8

The Balanced Scorecard: Measuring Total Business Unit Performance

Companies are now shifting from industrial age competition to information age competition. During the industrial age, financial control systems were developed in companies, such as General Motors, DuPont, Matsushita, and General Electric, to facilitate and monitor efficient allocations of financial and physical capital.[1] Summary financial measures, such as operating profits and return-on-capital-employed, could evaluate the effectiveness and efficiency by which operating divisions used financial and physical capital to create value for shareholders. We will discuss such financial control measures in Chapters 9 and 10.

The emergence of the information era, however, has made obsolete many of the fundamental assumptions of industrial age competition. No longer can companies gain sustainable competitive advantage just by rapidly deploying new technology into physical assets or by excellent management of financial assets and liabilities. The information age environment for both manufacturing and service organizations requires new capabilities for competitive success. The ability of a company to mobilize and exploit its intangible or invisible assets has become far more decisive than investing in and managing physical, tangible assets.[2] Intangible assets enable an organization to:

- Develop customer relationships that retain the loyalty of existing customers and enable new customer segments and market areas to be served effectively and efficiently
- Introduce innovative products and services desired by targeted customer segments
- Produce customized high-quality products and services at low cost and with short lead times
- Mobilize employee skills and motivation for continuous improvements in process capabilities, quality, and response times
- Deploy information technology, data bases, and systems

As companies invested in programs and initiatives to build their capabilities, however, the primary evaluation system consisted of monitoring progress by means of monthly, quarterly, and annual financial reports. Ideally, the financial accounting model should have expanded to incorporate the valuation of the company's intangible and intellectual assets, such as high-quality products and services, motivated and skilled employees, responsive and predictable internal processes, and satisfied and loyal customers. If intangible assets and company capabilities could be valued within the financial accounting model, organizations that enhanced those assets and capabilities could communicate this improvement to employees, shareholders, creditors, and communities. Conversely, when companies depleted their stock of intangible assets and capabilities, the negative effects could be reflected immediately in the income statement. Realistically, however, difficulties in placing a reliable financial value on assets—such as a new product pipeline, process capabilities, employee skills, motivation, flexibility, customer loyalties, data bases, and systems—precluded them from ever being recognized in organizational balance sheets. Yet these are just the assets and capabilities that are critical for success in today's and tomorrow's competitive environment.

THE BALANCED SCORECARD

The Balanced Scorecard (BSC) was developed to communicate the multiple, linked objectives that companies must achieve to compete on the basis of capabilities and innovation, not just tangible physical assets. The Balanced Scorecard translates mission and strategy into objectives and measures, organized into four perspectives: financial, customer, internal business process, and learning and growth (see Exhibit 8-1).

Financial Perspective

The Balanced Scorecard retains the financial perspective since financial measures are valuable in summarizing the readily measurable economic consequences of actions already taken. Financial performance measures indicate whether the company's strategy, implementation, and execution are contributing to bottom-line improvement. Financial objectives typically are related to profitability—measured, for example, by operating income, return-on-capital-employed, or, more recently, economic value added. Alternative financial objectives can be rapid sales growth or generation of cash flow.

Customer Perspective

In the customer perspective of the Balanced Scorecard, managers identify the customer and market segments in which the business unit will compete and the measures of the business unit's performance in these targeted segments. The customer perspective typically includes several core or generic measures of the successful outcomes from a well-formulated and implemented strategy. The core outcome measures include customer satisfaction, customer retention, new customer acquisition, customer profitability, and market and account share in targeted segments (see Exhibit 8-2).

These measures may appear to be generic among all types of organizations. For translating a particular strategy, however, they should be customized to the targeted customer groups from whom the business unit expects its greatest growth and profitability to be derived. We provide more-detailed descriptions of these core customer outcome measures in Chapter 11.

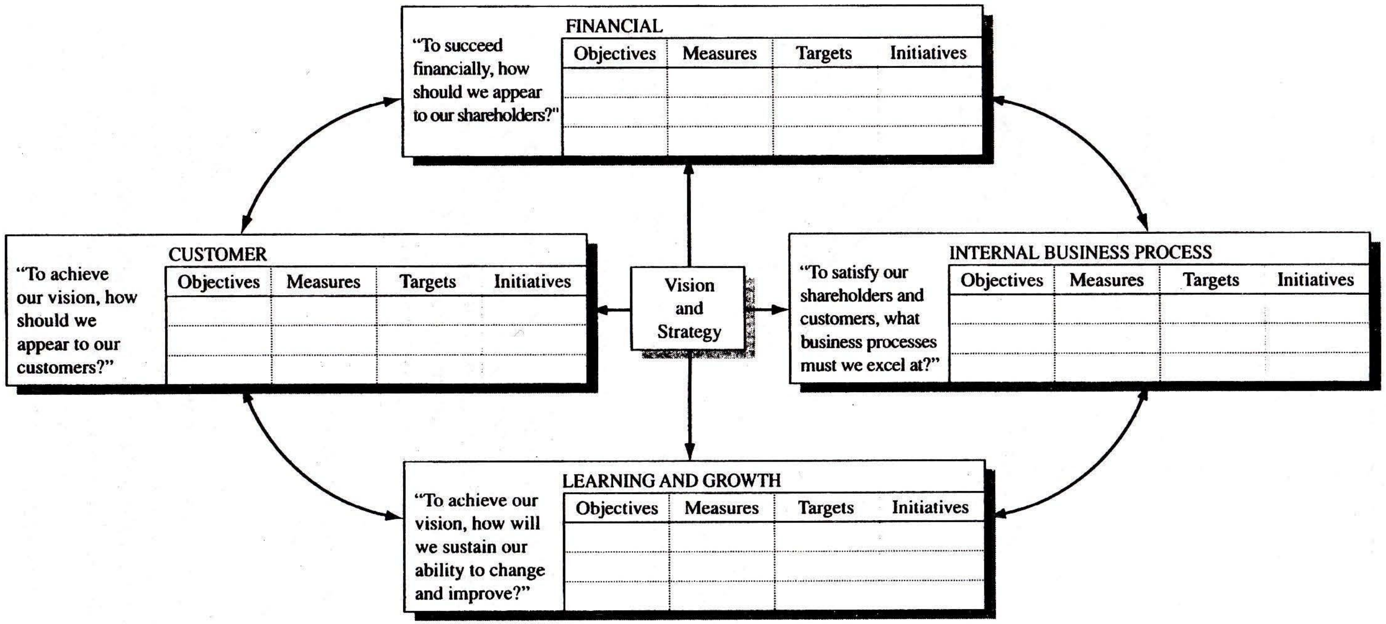

EXHIBIT 8-1 Translating Vision and Strategy: Four Perspectives

Source: R. S. Kaplan and D. P. Norton, *The Balanced Scorecard: Translating Strategy into Action* (Boston: Harvard Business School Press, 1996), p. 9.

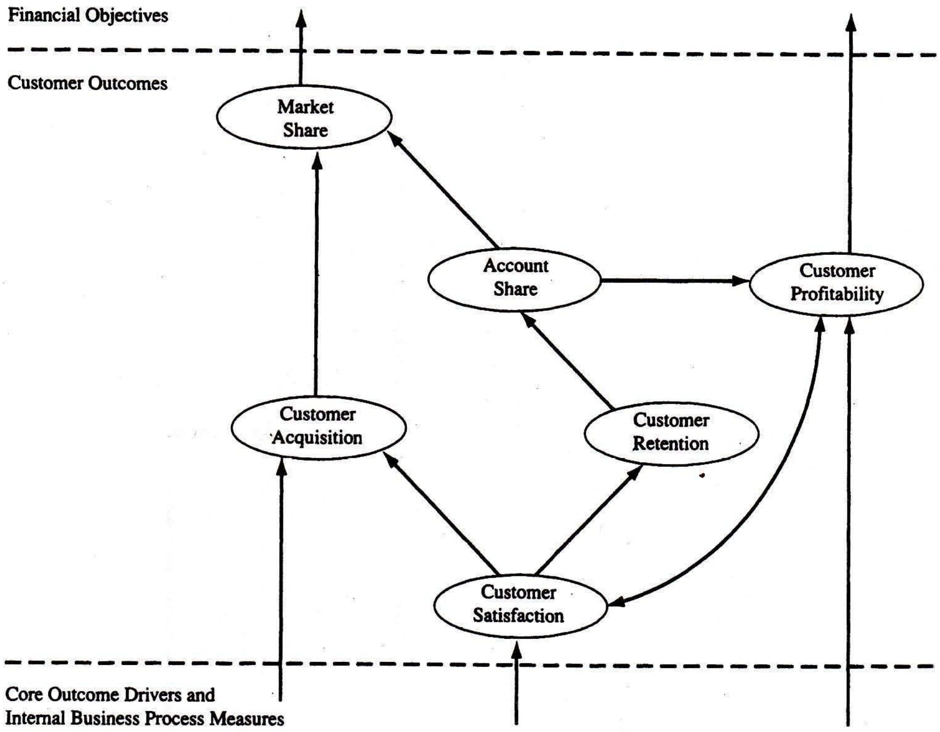

EXHIBIT 8-2 Customer Perspective: Core Outcome Measures

Source: R. S. Kaplan and D. P. Norton, "Linking the Balanced Scorecard to Strategy," *California Management Review* (Fall 1996), p. 59.

What truly makes a strategy unique is the value proposition the business unit decides to deliver to attract and retain customers in its targeted segments. Although value propositions vary among industries, and among market segments within industries, we have observed a common set of attributes that organizes the value propositions in many manufacturing and service industries. These attributes are organized into three categories (see Exhibit 8-3):

- Product and service attributes
- Customer relationship
- Image and reputation

Product and service attributes encompass the functionality of the product or service, its price, and its quality. The **customer relationship** dimension includes the delivery of the product or service to the customer, including the response and delivery time dimension and how the customer feels about the experience of purchasing from the company. The **image and reputation** dimension enables a company to proactively define itself for its customers.

In summary, the customer perspective enables business unit managers to articulate their unique customer and market-based strategy for producing superior future financial returns.

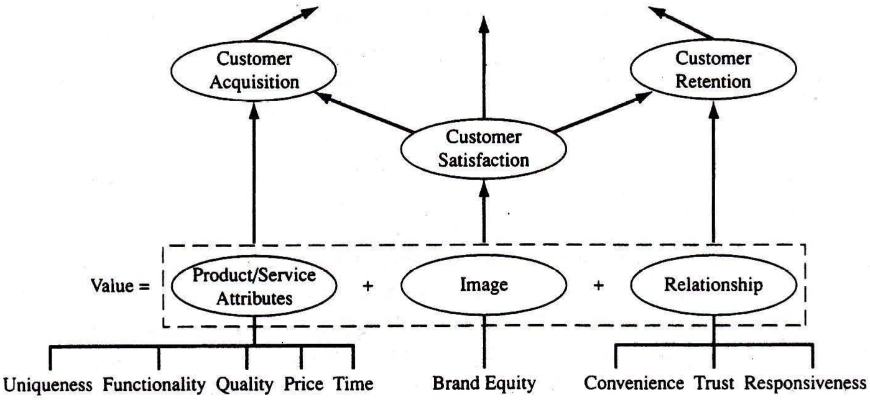

EXHIBIT 8-3 Customer Perspective: Linking Unique Value Propositions to Core Outcome Measures

Source: R. S. Kaplan and D. P. Norton, "Linking the Balanced Scorecard to Strategy," *California Management Review* (Fall 1996), p. 62.

Internal Business Process Perspective

In the internal business process perspective, executives identify the critical internal processes in which the organization must excel (see Exhibit 8-4).

The critical internal business processes enable the business unit to:

- Deliver the value propositions that will attract and retain customers in targeted market segments
- Satisfy shareholder expectations of excellent financial returns

The internal business process measures are focused on the internal processes that will have the greatest impact on customer satisfaction and achieving the organization's financial objectives.

Each business has its unique set of processes for creating value for customers and producing financial results. A generic value chain model, however, provides a template that companies can customize for their own objectives and measures in their internal busi-

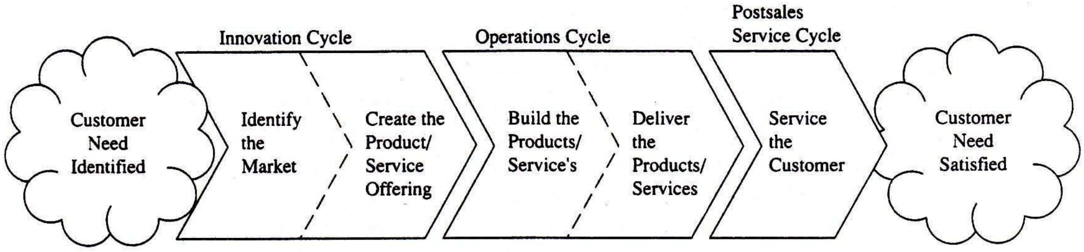

EXHIBIT 8-4 The Internal Value Chain

Source: R. S. Kaplan and D. P. Norton, "Linking the Balanced Scorecard to Strategy," *California Management Review* (Fall 1996), p. 63.

ness process perspective. The generic value chain model encompasses three principal business processes:

1. Innovation
2. Operations
3. Postsales service

Innovation

In the innovation process, the business unit researches the emerging or latent needs of customers and then creates the products or services that will meet those needs. The innovation process represents the "long wave" of value creation in which companies first identify and nurture new markets, new customers, and the emerging and latent needs of existing customers. Then, continuing in this long wave of value creation and growth, companies design and develop the new products and services that enable them to reach the new markets and customers and to satisfy customers' newly identified needs. The operations process, in contrast, represents the short wave of value creation, in which companies deliver existing products and services to existing customers.

