management, the Integrated Enterprise Excellence (IEE) system, in a series of four books. IEE provides a detailed roadmap that builds on and integrates the best practices of earlier disciplines like Six Sigma, Lean, TQM, PDCA, DOE, and TPS combined with innovative analytical tools to produce improvements at the highest level of an enterprise.

In addition to assisting hundreds of major clients in the wise implementation of improvement systems worldwide, Forrest has also developed over 300 hours of classroom instruction used to train executives, managers, and Black Belt practitioners to plan for, implement, and manage IEE systems. He also leads formal seminars and workshops worldwide.

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