The innovation process consists of two components. In the first component, managers perform market research to identify the size of the market and the nature of customers' preferences and the price points for the targeted product or service. As organizations deploy their internal processes to meet specific customer needs, accurate, valid information on market size and customer preferences becomes vital. In addition to surveying existing and potential customers, this segment could also include imagining entirely new opportunities and markets for products and services that the organization could supply.

Operations

The operations process, the second major step in the generic internal value chain, is where existing products and services are produced and delivered to customers. The operations process represents the short wave of value creation in organizations. The operations process can start with receipt of a customer order and finish with delivery of the product or service to the customer. This process stresses efficient, consistent, and timely delivery of existing products and services to existing customers.

The operations process has historically been the focus of most organizations' performance measurement systems. Operational excellence and cost reduction in manufacturing and service delivery processes remain important goals. The internal value chain in Exhibit 8-4 shows, however, that such operational excellence may be only one component, and perhaps not the most decisive component, in an entire internal value chain for achieving financial and customer objectives.

Existing operations tend to be repetitive, so scientific management techniques can be readily applied to control and to improve customer order receipt and processing and vendor, production, and delivery processes. Traditionally, these operating processes have been monitored and controlled by financial measures such as standard costs, budgets, and variances. Over time, however, excessive focus on narrow financial measures such as labor efficiency, machine efficiency, and purchase price variances led to highly dysfunctional actions: keeping labor and machines busy building inventory, usually not related to current customer orders, and switching from supplier to supplier to chase cheaper purchase prices (but ignoring the costs of large-volume orders, poor quality, uncertain delivery times, and disconnected ordering, receiving, invoicing, and collection processes between lower-priced suppliers and the customer). By now, the defects associated with using traditional cost accounting measures in today's short-cycle-time, high-quality, customer-focused environment have been amply documented.[3]

The influence, in recent years, of the total quality management and time-based competition practices of leading Japanese manufacturers has led many companies to supplement their traditional cost and financial measurements with measurements of quality and cycle time.[4] Measurements of operating processes' quality, cycle time, and cost have been developed extensively during the past 15 years. Some aspects of these quality, time, and cost measurements will likely be included as critical performance measures in any organization's internal business process perspective. These will be discussed in Chapter 11.

In addition to these time, quality, and cost measurements, managers may wish to measure additional characteristics of their processes and product and service offerings. Such additional measures could include measurement of flexibility and of the specific characteristics of products or services that create value for customers. For example, companies may offer unique product or service performance, which could be measured by accuracy, size, speed, clarity, or energy consumption, that enables them to earn high margins on sales to targeted market segments. Companies that can identify the differentiating characteristics of their products and services will want the focus and attention that measurement on the Balanced Scorecard can command. Such critical product and service performance attributes (beyond response time, quality, and cost) are incorporated into the operating process component of the Balanced Scorecard's internal business process perspective.

Postsales Service

The third and final stage in the internal value chain is service to the customer after the original sale or delivery of service. Postsales service includes warranty and repair activities, treatment of defects and returns, and the processing and administration of payments, such as credit card administration. Some companies have explicit strategies to offer superior postsales service. For example, companies that sell sophisticated equipment or systems may offer training programs for customers' employees to help them use the equipment or system more effectively and efficiently. They may also offer rapid response to actual or potential failures and downtime. Newly established automobile dealerships, such as Acura and Saturn, have deservedly earned superb reputations by offering dramatically improved customer service for warranty work, periodic car maintenance, and car repairs. A major element in the value proposition these car companies deliver to their customers is responsive, friendly, and reliable warranty and service work. Another aspect of postsales service is the invoicing and collection process. Companies with extensive sales on credit or on company-specific credit cards will likely need to apply cost, quality, and cycle-time measurements to their billings, collection, and dispute resolution processes. Several department stores offer generous terms under which customers can exchange or return merchandise.

And companies that deal with hazardous or environmentally sensitive chemicals and materials may introduce critical performance measures associated with the safe disposal of waste and byproducts from the production process. For example, one distributor of industrial chemicals developed a capability to maintain detailed documentation and disposal services for used chemicals, freeing its customers from an expensive task, fraught with liability and subject to intense governmental scrutiny by agencies such as the Environmental Protection Agency and the Occupational Safety and Health Administration. Recognizing that excellent community relations may be a strategic objective for continuing to enjoy a franchise to operate production and service facilities, other companies set objectives, under postsales service, for excellent environmental performance. Measures such as waste and scrap produced during production processes may be more significant for their impact on the environment than for their slight increase in production costs. All of these activities add value to the customers' use of the company's product and service offerings.

The internal business process perspective reveals two fundamental differences between the traditional and the Balanced Scorecard approaches to performance measurement. Traditional approaches attempt to monitor and improve existing business processes. They may go beyond mere financial measures of performance by incorporating quality and time-based metrics, but they still focus on improving existing processes. The Balanced Scorecard approach, however, will usually identify entirely new processes at which the organization must excel to meet customer and financial objectives. For example, the organization may realize that it must develop a process to anticipate customer needs or one to deliver new services that targeted customers value. The BSC internal business process objectives highlight the processes, several of which the company may not be currently performing at all, that are most critical for the organization's strategy to succeed.

The second departure of the Balanced Scorecard approach is to incorporate innovation processes into the internal business process perspective. Traditional performance measurement systems focus on the processes of delivering today's products and services to today's customers. But the drivers of long-term financial success may require the organization to create entirely new products and services that will meet the emerging needs of current and future customers. The innovation process is, for many companies, a more powerful driver of future financial performance than the short-term operating cycle. For many companies, their ability to manage successfully a multiyear product development process or to develop a capability to reach entirely new categories of customers may be more critical for future economic performance than managing existing operations efficiently, consistently, and responsively. The internal business process perspective of the Balanced Scorecard incorporates objectives and measures for both the long-wave innovation cycle and the short-wave operations cycle.

Learning and Growth Perspective

The fourth Balanced Scorecard perspective, learning and growth, identifies the infrastructure that the organization must build to create long-term growth and improvement. The customer and internal business process perspectives identify the factors most critical for current and future success. Businesses are unlikely to be able to meet their long-term targets for customers and internal processes using today's technologies and capabilities. Also, intense global competition requires that companies continually improve their capabilities for delivering value to customers and shareholders.

Organizational learning and growth come from three principal sources: people, systems, and organizational procedures. The financial, customer, and internal business process objectives on the Balanced Scorecard will typically reveal large gaps between existing capabilities of people, systems, and procedures and what will be required to achieve targets for breakthrough performance. To close these gaps, businesses must invest in reskilling employees, enhancing information technology and systems, and aligning organizational procedures and routines. These objectives are articulated in the learning and growth perspective of the Balanced Scorecard. As in the customer perspective, employee-based measures include several generic outcome measures: employee satisfaction, employee retention, employee training, and employee skills. In addition, the learning and growth perspective includes specific drivers of these generic measures, such as detailed, business-specific indexes of specific skills required for the new competitive environment. Information systems capabilities can be measured by real-time availability of accurate, critical customer and internal process information to employees on the front lines of decision making and actions. Organizational procedures can examine alignment of employee incentives with overall organizational success factors and measured rates of improvement in critical customer-based and internal processes.

Summary of Balanced Scorecard Perspectives

The Balanced Scorecard retains traditional financial measures. Financial measures alone, however, are inadequate for guiding and evaluating how information age companies create future value through investment in customers, suppliers, employees, processes, technology, and innovation. Financial measures tell the story of events already completed, an adequate story for industrial age companies for whom investments in long-term capabilities and customer relationships were not critical for success.

With the Balanced Scorecard, company executives can measure how their business units create value for current and future customers, how they must build and enhance internal capabilities, and the investment in people, systems, and procedures necessary to improve future performance. The Balanced Scorecard captures the critical value-creation activities performed by skilled, motivated organizational participants. While retaining, via the financial perspective, an interest in short-term performance, the Balanced Scorecard clearly reveals the value drivers for superior long-term financial and competitive performance.

In addition, the Balanced Scorecard enables financial and nonfinancial measures to be part of the information system for employees at all levels of the organization. Front-line employees can understand the financial consequences from their decisions and actions, and senior executives can understand the drivers of long-term financial success. The Balanced Scorecard represents a translation of a business unit's mission and strategy into tangible objectives and measures. The four perspectives of the scorecard permit a balance (1) between short- and long-term objectives, (2) between external measures—for shareholders and customers—and internal measures of critical business processes, innovation, and learning and growth, (3) between outcomes desired and the performance drivers of those outcomes, and (4) between hard objective measures and softer, more-subjective measures.

Many people think of measurement as a tool to control behavior and to evaluate past performance. The measures on a Balanced Scorecard should be used in a different way: to articulate the strategy of the business, to communicate the strategy of the business, and to help align individual, organizational, and cross-departmental initiatives to achieve a common goal. Used in this way, the scorecard does not strive to keep individuals and organizational units in compliance with a preestablished plan, the traditional control system objective. The Balanced Scorecard should be used as a communication, informing, and learning system, *not* as a controlling system.

The multiplicity of measures on a Balanced Scorecard may seem confusing. However, properly constructed scorecards, as we will see, contain a unity of purpose because all the measures are directed toward achieving an integrated strategy.

LINKING MULTIPLE SCORECARD MEASURES TO A SINGLE STRATEGY

Typically, each of the four perspectives in the Balanced Scorecard has between four and seven separate measures, thus creating a scorecard with up to 25 measures. Is it possible for any organization to focus on 25 separate things? If a scorecard is viewed as 25 (or even 10) independent measures, will it be too complicated for an organization to absorb?

The multiple measures on a properly constructed Balanced Scorecard should consist of a linked series of objectives and measures that are both consistent and mutually reinforcing. The Balanced Scorecard should be viewed as the instrumentation for a *single* strategy. When the scorecard is viewed as the manifestation of a single strategy, then the number of measures on the scorecard becomes irrelevant. Companies can indeed formulate and communicate their strategy with an integrated system of approximately two dozen measurements. The integrated system of scorecard measures should incorporate the complex set of cause-and-effect relationships among the critical variables—including leads, lags, and feedback loops—that describe the trajectory, the flight plan, of the strategy. The linkages should incorporate both cause-and-effect relationships and mixtures of outcome measures and performance drivers.

Cause-and-Effect Relationships

A strategy is a set of hypotheses about cause and effect. The measurement system should make the relationships (hypotheses) among objectives (and measures) in the various perspectives explicit so that they can be managed and validated. The chain of cause and effect should pervade all four perspectives of a Balanced Scorecard. For example, return on capital employed (ROCE) may be a scorecard measure in the financial perspective. The driver of this financial measure could be repeat and expanded sales from existing customers, the result of a high degree of loyalty among existing customers. So, customer loyalty is included on the scorecard (in the customer perspective) because it is expected to have a strong influence on ROCE. But how will the organization achieve customer loyalty? Analysis of customer preferences may reveal that on-time delivery (OTD) of orders is highly valued by customers. Thus, improved OTD is expected to lead to higher customer loyalty, which, in turn, is expected to lead to higher financial performance. So both customer loyalty and OTD are incorporated into the customer perspective of the scorecard.

The process continues by asking at what internal processes must the company excel to achieve exceptional on-time delivery. To achieve improved OTD, the business may need to achieve short cycle times in operating processes and high-quality internal processes, both factors that could be scorecard measures in the internal perspective. And how do organizations improve the quality and reduce the cycle times of their internal processes? By training operating employees and improving their skills, an objective that would be a candidate for the learning and growth perspective. We can now see how an entire chain of cause-and-effect relationships can be established as a vertical vector through the four Balanced Scorecard perspectives:

Financial	Return on capital employed/Economic Value Added*
	⇑
Customer	Customer loyalty
	⇑
	On-time delivery
	⇑ ⇑
Internal business process	Process quality Process cycle time
	⇑ ⇑
Learning and growth	Employee skills

**See Chapter 10 for a discussion of EVA.*

Thus, a properly constructed Balanced Scorecard should tell the story of the business unit's strategy. It should identify and make explicit the sequence of hypotheses about the cause-and-effect relationships between outcome measures and the performance drivers of those outcomes.

Performance Drivers

A good Balanced Scorecard should also have a mix of outcome measures and performance drivers. Outcome measures without performance drivers do not communicate how the outcomes are to be achieved. They also do not provide an early indication about whether the strategy is being implemented successfully. Conversely, performance drivers alone, such as cycle times and part-per-million defect rates, without outcome measures may enable the business unit to achieve short-term operational improvements. But they will fail to reveal whether the operational improvements have been translated into expanded business with existing and new customers and, eventually, into enhanced financial performance. A good Balanced Scorecard should have an appropriate mix of outcomes and performance drivers of the business unit's strategy. In this way, the scorecard translates the business unit's strategy into a linked set of measures that define both the long-term strategic objectives and the mechanisms for achieving those objectives.

DIAGNOSTIC VERSUS STRATEGIC MEASURES

Most organizations today already have many more than 16 to 25 measures to keep themselves functioning. Some managers are incredulous that a Balanced Scorecard of no more than two dozen measures can be sufficient for measuring their operations. They are, of course, correct in a narrow sense but are failing to distinguish between *diagnostic measures* (which monitor whether the business remains "in control" and are able to signal when unusual events are occurring that require immediate attention) and *strategic measures* (which define a strategy designed for competitive excellence and future success).

A simple example clarifies this point. Many of our bodily functions require narrow operating parameters. If our body temperature rises or falls five degrees or more or our blood pressure drops too low or escalates too high, our survival is endangered. In such circumstances, all of our energies (and those of skilled professionals) are mobilized to restore our bodies to their normal levels. But we do not devote enormous energy to optimizing our body temperature and blood pressure. Being able to control our body temperature to within 0.01° of the optimum will not be one of the strategic success factors that will determine whether we become a chief executive of a company, a senior partner in an international consulting firm, or a tenured full professor at a major university. Other factors are much more decisive in determining whether we achieve our unique personal and professional objectives. Are body temperature and blood pressure important? Absolutely. Maintaining them within a normal range is *necessary*; it is not, however, *sufficient* for the achievement of our long-run goals.

Similarly, corporations should have hundreds, perhaps thousands, of measures that they can monitor to ensure that they are functioning as expected and to signal when corrective action must be taken. But these are not the drivers of businesses' competitive success. Such measures capture the necessary vital signs that enable the company to operate. Vital signs that must meet standards are not the basis for competitive breakthroughs. But if the vital signs do not meet the standards, they can prevent the organization from meeting even modest objectives, much less its strategic aspirations. Vital signs should be monitored diagnostically. A diagnostic control system measures performance against a preset standard, and management need not take action as long as actual performance meets the standard; this process is management by exception. Diagnostic measures, however, are not the basis for competitive breakthroughs.[5]

The Balanced Scorecard is not a replacement for an organization's day-to-day performance measurement system. The measures on the Balanced Scorecard are chosen to direct the attention of managers and employees to those factors for which superb performance can be expected to lead to competitive breakthroughs for the organization. The outcome and performance-driver measures on the Balanced Scorecard should be the subjects of intensive and extensive interactions among senior and middle-level managers as they evaluate strategies based on new information about competitors, customers, markets, technologies, and suppliers.

For example, in the 1980s, the product and process quality of many Western companies were so poor compared with their Japanese competitors that the companies had to put quality improvements at the top of their priorities. After years of diligent work, many companies have now achieved excellent quality and are now at parity with their competitors. At this point, quality may have been neutralized as a competitive factor. Companies may need to maintain existing quality and continue to make incremental improvements, but quality may no longer be the most important factor for determining future strategic success. In such a situation, quality is monitored diagnostically, and the company needs to find other dimensions in the value proposition it delivers to customers to distinguish itself from competitors. These other dimensions become elevated to the Balanced Scorecard.

FOUR PERSPECTIVES: ARE THEY SUFFICIENT?

The four perspectives of the Balanced Scorecard should be considered a template, not a straitjacket. No mathematical theorem exists that four perspectives are both necessary and sufficient. Companies rarely use fewer than four perspectives, but depending on industry circumstances and a business unit's strategy, one or more additional perspectives may be needed. For example, some people have expressed concern that, although the Balanced Scorecard recognizes explicitly the interests of shareholders and customers, it does not explicitly incorporate the interests of other important stakeholders, such as employees, suppliers, and the community.

The interests of shareholders—the owners and capital contributors to the organization—appear on the scorecard through objectives and measures in the financial perspective. Customer measures also appear on every scorecard (in the customer perspective) since customers are essential for meeting the financial objectives. And objectives and measures for employees, suppliers, and the community appear on the Balanced Scorecard when outstanding performance along those objectives and measures will lead to breakthrough performance for customers and shareholders.

When relationships with key stakeholders, such as suppliers or the community, however, are required only to be "in control" and consistent with implicit or explicit contracts between the company and the stakeholder, then performance for those contracts can be monitored by the company's diagnostic performance measurement system. In effect, such relationships become vital signs; they are necessary but not decisive for strategic success.

The employee perspective has been incorporated in virtually all scorecards through the learning and growth perspective. That is, improvements in employee capabilities in critical jobs and in employee motivation are essential components for the learning and growth perspective. Employee objectives and measures appear with other learning and growth enablers, such as information technology deployment. These objectives appear because they are necessary to drive improved performance in the internal business process, customer, and financial perspectives. Similarly, when strong supplier relationships are part of the strategy leading to breakthrough customer or financial performance, then outcome and performance driver measures for supplier relationships should be incorporated within the organization's internal business process perspective. And, when outstanding environmental and community performance is a central part of a company's strategy, then objectives and measures for that perspective also become an integral part of a company's scorecard.[6]

SUMMARY

Information age companies succeed by investing in and managing their intellectual assets. Functional specialization must be integrated into customer-based business processes. Mass production and service delivery of standard products and services are being replaced by flexible, responsive, and high-quality delivery of innovative products and services that can be individualized to targeted customer segments. Innovation and improvement of products, services, and processes will be generated by reskilled employees, superior information technology, and aligned organizational procedures.

As organizations invest in acquiring these new capabilities, their success (or failure) cannot be motivated or measured in the short run solely by the traditional financial accounting model. This financial model, developed for trading companies and industrial age corporations, measures events of the past not the investments in the capabilities that provide value for the future.

The Balanced Scorecard integrates measures derived from strategy. While retaining financial measures of past performance, the Balanced Scorecard introduces the drivers of future financial performance. The drivers—encompassing customer, internal business process, and learning and growth perspectives—are derived from an explicit and rigorous translation of the organization's strategy into tangible objectives and measures.

ENDNOTES

1. See A. D. Chandler, *The Visible Hand: The Managerial Revolution in American Business* (Cambridge: Harvard University Press, 1977); and H. T. Johnson and R. S. Kaplan, *Relevance Lost: The Rise and Fall of Management Accounting* (Boston: Harvard Business School Press, 1987).
2. H. Itami, *Mobilizing Invisible Assets* (Cambridge: Harvard University Press, 1987).
3. See J. Lessner, "Performance Measurement in a Just-in-Time Environment: Can Traditional Performance Measurements Still Be Used?" *Journal of Cost Management* (Fall 1989), pp. 22–28; R. Kaplan, "Limitation of Cost Accounting in Advanced Manufacturing Environments," in *Measures for Manufacturing Excellence*, ed. R. S. Kaplan (Boston: Harvard Business School Press, 1990), chap. 1; and E. M. Goldratt and J. Cox, *The Goal: A Process of Ongoing Improvement* (Croton-on-Hudson, NY: North River Press, 1986).
4. Many references could be cited here. A representative sample includes C. Berliner and J. Brimson, "CMS Performance Measurement," in *Cost Management for Today's Advanced Manufacturing* (Boston: Harvard Business School Press, 1988), chap. 6; C. J. McNair, W. Mosconi, and T. Norris, *Meeting the Technology Challenge: Cost Accounting in a JIT Environment* (Montvale, NJ: Institute of Management Accountants, 1988); and R. Lynch and K. Cross, *Measure Up! Yardsticks for Continuous Improvement* (Cambridge, MA: Basil Blackwell, 1991).
5. The important distinction between the measures monitored in the organization's diagnostic control systems and those that are part of the continual interactions among managers has been articulated in R. L. Simons, *Levers of Control: How Managers Use Innovative Control Systems to Drive Strategic Renewal* (Boston: Harvard Business School Press, 1995).
6. See comments of D. W. Boivin, President and COO of Novacor Chemicals, "Using the Balanced Scorecard," letter to the editor, *Harvard Business Review* (March–April 1996), p. 170.

■ CASES

CHADWICK, INC.: THE BALANCED SCORECARD (ABRIDGED)*

The "Balanced Scorecard"[1] article seemed to address the concerns of several division managers who felt that the company was overemphasizing short-term financial results. But the process of getting agreement on what measures should be used proved a lot more difficult than I anticipated.

Bill Baron, Comptroller of Chadwick, Inc.

Company Background

Chadwick, Inc. was a diversified producer of personal consumer products and pharmaceuticals. The Norwalk Division of Chadwick developed, manufactured and sold ethical drugs

*Professor Robert S. Kaplan prepared this case.

[1] R. S. Kaplan and D. P. Norton, "The Balanced Scorecard: Measures That Drive Performance," *Harvard Business Review* (January–February 1992).

for human and animal use. It was one of five or six sizable companies competing in these markets and, while it did not dominate the industry, the company was considered well-managed and was respected for the high quality of its products. Norwalk did not compete by supplying a full range of products. It specialized in several niches and attempted to leverage its product line by continually searching for new applications for existing compounds.

Norwalk sold its products through several key distributors who supplied local markets, such as retail stores, hospitals and health service organizations, and veterinary practices. Norwalk depended on its excellent relations with the distributors who served to promote Norwalk's products to end users and also received feedback from the end users about new products desired by their customers.

Chadwick knew that its long-term success depended on how much money distributors could make by promoting and selling Norwalk's products. If the profit from selling Norwalk products was high, then these products were promoted heavily by the distributors and Norwalk received extensive communication back about future customer needs. Norwalk had historically provided many highly profitable products to the marketplace, but recent inroads by generic manufacturers had been eroding distributors' sales and profit margins. Norwalk had been successful in the past because of its track record of generating a steady stream of attractive, popular products. During the second half of the 1980s, however, the approval process for new products had lengthened and fewer big winners had emerged from Norwalk's R&D laboratories.

Research and Development

The development of ethical drugs was a lengthy, costly, and unpredictable process. Development cycles now averaged about 12 years. The process started by screening a large number of compounds for potential benefits and use. For every drug that finally emerged as approved for use, up to 30,000 compounds had to be tested at the beginning of a new product development cycle. The development and testing processes had many stages. The development cycle started with the discovery of compounds that possessed the desirable properties and ended many years later with extensive and tedious testing and documentation to demonstrate that the new drug could meet government regulations for promised benefits, reliability in production, and absence of deleterious side effects.

Approved and patented drugs could generate enormous revenues for Norwalk and its distributors. Norwalk's profitability during the 1980s was sustained by one key drug that had been discovered in the late 1960s. No blockbuster drug had emerged during the 1980s, however, and the existing pipeline of compounds going through development, evaluation and test was not as healthy as Norwalk management desired. Management was placing pressure on scientists in the R&D lab to increase the yield of promising new products and to reduce the time and costs of the product development cycle. Scientists were currently exploring new bio-engineering techniques to create compounds that had the specific active properties desired rather than depending on an almost random search through thousands of possible compounds. The new techniques started with a detailed specification of the chemical properties that a new drug should have and then attempted to synthesize candidate compounds that could be tested for these properties. The bio-engineering procedures were costly, requiring extensive investment in new equipment and computer-based analysis.

A less expensive approach to increase the financial yield from R&D investments was to identify new applications for existing compounds that had already been approved for use. While some validation still had to be submitted for government approval to demonstrate the effectiveness of the drug in the new applications, the cost of extending an existing product to a new application was much, much less expensive than developing and creating an entirely new compound. Several valuable suggestions for possible new applications from existing products had come from Norwalk salesmen in the field. The salesmen were now being trained not only to sell existing products for approved applications, but also to listen to end users who frequently had novel and interesting ideas about how Norwalk's products could be used for new applications.

Manufacturing

Norwalk's manufacturing processes were considered among the best in the industry. Management took pride in the ability of the manufacturing operation to quickly and efficiently ramp up to produce drugs once they had cleared governmental regulatory processes. Norwalk's manufacturing capabilities also had to produce the small batches of new products that were required during testing and evaluation stages.

Performance Measurement

Chadwick allowed its several divisions to operate in a decentralized fashion. Division managers had almost complete discretion in managing all the critical processes: R&D, Production, Marketing and Sales, and administrative functions such as finance, human resources, and legal. Chadwick set challenging financial targets for divisions to meet. The targets were usually expressed as Return on Capital Employed (ROCE). As a diversified company, Chadwick wanted to be able to deploy the returns from the most profitable divisions to those divisions that held out the highest promise for profitable growth. Monthly financial summaries were submitted by each division to corporate headquarters. The Chadwick executive committee, consisting of the chief executive officer, the chief operating officer, two executive vice presidents, and the chief financial officer met monthly with each division manager to review ROCE performance and backup financial information for the preceding month.

The Balanced Scorecard Project

Bill Baron, Comptroller of Chadwick, had been searching for improved methods for evaluating the performance of the various divisions. Division managers complained about the continual pressure to meet short-term financial objectives in businesses that required extensive investments in risky projects to yield long-term returns. The idea of a Balanced Scorecard appealed to him as a constructive way to balance short-run financial objectives with the long-term performance of the company.

Baron brought the article and concept to Dan Daniels, the President and Chief Operating officer of Chadwick. Daniels shared Baron's enthusiasm for the concept, feeling that a Balanced Scorecard would allow Chadwick divisional managers more flexibility in how they measured and presented their results of operations to corporate management. He also liked the idea of holding managers accountable for improving the long-term performance of their division.

After several days of reflection, Daniels issued a memorandum to all Chadwick division managers. The memo had a simple and direct message: Read the Balanced Scorecard article, develop a scorecard for your division, and be prepared to come to corporate headquarters in 90 days to present and defend the divisional scorecard to Chadwick's Executive Committee.

John Greenfield, the Division Manager at Norwalk, received Daniel's memorandum with some concern and apprehension. In principle, Greenfield liked the idea of developing a scorecard that would be more responsive to his operations, but he was distrustful of how much freedom he had to develop and use such a scorecard. Greenfield recalled: This seemed like just another way for corporate to claim that they have decentralized decision making and authority while still retaining ultimate control at headquarters.

Greenfield knew that he would have to develop a plan of action to meet corporate's request but lacking a clear sense of how committed Chadwick was to the concept, he was not prepared to take much time from his or his subordinates' existing responsibilities for the project.

The next day, at the weekly meeting of the Divisional Operating Committee, Greenfield distributed the Daniels memo and appointed a three man committee, headed by Divisional Controller, Wil Wagner, to facilitate the process for creating the Norwalk Balanced Scorecard.

Wagner approached Greenfield later that day:

> I read the Balanced Scorecard article. Based on my understanding of the concept, we must start with a clearly defined business vision. I'm not sure I have a clear understanding of the vision and business strategy for Norwalk. How can I start to build the scorecard without this understanding?

Greenfield admitted: "That's a valid point. Let me see what I can do to get you started."

Greenfield picked up a pad of paper and started to write. Several minutes later he had produced a short business strategy statement for Norwalk (see Exhibit 1). Wagner and his group took Greenfield's strategy statement and started to formulate scorecard measures for the division.

EXHIBIT 1 Norwalk Pharmaceutical Division—Business Strategy

1. Manage Norwalk portfolio of investments
   Minimize cost to executing our existing business base
   Maximize return/yield on all development spending
   Invest in discovery of new compounds
2. Satisfy customer needs
3. Drive responsibility to the lowest level
   Minimize centralized staff overhead
4. People development
   Industry training
   Unique mix of technical and commercial skills

CHEMICAL BANK: IMPLEMENTING THE BALANCED SCORECARD*

In early 1995, Michael Hegarty, Head of the Retail Bank of Chemical Banking Corporation, was overseeing a transformation in his organization. The process had begun with the merger of Chemical and the Manufacturers Hanover Corporation at year-end 1991. The new, larger banking company was better positioned to compete in a marketplace characterized by intense pricing competition, an outflow of deposits to mutual funds, rapidly evolving technology, and increased customer demand for value. Hegarty commented on just one indicator of the future competitive environment for retail banking:

> At the time of the merger, the old Chemical Banking Corporation with assets of $75

*This case was prepared by Norman Klein and Professor Robert S. Kaplan.

> billion, had a market capitalization of $2 billion. Less than four years later, Microsoft has offered to buy Intuit, a personal financial software company with $223 million in sales for $1.5 billion. What do you think Bill Gates is buying for all that money?

Historically, retail banking had emphasized efficient collection and processing of deposits. Hegarty wanted to transform the bank into a market-focused organization that would be the financial service provider of choice to targeted customer groups. To implement this strategy, Hegarty knew that the bank had to make major investments to understand customer needs and to identify attractive customer segments. The bank also had to develop and tailor new products such as annuities, investment products, and technology-based payment services to meet customer needs in the targeted segments. With a broader product and service line, and excellent knowledge of its customer base, the bank would then be able to find ways to develop new relationships with its most desirable customers, and expand the bank's business with them—increasing its share of its customers' financial transactions (or "share of wallet" as it was described in the bank).

When asked how he expected to implement such dramatic and extensive strategic change, Hegarty said:

> My biggest problem is communicating and reinforcing strategy. The Balanced Scorecard is one of a set of tools we are using—along with Mission and Vision Statements, Gap Analysis, Strategy Consensus, and Brand Positioning—for strategy formulation and communication. The Balanced Scorecard can't win without a good mission statement and vision, an excellent strategy, and good execution. But it is certainly part of the architecture of success. It is an element in a major communications program to 15,000 individuals.
>
> No one owns a process end-to-end (most do just a small snippet). But every individual should understand how they fit in; what their role is for helping the company achieve its strategy. The scorecard gives us the measures we need to stay focused on performance, while at the same time enabling us to clarify and communicate our vision, and focus our energies for change. The measurement allows learning, and the learning renews the vision and refuels our energy for change.

Retail Banking in the 1990s

Experts predicted that the 1990s would prove to be an intensely competitive decade in retail banking. In the past 10 years, the approximately 14,000 banks in the United States had shrunk to 10,000, and there were predictions of as few as 4,000 to 5,000 banks by early in the next century.

Customers were demanding new investment and insurance products, and far more convenient ways to do their banking. They were asking banks for new telephone options, and for improved access to ATMs with enhanced functionality. These changes meant that branch personnel would be doing fewer deposit, withdrawal, and check-cashing transactions and would have to become more involved with higher-value interactions with customers, including sales of new products. But even with the move to higher-value services, banks anticipated operating fewer branches at the turn of the decade.

Research indicated that 61% of retail banking customers between the ages of 18 and 24 actively used ATMs, while only 27% of customers 55 to 64 did so. The trend lines were clear. The banks that would survive and prosper would be deploying superior technology, offering new products, and delivering service through new channels. Further, technology would be the key to new partnerships, especially with insurance companies and brokerage firms, and new strategies to identify, attract, and retain more profitable customers.

Ted Francavilla, Managing Director of Strategic Planning and Finance, noted that the traditional retail deposit business had become very tough. Revenue growth was slow due to lower interest rates and outflows of deposits to nonbanking service providers, such as mutual funds. Growth in core operating expenses and the need to invest in new delivery systems added to the challenge.

> Currently we have over $800 million in operating expenses and 8,000 employees in our New York Markets division. Landlords expect rental increases on their properties and employees expect raises. These factors, coupled with low revenue growth, produce a real profitability squeeze for retail banking. We need to demonstrate to our corporate parent that we can earn good returns on the $800 million we spend each year and free up funds for investment in the future.

Chemical Bank's Strategy

After the merger had been completed in 1992, the Retail Bank's New York Markets division had identified the following six critical success factors:

1. Commit to business processes driven by service quality.
2. Implement a continuous process for understanding markets, segments, and individual customers.
3. Develop a rapid, customer-focused product management and development process.
4. Ensure flexible and market-responsive delivery channels.
5. Develop information management processes and platforms driven by business needs.
6. Implement expense management process to streamline the cost base.

In 1994, New York Markets was responsible for managing $27 billion in consumer and small business deposits, as well as over 300 branches, over 800 proprietary ATMs, a state-of-the-art telephone service center, and other related distribution channels. The division also acted as a distributor and referral source for Chemical's mortgages, credit cards, home equity loans and other consumer credit products, which were managed by Hegarty as national business lines. Mutual funds were also sold through a branch-based brokerage operation.

The New York Markets division had the number one market share among small commercial companies (under $1 million in sales) with a total of roughly 150,000 accounts. This represented a 24% market share in the metropolitan area. New York Markets also claimed a 16%–17% share of the consumer market, with 1.5 million customers holding approximately 3 million accounts. Net income of $15.3 million for 1993 was planned to improve to $28.6 million in 1994. Exhibit 1 shows summary financial information for New York Markets division, and Exhibit 2 shows the organization chart of the Retail Bank.

EXHIBIT 1 New York Markets (Dollars in Millions)

INCOME STATEMENT ITEM	ACTUAL 1993	PLAN 1994
Net interest income	$693.3	$666.8
Total noninterest income	209.8	245.1
Total revenue	$903.1	$911.9
Noninterest Expense		
Total salaries and benefits	$345.7	$354.7
Occupancy and equipment	171.3	175.0
FDIC	73.0	61.0
Other	105.4	108.6
Total direct expense	$695.4	$699.3
Total indirect	177.5	159.1
Total noninterest expense	$872.9	$858.4
Operating margin	$30.2	$53.5
Provision for loan loss	2.9	2.4
Income before taxes	$27.3	$51.1
Income taxes	12.0	22.5
Net income	$15.3	$28.6
Average Gross Deposits ($billions)		
Consumer	$24.3	$23.4
Commercial	4.1	4.0
Total NY markets	$28.4	$27.4

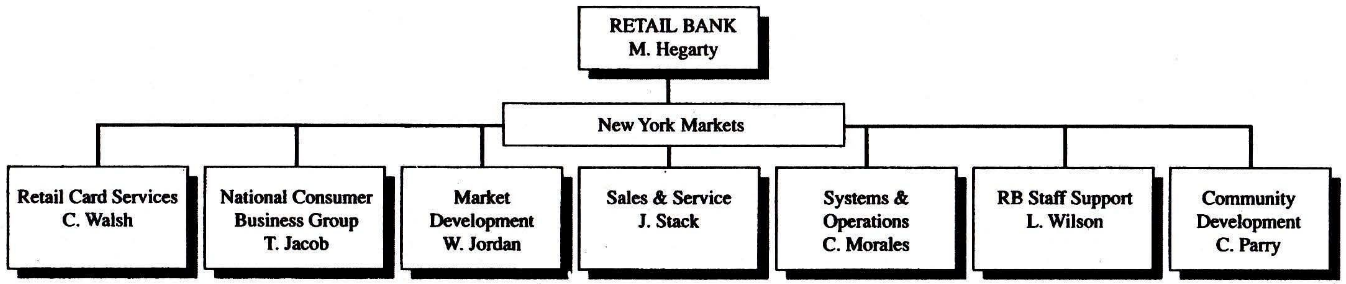

EXHIBIT 2 Organization Chart of the Retail Bank, August 1994

Developing the Balanced Scorecard

Francavilla had been introduced to the BSC concept in mid-1992 while attending a one-week business school executive program. He had immediately sensed that the BSC insistence on clear specification of strategic objectives and appropriate measures in four areas—financial, customer, internal business, and learning and growth—would be a useful way to create change at Chemical Bank.

Francavilla asked Tony LoFrumento, Vice President–Retail Bank Strategic Planning and Finance, to chair a middle-management task force to build a Balanced Scorecard for the New York Markets division. LoFrumento recalled the task force experience:

> The group worked hard and generated good ideas and analysis. But we soon realized that a mid-level group would find it difficult to push performance measures up to senior management. If the BSC was going to have an impact, Mike Hegarty had to be committed to the concept.

In May 1993, Hegarty attended a presentation introducing the BSC and was convinced that this approach could help create the cultural change he desired at the Retail Bank. Other senior managers at the bank, however, remained skeptical. David Norton, one of the co-authors of the initial BSC article, was brought in for a presentation to the senior management group. After the presentation, the group became committed to moving ahead with a scorecard project.

The Retail Bank's Balanced Scorecard

Francavilla, as head of Strategic Planning and Finance, functioned as the internal champion for the BSC. LoFrumento led the day-to-day functioning of BSC activities, and Norton was retained for consulting support. They divided the senior management group into four subgroups, each one responsible for developing objectives for one of the BSC perspectives. By October 1993, strategic objectives had been identified for each of the four BSC perspectives (see Exhibits 3A–3D).

EXHIBIT 3A Strategic Financial (Shareholder) Objectives for BSC

I. Financial (Shareholder)

Improve Return on Spending

Return on spending reflects our ability to create wealth with the corporation's funds. ROS is the appropriate objective because the business is assigned a low level of capital by the corporation due to its low credit risk. ROS will align our expense outlays with the revenue generated. By aligning our spending with high value and high return activities, we will increase the return we achieve on dollars spent.

Reduce Costs

By becoming more streamlined and efficient, we will focus resources and help to achieve acceptable profitability over the 3–5 year span. We will accomplish this by eliminating expenses that do not lead to revenue generation, by improving productivity, and by streamlining and redesigning key business processes

Increase Revenues

To achieve our financial vision, we need to grow our revenue streams. We need to redefine our core businesses and increase the number of valuable customers. We will achieve this by retaining and acquiring valuable customers, and broadening valuable customer relationships through the cross-sell of existing products and the sale of new products.

Reduce Risk

We plan to move away from a dependence on net interest income by broadening and selling our portfolio of fee-based products to cover a greater portion of our expense base. Changing our mix toward more fee-based business will cushion Chemical from the risks of the interest rate cycle.

EXHIBIT 3B Strategic Customer Objectives for BSC

II. Customer

Differentiators

Offer customized value propositions to targeted customer segments:

i. Define propositions that different customers value.

ii. Understand the economics of fulfilling various propositions.

iii. Target those customers whose value propositions can be fulfilled profitably.

Differentiate ourselves through employees capable of recognizing customer needs and possessing the knowledge to proactively satisfy them:

A greater knowledge of Chemical's product and service offerings will help our customers better fulfill their banking needs. This knowledge, along with cross-selling, consultative skills, and a supporting operating structure will satisfy a greater proportion of our customer's financial needs.

Give customers access to banking services or information 24 hours a day, consistent with the appropriate value proposition for the segment they represent.

Essentials

Perform consistently and seamlessly in the eyes of the customer.

Service customers expediently: the timeliness of the response should meet or exceed the customer's perceived sense of urgency.

Eliminate mistakes in all customer service encounters.

EXHIBIT 3C Strategic Internal Objectives for BSC

III. Internal

A. Innovation

Make the Market

Identify the needs of customer segments who represent high current profitability and their underlying economic potential. Understand the risk of each and how Chemical Bank can sustain differentiation with these target customers in the market by exploiting its key competencies.

Create the Product

Create profitable, innovative financial service products which are among the first to market, easy to use, and convenient to our targeted customers, yielding perceived superior value by the customer, and cost effective for Chemical Bank.

B. Delivery

Market and Sell

Cross-sell our products and services through organized, knowledgeable, consultative and proactive employees. We must listen to our customers, proactively educate them about our products and communicate to them how our products can meet their financial needs. To perform these activities, our salespeople must have a high level of systematic and regular contact with our customers and employ professional sales management practices.

Distribute and Service

Achieve service excellence based on our people and systems providing customers with the best reliability/availability, responsiveness, and no defects/errors. Quality delivery of our products and services is not an area of differentiation, but it is critical to our survival. Service excellence is the key to maintaining existing relationships and prerequisite to entering the battle for new customers. Without excellent performance on the "hygiene factors," we cannot move off square one.

EXHIBIT 3D Strategic Learning and Growth Objectives for BSC

IV. Learning and Growth

Strategic Information Assets

The ability to extract, manipulate, and use information holds the key to competitive advantage in our industry. First, we must recognize, harvest, and disseminate the considerable amount of information we have today. Second, business units and decision makers need to understand what and how much data are required to make a decision with a reasonably high degree of confidence. Third, we must improve the utility, access, ease of use and timeliness of information.

Reskilling: Strategic Jobs and Competencies

Build our marketing, sales, and customer services competencies to accomplish our aggressive revenue generation targets. First, our people need the competency to cross-sell our products and services. This demands a customer-focused orientation, the ability to recognize customer needs, the initiative to proactively solicit business, and superior consultative selling skills. Second, our people need a broader knowledge of our product portfolio and financial markets to support their cross-selling activities.

Accountability and Reward Linkage

Performance management systems are the pivotal points used to communicate, motivate, and reward employees for behavior that supports the Balanced Scorecard business objectives. We will align incentive plans to BSC business objectives to encourage behavior toward our business vision.

Focus Our Resources

We will focus our resources to align our capital, expense, and personnel decisions with strategic priorities. Allocating resources where the return is the highest, setting priorities on competing expenditures based on that criterion, and remaining focused will enable us to operate more predictably and profitably.

The subgroups, with assistance from lower-level managers, then developed measures for the objectives in their assigned BSC perspective. By the end of 1993, the entire group had reached consensus on a complete scorecard for the New York Markets division (see Exhibit 4).

Francavilla noted that an immediate impact of the BSC project was to simplify the bank's strategy statements:

> Formerly, we communicated our strategy to the 8,000 people in the organization using the five dimensions on the left [see below]. We found we could boil it down to three core strategic themes which aligned well with three of the perspectives of the BSC. The scorecard focused our thinking in this way, and Mike [Hegarty] now communicates these three themes continually to all 8,000 people. It's been branded into their minds so that they know that if they're doing something that doesn't fit into one of these three themes, they probably shouldn't be doing it. And as we were building the scorecard, we found that we could relate each measure to one of those three themes.

ORIGINAL STATEMENTS	CORE STRATEGIC THEMES	BALANCED SCORECARD PERSPECTIVE
Focus on attractive markets Increase fee revenue	Shift the Customer/ profit mix	Customer
Improve service quality Improve operating efficiency	Improve productivity	Internal
Promote continuous learning and improvement	Create an enabled organization	Learning and growth

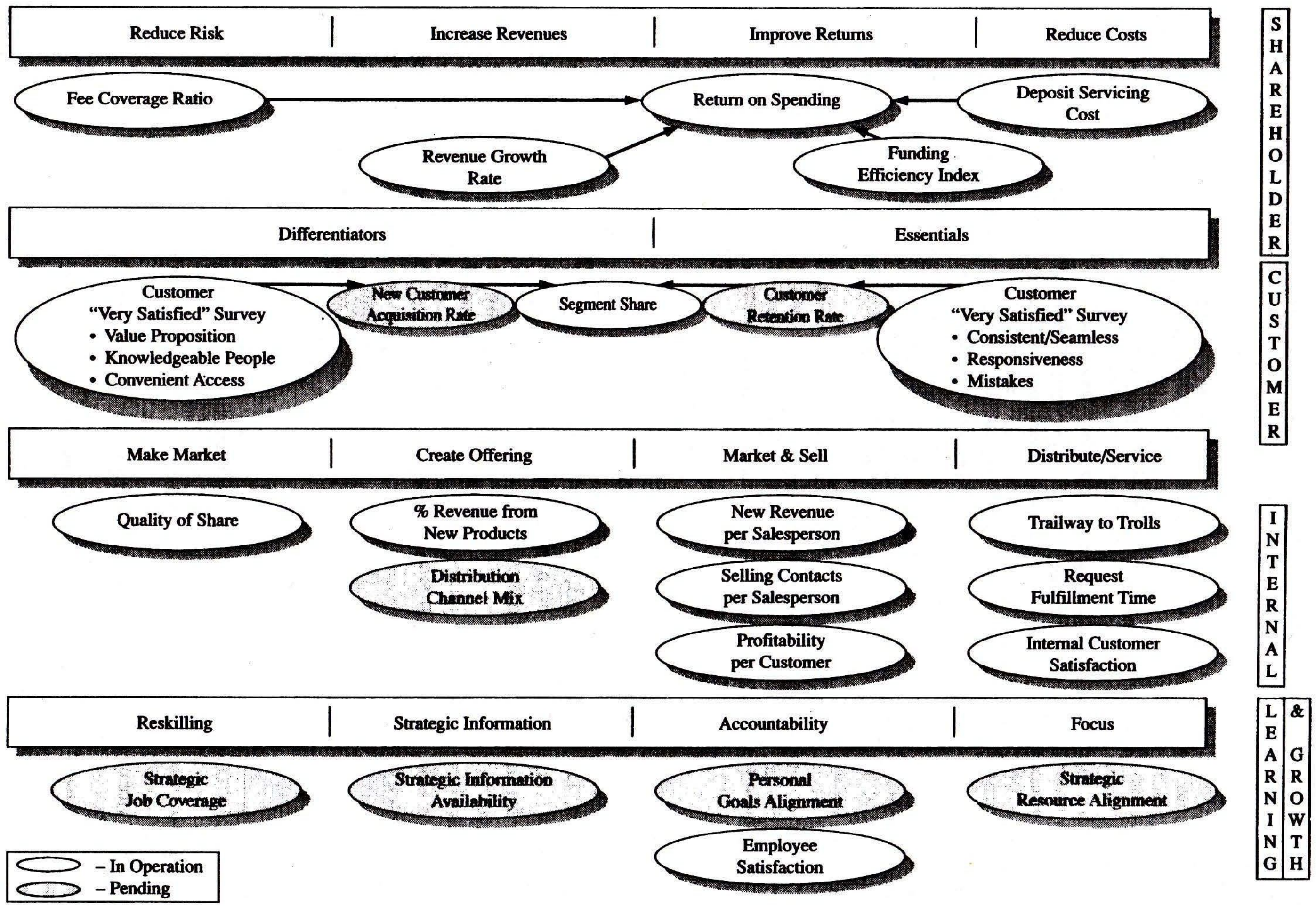

EXHIBIT 4 Retail Bank's Balanced Scorecard—Overview

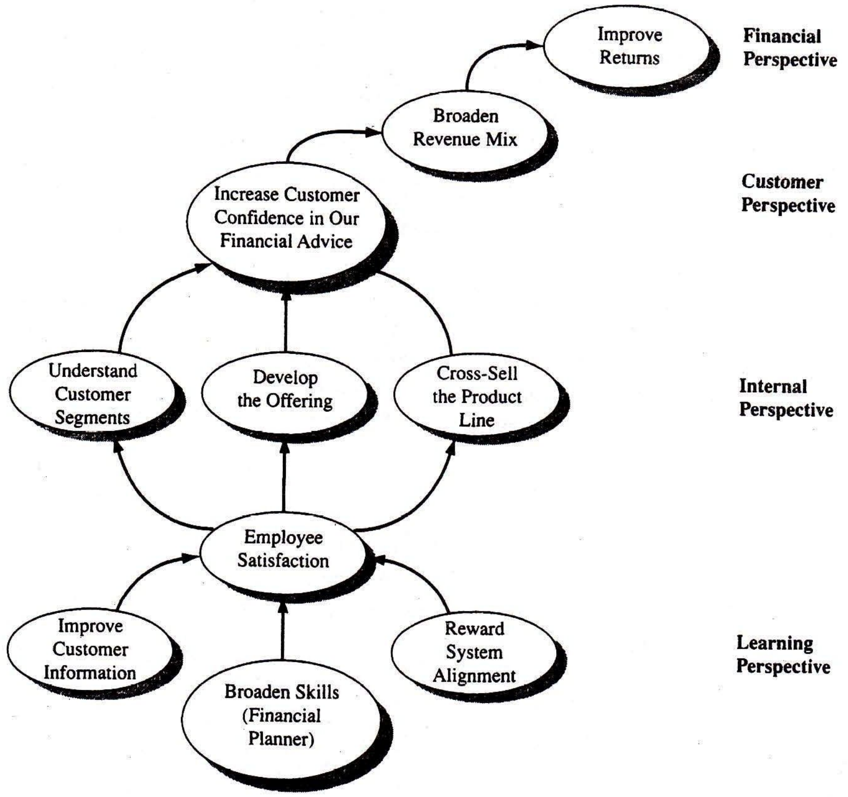

EXHIBIT 5 Strategic Objectives for Revenue Growth Strategy

In addition to aligning the scorecard measures to the three strategic themes, the team developed causal links across the objectives and measures. For example, two of the financial objectives—Revenue Growth and Reduce Risk—were expected to be outcomes from the theme Shift the Customer/Profit Mix. The BSC group linked the Revenue Growth and Reduce Risk outcome objectives back to objectives in, respectively, the customer, internal, and learning and growth perspectives that were the performance drivers of these outcomes (see Exhibit 5). This chain of cause-and-effect relationships illustrated that if the bank was to broaden and increase the set of financial products that retail customers transacted with the bank, then it must shift its image from a provider of a narrow set of banking services to becoming a financial adviser and service provider for targeted customer groups—an objective to *Increase customer confidence in our financial advice.*

Having specified the link from financial objectives to customer objectives for the Broaden Revenue Mix objectives, the BSC team then linked to three of the internal objectives that its people must excel at if the bank were to create its new image as a broad provider of financial services:

Understand customer segments
Develop new products
Cross-sell the product line

These internal processes were now identified as vital to implementing the bank's Broaden Revenue Mix strategy. Previously, performance measurement had focused on continuous improvement of existing processes like check processing and teller transactions. Thus the BSC process, starting from identifying financial and customer objectives, had highlighted several new internal processes for the organization to develop best-in-class delivery capabilities.

The three internal perspective objectives led naturally to objectives in the learning & growth perspective. The bank's customer representatives would have to expand their skills, so that they could serve as a customer's financial counselor, and communicate credibly and knowledgeably about an expanded set of financial products. The customer representatives also would need ready access to information on all the bank's relationships with each customer. The incentive system for the bank's employees would also have to be changed to encourage the new behavior and skill acquisition. These three enablers—new skills, access to strategic information, and aligned incentives—would contribute to more capable and skilled employees who, in turn, would drive the internal process objectives. Each objective in the Retail Bank's BSC was similarly linked in a series of cause-and-effect relationships that told the story of how the bank's strategy would be accomplished.

Francavilla commented on the benefits from establishing the linkages in BSC objectives and measures:

> In the past, we found it hard to get and maintain focus on our infrastructure—things like MIS and employee training and skills. We talked about their importance, but when financial pressure was applied, these were among the first spending programs to go. Now with measures of Strategic Information Availability and Strategic Job Coverage on the BSC, people can see the linkages between improving these capabilities and achieving our long-term financial goals. The BSC kept these issues front and center for the senior management group, so that a focus on these infrastructure investments could be sustained even in a highly constrained environment for corporate spending.

Lee Wilson, Chief of Staff for the Retail Bank, concurred with this view:

> The process has increased learning in the organization. Everybody agrees on the overall objectives, but it takes time to align 8,000 people and make appropriate infrastructure investments and commitments. If we stay the course, the BSC's learning perspective will enable Chemical Bank to really deliver superior service sooner than other banks.

By the end of 1993, measures for each of the objectives had been selected and a senior manager had been designated for collecting the information and reporting on each measure. For example, the owner of the three measures, under "Market & Sell" was Dave Mooney, manager of the Manhattan branch network, who reported to Jack Stack, the Managing Director of Sales and Service (see Exhibit 2). Mooney met frequently with branch marketing and selling managers and with Jack Stack to discuss progress along these three measures.

Impact of the Balanced Scorecard

Lee Wilson had not come to the bank until April 1994. While he had missed the 1993 process that led to the BSC, he could offer observations from his somewhat independent perspective:

> I see the BSC as a very valuable tool for the management team, but one that needs to keep evolving. To begin to appreciate the value of BSC at Chemical, you have to understand that its primary benefit was to pull together the two management teams. At Manufacturers Hanover, company-wide policies had been handed down by a strong central staff. Chemical, on the other hand, relied on a more decentralized approach. Given the two

> cultures, there were inevitable tugs-of-war between them after the merger.
>
> In early and mid-1993, the BSC meetings provided a mechanism for the senior people to focus on a common objective: devise a new strategy for the Retail Bank. Those meetings allowed people to come together and overcome their differences in assumptions and styles. A powerful shared sense emerged in these meetings about how the combined bank could capitalize on the potential from its new scale of operation. The BSC gave the senior executive group a positive perspective, focused on serving customers in a learning environment.

Francavilla concurred, recalling the frustration of attempting to develop a consensus on strategy in 1992, shortly after the merger:

> Everyone had agreed to the strategy—"Provide superior service to targeted customers." But we couldn't agree on how to implement this strategy since everyone had a different opinion about what superior service really meant, and who our targeted customers should be. The BSC process gave us specific and operational definitions of superior service and targeted customers.

But the glow of consensus-building gave way to frustration in late 1993 as work teams began to struggle with implementation. Several of the measures were difficult to obtain. People debated whether to use substitute measures or leave the measures blank until improved data systems could be developed.

Senior managers also noted that the BSC was quite visible only in the lives of 27 top-level managers in the Retail Bank. It was not yet being used to drive change throughout the organization. Some of the BSC themes had been communicated to employees through the monthly newsletter, *News & Views* (see Exhibit 6), and at the annual Branch Managers meeting. But the BSC had not been communicated to rank and file employees as a new management tool. LoFrumento explained:

> We got delayed by gaps in our measurement system. We had most of the information on customer satisfaction and customer profitability, but we didn't have the requisite data on customer share and retention by segment. The data for some of the new measures, like Strategic Job Coverage and Strategic Resource Alignment, did not exist at all and had to be created and developed by the responsible department. Even when we had some data, such as the mix of transactions in different channels, we had problems bringing together the information from diverse systems. As a result, we haven't built a credible base yet. The measures are just now on board. The tracking has just begun.

Wilson felt that some of the BSC measures were not critical for customer satisfaction goals, nor actionable. He explained:

> We have an internal measure called "Trailway to Trolls" [Trolls are unhappy customers]. This index aggregates over a hundred different measures of customer complaints and degrees of dissatisfaction, but it isn't actionable. If the Trailway to Troll Index starts to deteriorate, I don't know if it's been caused by performance that valued customers consider critical, or whether it's a minor matter. When it was first developed, it was quite valuable in focusing management's attention on service quality. But we can't do quality for quality's sake. We need to focus on those dimensions most critical for meeting or exceeding customer expectations of service quality. And to do that we need measures that are actionable.

Measuring Customer Profitability

William Jordan, Managing Director, had market management responsibility for the consumer and small business activities in New York Markets. When asked for his perspective on the BSC, he immediately voiced his support, and expressed, in strategic terms, the fundamental importance of BSC:

> We tend to focus on the short term and the month-by-month financials. This makes us excellent at tactics, but sometimes we find it difficult to think strategically about where we should be three to five years out. The Balanced Scorecard provided a forum for

EXHIBIT 6 Retail Bank *News & Views* (Fall 1994): "Customer Focus" (page 3, excerpts)

Segmentation: A Way to Get to Know Our Customers Better

Consumer Market Management recently completed analysis of the files of all 1.2 million deposit households of the Retail Bank and has assigned each household two scores: one indicating current relationship profitability and the second indicating the customer's Financial Personality segment—a strong indicator of potential profitability. The availability of this information is critical progress towards putting segmentation data into action.

Shifting the Customer/Profit Mix in New York Markets

One of our strategic goals is to increase the number of profitable customers. There are two related ways to develop and maintain a more profitable customer base. One is to provide exceptional service with targeted offerings to those customers who are currently highly profitable in order to strengthen the relationship and retain them longer. The other is to encourage customers who are most likely to become profitable to do more business with Chemical. The profit scores and segment codes can help us achieve these ends by helping us identify those customers.

The Segment Coding Process

The data-gathering process began with a comprehensive study involving 2,000 customers and noncustomers who were asked over 200 questions about how they handled money, their attitudes toward banks, and many other subjects. This initial study resulted in the identification of five financial segments. After establishing the Financial Segmentation framework, Consumer Market Management administered a much shorter questionnaire to more than 25,000 customers.

Measuring Customer Profitability

In addition to the segment codes which have been assigned to all retail deposit customers, actual profitability scores were assigned to customers of record as of December 1993. The profit score incorporates both the revenues and expenses associated with deposits, consumer and shelter loans, and revolving products for each individual household. There are four profitability levels:

Premier The most profitable customers.
High Profitable because the revenues from fees and spreads more than cover the costs of the products and services we provide them.
Medium The bulk of our customers yield a small profit on the products and services we provide them.
Low Generate little or no profit for the Retail Bank. In many cases, the revenues generated by their accounts do not cover the costs of providing the services.

How We Will Utilize This Information

During the first quarter of 1995, a profitability and segment information will be available on-line. With information provided in a workbook, a video, and an interactive training disk, branch staff will be able to improve their sales efforts by customer segment and profit score. The ablity to identify the most profitable customers for superior service will be made possible with this information. This should ultimately result in more business from our most profitable customers and more profitability for the Bank.

senior management to have active discussions about both the present performance and future targets we must achieve. I like the way it forced us to think about revenue opportunity and potential, and how we should measure our progress down the path that will insure our future.

The BSC reinforces the need for a new focus on the customer, especially the need to get to a more profitable mix of customers, and to retain and deepen our relationship with our best customers.

Jordan for years had believed that most of the Retail Bank's small business accounts were profitable. Recently an activity-based cost study had matched "costs to serve" with "revenues earned" down to individual customers. The study showed that only 55% of small business accounts were profitable on a fully loaded basis. This information prompted Jordan to launch several new initiatives to enhance small-business customer profitability. He wanted to know the defining characteristics of profitable and unprofitable customers so that he could begin thinking about how unprofitable accounts could be made profitable by changing earnings credit, or minimum balance, or perhaps introducing fees and better control over fee waivers.

Jordan, however, emphasized:

> Although we have raised our consciousness about strategic measures, the measures are not yet integrated. For 1995, I would like the BSC teams to identify a number of top-of-mind measures, perhaps as few as two or three, that reflect our strategic themes and priorities. I want to see a graphical presentation of the BSC that gives us a five-year view of the journey, and to be able to view short-term performance in terms of progress towards our five-year targets.

Taking Sales Measures to the Branches

Dave Mooney was implementing one of the first BSC measures—"Selling Contacts per Salesperson"—in the Manhattan branches. He recalled his first impressions of the BSC:

> I remember thinking, as we were going through it, how valuable the process was. It forced us to specify and understand the simple causal linkages from high-level financial objectives to operational measures. The BSC was well accepted because it was very consistent with our management philosophy to focus on activities, process, and components that, according to our theory of linkages, must be accomplished to produce the outcomes we desire.
>
> But as simple as that sounds, we weren't working the fundamental processes. Like most other banks, we had been managing by hammering on outcomes. We kept telling people, "Get more deposits!"
>
> In the summer of 1993, we started to focus on a measure at the beginning of the causal chain—how to make more sales contacts with customers. We now realized that a necessary condition to produce new sales was for our sales people to have more customer contacts. So my first step was to ask for 10 *completed* contacts per sales person every week. The sales people responded, "We can't do that. We're too busy." But we dug in and told them that we were serious about this objective. Selling was no longer to be an optional or discretionary activity, to be done if time allowed. Selling must become something that you find time to do.

Mooney emphasized the importance of taking hold and managing the problem at that point. "There is an important lesson here," he said. "Measures don't manage. The BSC gave us an engine, but it was management that had to put the vehicle in motion." Mooney was asked why the Balanced Scorecard was required to encourage sales people to do more selling. He replied:

> A lot of ideas were converging at the same time. We were just putting into place a more formal, highly structured customer calling process that produced the customer-contact measure. But then this measure had to survive a highly competitive debate that the senior management team put all prospective measures through to create the BSC. My confidence increased about the importance of that measure and of the selling activity. The great value of the BSC was that it articulated the key levers of performance and reduced these to a few important drivers.

He recalled that implementation became easier when the first results of increasing sales contacts with customers were known:

> We started to see phenomenal results, two and a half to three product sales for every 10 contacts. That helped. But there was something else going on as well. People learned that the senior executives at the bank were not going to stop caring about this measure. The four or five people who ran the branch districts knew I was going to have to report out on the measure to Jack Stack and Mike Hegarty. That's one of the powerful features of the BSC: it's both motivating and obligating. The BSC forced us to stay on track and to follow up.

Looking Ahead

When asked to assess the current status of the BSC, Francavilla stressed that the work was well under way but nowhere near complete.

> The scorecard has been very useful in helping us better understand the key drivers of our business. Our monthly financial review meetings have now become strategic review sessions with some excellent learning and idea generation.
>
> But the BSC is still a senior- and middle-management tool, a work in progress that we are not yet ready to introduce to the entire organization. If you were to walk into any branch in Manhattan today and ask how things are going with the BSC, they wouldn't know what you're talking about.

He and LoFrumento were intent on refining the BSC for 1995, hoping to identify fewer and better measures. They continued to live with the frustration of finding that certain measures were harder to get than they had anticipated. In 1994, they had contracted with an outside vendor to track customer retention data. After months of reported "progress," the vendor finally admitted that it could not deliver the data. The implementation team had therefore assigned this task to an in-house expert.

At the same time, LoFrumento felt that they had come a long way:

> There's a lot we know we have to do, things like being able to track customer acquisition and retention. But we're probably ahead of the competition. Most banks are working with aggregate bottom-line information. They may know that 20% of their customers are generating most of their profits, but they don't know who those customers are. They are still living in a world where a marketing program would be hailed as a success for bringing 10,000 checking accounts into a bank—and the bank would never know that 9,000 of those accounts were going to lose money.
>
> We are well beyond that point. We now have three million accounts in our data base, and we can do any number of cross cuts on those accounts. We can look at deposits, credit cards, and very soon loans, and know just how profitable each account and each customer is.

Francavilla added that knowledge of customer segments and customer profitability was already driving the pricing of some products, and was allowing the bank to be far more sophisticated in designing new products and marketing programs.

In summing up, Francavilla said that there was more to be done on the infrastructure. "We've just scratched the surface on the power of Lotus Notes, for instance. Not just for E-mail but the database side," he said. "And, of course, BSC itself is a tool that we will apply increasingly more rigorously as it improves." Then he went on to describe a future that would find performance goals, and performance reviews, aligned to the BSC. And once that happened he and LoFrumento expected that results would follow.

Lee Wilson concurred that for the BSC to truly drive behavior, it would have to be linked to compensation of senior executives:

> In 1994, the size of the compensation pool was tied to financial measures and BSC measures, such as customer satisfaction and customer retention. In 1995, we are making linkages much more explicit between BSC measures and the compensation to Top-20 executives. In future years, we will drive this process down through the organization.

Mike Hegarty summarized his views on the BSC:

> I like the BSC because it is both a forward-thinking tool and one that will supply the measures that will drive improved performance in our branches. And while BSC is not promoted in the branches under the name "BSC," it is visible in the branches. For example, if an ATM at a given branch isn't serviced, a computerized monitoring system will make a phone call to a branch manager and tell her that ATM number 3 will go down

in 10 minutes. And if a branch manager should, say, decide to let three ATMs go down, the computer will call Dave Mooney and give him a status report.

The team that made that kind of monitoring possible understands how that all fits with BSC, but the branch manager probably doesn't think of it that way. The 2,000 tellers in our branches will be able to tell you the dozens of things we are tracking—from customer satisfaction data to cleanliness in the ATM areas—but they won't know it by the name BSC.

By the end of the year, branch managers will not only tell you what we are tracking but also tell you how they are performing on key measures. They will know, because they will be evaluated on how they perform on designated measures. We will even have bonuses determined by multiple measures that are weighted by revenue contribution to the bank.

I'm not saying we have done it all. One major problem right now is that I have no idea how good my salesforce is. That evaluation is not happening. We're also just beginning to rethink training, and we will have to find new measures to evaluate that training. But again, that's the virtue of the BSC. It is a tool that can get us to new goals and measures, and then to a process that will take us beyond those measures.

We always had communication. That part isn't new. But the communication was by anecdotes, and not a basis for setting priorities for programs or for resource allocation. The BSC came along in the resource-constrained environment of the 1990s, where excellence in revenue, expense, and investment management would be decisive. The BSC will help us to take the "noise" out of the anecdotes, it will tell us whether we have the right priorities for our activities and whether our activities are in synch with our strategy.

And finally, it provides us with feedback on our strategies, whether they are working and whether we have set our targets high enough. The scorecard is helping us all to learn and to enable change.

United Way of Southeastern New England (UWSENE)*

The Balanced Scorecard is really a managerial tool, not a policy tool. A CEO needs to keep the Board fully informed but not overwhelm the members with details and operational decision making. There is a delicate balance about how much information and detail you provide. I certainly report to the board and seek their approval of where I want to take the organization. But the vision is mine. Having said this, I would be comfortable sharing the BSC in depth with the board and reporting how we are doing on the measures.

Doug Ashby, President, UWSENE

History

United Way of Southeastern New England (UWSENE) is a not-for-profit corporation operating in the state of Rhode Island and adjacent communities in Connecticut and Massachusetts. United Way organizations provide services to donors, communities, and social service agencies. They enable individual donors to contribute, in an annual consolidated campaign at their workplace, to a wide range of human service programs in their communities. UWSENE conducts workplace campaigns at over 900 work establishments. A separate mail campaign solicits thousands of individual givers not associated with a workplace. United Way organizations provide community services by giving local

*Professor Robert S. Kaplan and Research Associate Ellen L. Kaplan prepared this case.

human service agencies access to the fund-raising capabilities of United Way. UWSENE directly funds more than 100 agencies through its Community Care Fund and Critical Issues Funds allocation processes. In addition, a donor choice option enables individuals to reach directly many additional agencies (more than 1,300 in 1995). UWSENE also provides agencies and other funders with information and technical assistance to assist in program planning, service coordination, and service improvement. Its community building initiatives support community development, children and families, welfare reform, and jobs.

Consolidated fund raising in Rhode Island originated in 1926 to eliminate the inefficiency and disorganization caused by having each individual social service agency conduct its own annual fund-raising drive. The first Providence Community Chest drive raised its goal of $442,000. The organization subsequently was known as The Providence–Cranston Community Chest, the Red Feather, and the United War Fund. Over time, the federation of separate drives throughout towns and cities in Rhode Island, and nearby communities in Massachusetts and Connecticut, coalesced into the United Way of Southeastern New England. In 1995, UWSENE raised more than $17.4 million from about 68,000 donors; 63% from workplace campaigns, 21% from corporate gifts, and 16% from individual and foundation contributions.

UWSENE has an endowment of $50 million, the largest endowment of any United Way in the country. The income from this endowment, of about $2.5 million per year, and other income of about $400,000, covers all of UWSENE's fund-raising and management expenses. The endowment enables the organization to offer a guarantee that 100% of all funds collected from donor contributions will flow to community services.

Competition had emerged even in UWSENE's charitable and volunteer-based industry. Since the 1970s, the number of not-for-profit agencies seeking funding had tripled, and several of them had formed new federations to seek access to workplace campaigns. In addition, many organizations, such as hospitals, colleges, and the arts, had greatly expanded their fund-raising capabilities. Nationally, United Way's share of total philanthropy dollars was shrinking. Locally, UWSENE's share of agency budgets had fallen from the 40% level in 1975 to an average of about 10% in the mid-1990s.

UWSENE faced particular local challenges with declines in regional employment, downsizing and relocation of large corporate divisions, and shifts in employment to small, entrepreneurial enterprises. At the same time, increases in substance abuse, homelessness, single-parent households, and unemployment were increasing in the urban areas and old industrial communities served by UWSENE-funded agencies throughout Rhode Island.

Organization

Doug Ashby was president of UWSENE from 1987 to 1996, a period in which the organization had enjoyed fund-raising increases that were among the highest in New England.[1] Six vice presidents reported directly to Ashby: five executive vice presidents responsible for finance, donor services, community services, management information systems, and organizational development and marketing and a senior vice president of communications. Of the seven senior staff, three held MBAs, two had Bachelor's degrees, and two had Master's degrees—in social planning and communications. There were 40 additional staff providing profes-

[1]In late 1995, Ashby announced his intentions to resign on June 30, 1996.

sional and support services: 25 salaried and 15 hourly employees. UWSENE's president reported to a 21-member board of directors. The board consisted of representatives of UWSENE's constituent groups, primarily corporations, agencies, unions, and local government. The volunteer board of directors met monthly and was responsible for setting policy. In addition, UWSENE had an extensive volunteer committee system to make recommendations to the board on specific policy issues. For example, the finance committee, with staff assistance, made recommendations on all major financial matters. An extensive volunteer system, involving hundreds of individuals each year, assisted in donor and agency services.

In 1990, Ashby, with the support of senior managers and key volunteers, had developed and gained acceptance of mission and vision statements for UWSENE (see Exhibit 1). In 1991, the board began work on a five-year strategic plan based on the vision. Also, in 1991, Ashby and senior staff initiated a major effort to instill a total quality management (TQM) culture in the organization. By December 1991, the president and senior staff had developed the Eight Elements of Continuous Improvement (See Exhibit 2) and received approval from the board of directors and all the staff. Senior management would, through their actions and practices, set the leadership for improving customer satisfaction. They would involve all employees in activities and behaviors that would make UWSENE a more successful organization. During 1992, Ashby distributed copies of Stephen Covey's *Seven Habits of Highly Effective People* and developed a full-day workshop to encourage employees to translate the message into a framework for individual and organizational growth.

EXHIBIT 1 Mission and Vision Statement

Mission: Increase the Organized Capacity of People to Care for One Another.

Vision Statement

We see a future in which every person can have adequate food and shelter. Every individual can be safe from abuse and violence. Every individual in our community can learn to read. Everyone in our community can be healthier in significant, measurable ways. Every individual can have a drug-free future. Every child can succeed in becoming a happy, productive adult. Every elderly person can have a dignified life. Every individual can live in a clean and healthy environment. Every disabled person can live up to his/her full potential. And family life can be enhanced for everyone.

Our vision rests on the values inherent in private philanthropy and our belief that community needs, donor needs, and agency needs are one and the same. To bring about our vision, United Way will be an organization of the best volunteers and staff working together to:

- Increase private philanthropy for health services through a communitywide campaign
- Increase understanding of urgent community problems through year-round communications with donors, agencies, and other public and private institutions
- Increase value to donors through an inclusive system of donor choice
- Increase support to quality not-for-profit agencies that accomplish specific, measurable results
- Increase cooperation and develop alliances with public and private groups
- Increase our influence on public policy related to health and human service issues

To successfully implement these long-term community problem-solving strategies:

- We must ensure that our strategic direction, goals, and activities are aligned with our vision.
- We must ensure efficient and effective internal services to support the achievement of United Way's vision.
- We must constantly strive for the highest level of volunteer and staff excellence.

EXHIBIT 2 Eight Elements of Continuous Improvement

1. **Integrated Planning for Results** —All of the components of our planning effort—mission, vision, strategic plan, annual plan, and plans for departments and individuals—will be consistent with each other and will form a continuous, smooth cycle of operations. We will develop measurable objectives at each step in the process and regularly measure our progress. The end result of integrated planning is a cohesive, customer-focused, results-focused plan that drives our United Way forward as it is executed.
2. **Customer Focus** —United Way's customer groups include donors, agencies, recipients, volunteers, and staff. The needs of each customer group will be understood and satisfied to the utmost of our ability. Satisfied customers will be the most important measure of our success.
3. **Benchmarking** —To achieve excellence, we will seek out those businesses, United Ways, and other organizations who "do it best," find out how they do it, and import those ideas and programs as standards for our organization. Then we will improve our efforts until we meet or exceed those standards.
4. **Employee Involvement** —All employees will be encouraged to participate through multiple opportunities to make suggestions and in planning, decision making, and problem solving. Supervisors and department heads will set an example by seeking out and being open to diverse ideas and opinions, by responding to every idea with respect and appreciation, and by coaching employees to take risks and try new ideas.
5. **Teamwork** —Everyone in the organization will be an active, contributing member of various teams. Everyone will be able to see how his or her role is an integral part of achieving our goals. Participation on teams—one's own department, cross-functional project teams, and continuous improvement teams—will be the vehicle to achieving success. Teamwork will be facilitated through strong, ongoing employee communication efforts.
6. **Training—Training—Training** —Learning is never over. At every level of the organization, new knowledge will be systematically and purposefully acquired and deployed. We will develop a training program that involves the whole organization on topics of major importance and will provide targeted training for departments and individuals to expand their capacity to do their jobs and achieve their goals, such as workshops, readings, and conferences, lectures, skills development.
7. **Research-Based Decision Making** —Decision making will be based on facts, not best guesses or assumptions based on limited information. Ongoing market research, community needs analysis, special studies, and staying close to the customer are our most reliable tools for finding out what is going on and responding effectively.
8. **Performance- and Skill-Based Compensation** —We will reward the accomplishment of what we set out to achieve, not just what happens. We will develop performance standards and skill level standards that, when attained, will be rewarded with employee growth and advancement and incentives for results achieved. Programs will be designed to celebrate individual, team, department, and organization success.

As part of the continuous improvement commitment, UWSENE collected and reported extensive information about operations. Financial summaries of cash flow, payables, and receivables were reviewed daily by the controller. Each month, management and the board reviewed financial statements that tracked collections, other revenues, investments, disbursements, and the balance sheet. Statistics on individual, company, and division giving were scrutinized daily during the annual campaign. Trends in donor designation and satisfaction were also monitored. As part of the employee empowerment initiative, UWSENE began an annua employee satisfaction survey and also startec to track dollars spent on training and numbe of courses taken. Ashby commented on th importance of TQM for the organization:

> In the past, the United Way customers were told to give, and they gave. They felt good about it, but they didn't have an alternative since we were almost a monopoly. But with increased competition, we woke up one day and noticed our customers were going away. TQM has been a savior, focusing us on listening to the customer. If the customer doesn't agree with what you're doing, even if you've been around for 100 years, you won't

> be successful. So we picked up the ball and shaped TQM to fit a not-for-profit. We worked on providing consistent quality and reducing our cycle time. Customers want answers right now, today. That's what we're working on.

UWSENE submitted an application in 1994 to the United Way national competition for the Excellence in Service Quality Award, modeled after the private-sector Malcolm Baldrige National Quality Award. The agency received the Bronze Award, signifying "a formal prevention-based system deployed and used in many major areas, with evidence of positive trends caused by the approach."

Launching the Balanced Scorecard

In late 1995, Doug Ashby received a phone call from United Way of America (UWA) to determine whether he would be interested in a pilot project. Faculty from the Social Enterprises (SE) interest group at the Harvard Business School (HBS) had contacted UWA asking it to participate in a joint research program to investigate the applicability of a new performance measurement approach, called the Balanced Scorecard (BSC), developed for the corporate private sector. The BSC retained *financial measures* but supplemented these with the drivers of future performance: *customers, internal business processes*, and *learning and growth*. The BSC's emphasis on non-financial dimensions of performance seemed quite applicable to not-for-profit organizations. The request came at a propitious time for UWSENE. Ashby knew that the five-year strategic plan adopted in 1991 was nearing the end of its cycle. He felt that the current planning process was not sufficiently integrated with the organization's quality initiative and envisioned that the BSC might provide the missing linkages. He consulted with his senior staff, and they agreed to learn more about the proposed project.

An HBS team conducted a morning briefing session for the seven senior managers in January 1996 at the Providence offices of UWSENE. The session introduced the BSC, gave examples of how it was working in private-sector companies, and what the benefits might be in a not-for-profit setting. After the meeting, the management team concurred that this approach might help them achieve even greater alignment of employees to UWSENE's vision and mission. Before proceeding, however, they wanted to expose all of their professional employees to the concept and gain their approval and commitment to the project. One month later, the HBS team gave an afternoon briefing to all the staff. After a lively discussion, the organization agreed to go forward with developing a Balanced Scorecard for UWSENE.

Developing the Scorecard

Eileen Moser, Executive Vice President of Organizational Development and Marketing, was selected to be the senior manager responsible for spearheading the BSC project. Moser had directed the implementation of the TQM effort at UWSENE. Under Moser's direction, Kelly Nevins, Director of Donor Services, assumed the role of on-site facilitator. An outside consultant, Ellen Lasher, volunteered to facilitate the scorecard-building process.

Moser launched the project with a series of brainstorming meetings and senior-level interviews, facilitated by Lasher and Nevins. During these initial meetings and interviews, managers were challenged to translate the mission of UWSENE—*increase the organized capacity of people to care for one another*—into meaningful, measurable objectives. They attempted to identify the critical drivers for strategic success and to reach a consensus on the highest priorities for achievement and improvement at UWSENE.

The senior staff found it relatively easy to agree on objectives for the financial and the learning and growth perspectives. For example, the financial objectives stressed the cost-effective generation of funds. The learning and growth perspective emphasized employee development and alignment with organizational goals. Much more debate occurred about who were the customers of UWSENE, what were the drivers of customer satisfaction, and which were the internal business processes that would deliver the products and services valued by customers.

Several constituencies could have been represented in the customer perspective: donors, volunteers, employees, agencies, and the individuals who were the ultimate recipients or consumers of agency services. Ashby framed the choice:

> United Ways have three primary choices. They can be donor-focused, agency-focused, or community-focused.
>
> With a donor-focused organization, you let the donors have free rein about their funding decisions. A significant proportion of donors will allocate their money outside traditional United Way member agencies, and these agencies will get less money. Funds will be more widely and differently dispersed.
>
> An agency-focused organization would identify and collect the best agencies in the community, ensure that they are well operated, and monitor that they do the best job and provide the best results. The agencies become the power behind the United Way, but agencies outside the system will feel unfairly treated by United Way, will want to access corporate payroll deduction campaigns, and may join with rivals of United Way for this access.
>
> A community focus would identify the most pressing needs of individuals in the community and aim United Way efforts at solving those problems. Success by Six[2] is a good example. The downside of this approach is that many agencies get left out, and you may not meet the interests and needs of many of your donors.
>
> Each of the three strategies is good, with the potential to yield positive end results. But each entails considerable downside risk. Many United Ways switch strategies, say, to meet specific community needs, for very good reasons but then are surprised when their agencies and donors get upset. UWSENE has definitely become a donor-focused organization, believing that if the donors are satisfied, then agencies will be provided for. That is why we chose the donor as the primary customer on the scorecard.

With this choice, the objectives for donors on the customer perspective became relatively straightforward to articulate. And the team formulated initial internal business process objectives that would deliver the financial and customer objectives. The team also discussed whether the four perspectives of a for-profit BSC were adequate and appropriate for its scorecard. Lasher suggested adding additional perspectives, say for agencies and for volunteers. Agencies, using United Way funds, supplied needed services to communities. Volunteers, through their board service and extensive participation in the annual campaign, provided substantial personnel resources to UWSENE. Ashby, however, felt that the four basic perspectives had sufficient flexibility to include objectives that would address the organization's relationship with agencies and volunteers.

The decision to exclude agencies remained a concern through the remainder of the project. Moser admitted that by excluding agencies from the BSC a gap existed:

> We could not sort through the issues of whether agencies are suppliers or customers. They are definitely a constituency, but where do we put them? We've been arguing about this for years, and this process has brought it home one more time, big-time. This issue is hanging out there like a red flag because we've got to figure out the meaningful relationships that we should have with our agencies.

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[2]This initiative was a strategy to improve the education and well-being of children under six years old.

Lasher also suggested that the BSC might include a perspective to represent the overriding vision of the organization. Unlike for-profit organizations, where excellent financial performance is the ultimate objective, not-for profit organizations use their financial resources to fulfill humanitarian missions. Keeping the mission visible in the BSC would serve as a constant reminder that the ultimate goal of UW was to contribute to the betterment of the community. But the senior staff wanted a BSC that resembled those produced in the private sector and decided to work within the existing four-perspective framework.

Employee Involvement

Ashby, Moser, and other senior managers presented the tentative objectives for the four scorecard perspectives to the entire staff. They assigned employees to the four teams that would refine and define the objectives for each perspective, establish the linkages between perspectives, and determine drivers and measures for the objectives on the scorecard. Employees were assigned based on individual preferences while still trying to achieve a mix of gender, department, level, ethnicity, age and personality type (measured by Myers-Briggs scores).

Initially, employees were both skeptical and concerned about the process. Many saw the BSC as just another "flavor of the month," an effort that would take a substantial amount of time and then fall by the wayside. Others did not want senior managers to get too involved with the process, such as by editing or rejecting the drivers and measures they had selected. These employees saw the BSC as an opportunity for increasing employee empowerment, and they wanted ownership rights without senior management veto rights over their contributions.

Ashby felt that employees had lost sight about the primary purpose of the BSC. It was not a mechanism for employees to make decisions about strategy and objectives. Senior management wanted active staff involvement in contributing to the scorecard, but employees had to realize that senior managers retained the right to edit and eliminate measures. Also, the implementation plan for the scorecard would be the prerogative of senior managers. At the request of senior management, Lasher addressed the ownership issue with the employee teams, discussing with them how they could develop the drivers and measures for the objectives identified by senior management. Ideally, she explained, the final BSC would reflect how staff roles and responsibilities would link to achieving the strategy and vision formulated by senior management.

The internal business process team had the most active debates. One related to how the BSC was linked to the total quality culture at UWSENE. Initially, the team proposed to have dozens of quality measures, one for each major process, on the scorecard. Eventually, they decided to use a few aggregated quality indices, such as *timeliness of processes compared to customer expectations* and *reduction of errors and rework,* to summarize individual process quality performance. The detailed measures of individual process quality would be presented on the relevant departmental scorecard.

The internal business process team also recognized the need to evaluate UWSENE products and services. Several new products and services were added each year, and rarely was an existing product or service eliminated. No methodology existed to review the contribution of new or existing products to the organization. The team struggled with developing an evaluation program, and this became a central focus of the group. The team started to get side-tracked on an issue that, while important, was quite complex and not central to the development of the scorecard. The team agreed to a suggestion made by Lasher to include as a scorecard objective *a timely review of effectiveness of all products and services.* The organization, over time, could establish an initiative to develop a comprehensive evaluation procedure. The BSC identified this objective as critical and strategic; how it would be accomplished was not a BSC issue.

When the teams presented the scorecard to management and management made their final modifications, several staff members were disappointed that changes and cuts had been made to their document. Ashby brought the document back to the teams for a discussion of why the changes had been made. This step succeeded in restoring some goodwill; the staff now felt that management cared about what the teams thought. Not everything was put back in the scorecard, but the teams felt that they had been consulted. Employees remarked, however, that, had Kelly Nevins been involved in the final senior management decisions, their views would have been better represented and fewer alterations would have been made. The staff felt that Nevins, as a midlevel manager and facilitator, was more objective about the scorecard and did not have as much vested interest in the project as Moser and Lasher.

UWSENE reached closure on its initial BSC by the end of June 1996. The objectives and measures in the four perspectives are shown in Exhibit 3. The process had taken about four calendar months and the active involvement of all levels of management. An immediate task was to obtain the data for the BSC. Moser noted:

> Even with all the focus on data gathering and measurement from our TQM program, we still needed new data for some of the scorecard measures. About half the measures will require repackaging existing data or gathering entirely new data.

The BSC was handed over to departments and teams to develop stretch targets and initiatives for each measure and to assign responsibility for each measure. The responsibility included specified dates for reporting on results: monthly, quarterly, or annually.

Balanced Scorecard and Total Quality Management

Some employees wondered about how the BSC related to the organization's TQM program. The senior managers believed that the BSC provided a valuable complement to UWSENE's TQM efforts. Moser noted an important connection:

> In many not-for-profits, the strategic plan can be very much board driven, while quality is a staff initiative. This leads to a large disconnect between strategy and operations. Even in our organization, where senior staff are heavily involved in both planning and quality, the two efforts were far apart. We tried, with our strategic planning structure, to bring the two pieces together, but it was too complex. With the BSC, we now see what we have to do to accomplish our mission and fulfill our vision. The BSC gave us a structure that linked our quality initiatives to the strategic plan. For example, by building a new system to measure the success of a new product, we're building quality into our business processes.

Ashby concurred:

> The BSC gave us a way to pull all the pieces together with some specific measures. Rather than have each department come up with its own goals, the BSC demonstrated how the organizational efforts fit together and how departments coordinated with one another. We could now look at UWSENE as a single interconnected system.

Bill Allen, Executive Vice President of Community Services, also agreed with the connection:

> The BSC provided a unity and focus to our TQM efforts, and also to our annual and long-

EXHIBIT 3 Strategic Objectives and Measures in Four Perspectives—Balanced Scorecard

PERSPECTIVE	OUTCOMES	STRATEGIC OBJECTIVES	MEASURES
Financial	External growth	Increase net amount of funds raised.	Achieve targeted annual giving in all categories (employee, corporate leadership, etc.). Broaden mix of sources of funds (special events, grants, endowment, new products, etc.). Achieve targeted number of donors in each category.
	Internal stability	Balance internal income and expenses to maintain our 100% guarantee to donors.	Achieve a balanced internal budget. Reserve funds as a targeted percentage of operating budget. Achieve targeted internal income. Achieve targeted internal expense
	Community building	Increase amount of funds that go to services.	Achieve targeted dollar amount of funds sent to agencies.
		Increase amount of funds that go to proprietary products.	Achieve targeted dollar amounts of funds sent to proprietary products (CCF, CI, Phil Fund).
Customer	Customer satisfaction	Recognition	Customer feedback on current recognition programs Strong recognition programs for donors and volunteers Customer wants and needs regarding recognition
		Ease of giving	Low level of error or rework Donor satisfaction survey
	Market growth	Products that customers care about and that will improve the community	Identify products that customers want and will invest in. Assess results achieved by products.
	Customer retention	Information on results	Increase frequency of testing donor perception of and satisfaction with results through surveys and other feedback mechanisms. Track the number of information vehicles and success stories providing results, and assess their effectiveness.
		Quality, timely service	Reduce errors and cycle time in customer service. Identify customer expectations for "timely" service regarding products, inquiries, information, complaints. Track number of opportunities we give customers to give us feedback on our service. Improve customer retention rate.
Internal business process	Key internal business processes based on quality	Improve key internal processes in the following areas: Fund raising Fund distribution Community building	Timeliness of process vis-à-vis customer requirements

EXHIBIT 3 Strategic Objectives and Measures in Four Perspectives—Balanced Scorecard
continued

PERSPECTIVE	OUTCOMES	STRATEGIC OBJECTIVES	MEASURES
		Information processing/ communications Pledge processing Product development Volunteer/staff develop-- ment Customer service Interdepartmental communications	Steps in process have a value-add to customer Reduce error rate and rework Timeliness of information/feedback per customer requirement
	Develop innova- tive products	Develop a research and development process to come up with new, innovative products.	A process to generate and evaluate new products/services will be in place within one year. Number of products or services the new system generates and evaluates. Number of new products or services that do not go through the process.
	Maintain viable product line	Develop a consistent process for evaluating existing products and services.	Process for product/service evaluation will be in place within one year. Number of products/services evaluated by new process. Number of products/services changed, improved, or discontinued due to evaluation. Level of customer satisfaction with products/services after improvement.
Learning and growth	Employee productivity	Training and development	Percentage of employees with a training plan developed in conjunction with supervisor Number of opportunities for training Number of training hours
		Technology	Extent of technology deployment Degree of skill/advancement in use of technology
		Teamwork	Number of active teams that exist Number of successful teams that have "produced" something in the past year
	Employee satisfaction	Open and effective communication	Number of communications opportunities Employee satisfaction survey
		Employee ownership and involvement	Percentage of employees with a BSC for his/her position Number of opportunities for employee empowerment/involvement
		Agency assistance	Training and development resources that improve agencies

> range planning. We had a lot of teams doing a lot of things, but the efforts were ad hoc. Our TQM experience gave us a strong emphasis on teamwork and on good data gathering and measurement. The BSC brought this all together into a unified systematic approach. Now when we develop teams or assign responsibilities to departments, we do it within a framework. That's why we have been so excited about it.

Reactions to the BSC

Nevins had played a critical role in facilitating the employee teams that worked on the scorecard. She commented on how it should be used on an ongoing basis:

> When each department formulates objectives each year, we should make sure that everything we do is on the BSC. If not, we should question whether we should do it. Or if we're doing something because we think it is important, then why isn't it on the BSC. For the BSC to be effective, it must be a living document. Each year, as the organization reviews our annual objectives and formulates next year's objectives, it must modify the BSC to reflect the new priorities.

Moser concurred:

> The BSC needs to be driven by senior management. Any roadblock will come from us, since the staff want the senior managers to keep them involved, to hold everyone's feet to the fire. They worked very hard on the BSC, and they want to see it happen.
>
> The president and the senior managers have the responsibility to revisit the BSC with their staff and update it on a regular basis. This document can really direct our energies and help us eliminate a lot of the busy work and things we shouldn't be doing.

For example, the organization had been sponsoring a partnership with a local elementary school. Developing the BSC had raised the issue of whether to continue this initiative since it didn't seem to relate to any objective or measure on the BSC. Nevins noted the enthusiasm among the staff for the BSC.

> Everyone was involved in it. People could speak up. We had different teams providing input. We used to have strategic plans handed down from on high, and there wasn't the buy-in we now have from the BSC. It should start to change behavior.
>
> In the past, if you raised more money than the previous year, you felt that you had done a good job. But those departments not involved with fund raising didn't get any recognition for the success of the organization. Now we will look to all the BSC measures to assess our success in reaching our goals. Each employee can be seen as making an important contribution. Even someone who just writes letters sees that this task is critical for our fund-raising objective. Recognition will be spread around the table.

One manager, however, was disappointed in the lack of an overriding mission on the scorecard:

> The final document seemed like a much colder document than I would have imagined for an organization that is so mission-driven. Our scorecard doesn't have a feeling component to it. It seems so dry. Maybe it's only because of where I am in the organization, in community services, where the work that the few of us do here is so mission-driven, it carries a passionate meaning to us. The only way that seems to be captured is half of a phrase, "improve the community." And product, it's hard for us to think what we do is a product. I'm surprised at what the BSC looks like, though it is technically accurate.

But most expressed enthusiasm for the scorecard; as one middle manager said:

> You can relate to the BSC. It shows where you fit in the organization. You can see how you contribute to the customer or financial needs of the organization and to staff advancement. It's nice to feel that what you're doing is worthwhile, that it relates to the big picture. I learned things I never knew, even after working here five years. I heard a lot of people say "I never knew that!"

Scott Famigletti, chief financial officer, related a conversation with United Way's custodian about the BSC:

> Initially he felt that the BSC was only for senior management, not him. His job was to plow snow, paint walls, and remove trash, and these didn't have anything to do with strategy or mission. I explained that his efforts were very important to us. We generate considerable rental income from tenants in our building. By maintaining the property well, tenants and United Way employees will be pleased to work in the facility. That will help us generate more rental income that helps us fulfill our 100% guarantee to donors and also to attract, retain, and motivate our employees. In addition, donors and volunteers who visit our building will value a clean building, attractive landscaping, and streets from which the snow has been removed. I could see the light of recognition cross his face. He said, "You're right; I can see now how what I do is important." The BSC lets every employee see how he or she fits into the organization.

Another employee reacted similarly to the BSC:

> From the secretaries' point of view, we never felt like we fit in the picture. But we really do; we just didn't know it. The scorecard made me think of the little things I do every day that I never thought mattered, but I now see are important.
>
> I created my own individual BSC. You don't take as much ownership in a departmental scorecard as you do in an individual one. I can now see how to do things differently to help balance the internal budget. For example, someone tells me to subscribe to magazines. But we never determine if anyone actually reads these magazines. Are we just spending money on magazines to put at the front desk? Also, do we have duplicate subscriptions? I plan to start a project to determine which magazines are really useful to us. We get lots of magazines, and we could certainly cut costs by eliminating many of them.

Moser commented, however, that not everyone embraced the concept:

> Some people in the organization just don't do well with change. They are unwilling to participate and resist any new initiative.

The Board and the Balanced Scorecard

During his tenure as president of UWSENE, Ashby had worked closely with the chairman of his board of directors, Richard Plotkin, a CPA and managing partner of a regional accounting firm. Ashby and Plotkin had been in close contact, sometimes speaking three times a day. Ashby planned to present the completed scorecard to the board as a working document that could be modified based on board reactions. Plotkin noted: "The board has been informed about the Balanced Scorecard and is very supportive of it. At this time, however, the board is not as knowledgeable as it should be. More board involvement with the BSC would be desirable."

Bill Allen, who would be acting president after Ashby retired from UWSENE, believed that the scorecard would improve communication with the board:

> We will be able to provide organized, regular reports to the board on our progress on the strategic plan. Here is the plan, here's what we want to do, here's how we will measure it, here's when the data will be available, and this is when we'll have a report based on the measurements that we define. It should enable the board to play a more active role in the management of the organization.

Ashby agreed that the BSC would prove a more effective communication device:

> Many not-for-profit boards get too focused on organizational finances. Money is something that everyone can relate to and is interested in. Every month, the board sees a financial report, and often that is the first item on the agenda. I've participated in meetings where 75% of the time was taken up by the financials and only 25% by what is being done with the money. The Balanced Scorecard should provide an opportunity to broaden the discussions at board meetings.

Plotkin indicated how the BSC could improve board deliberations:

Board members are willing to work hard if they feel they are actually contributing to the organization. I am always searching for ways to increase participation at our meetings. The BSC can facilitate interaction by defining a more intense dialogue. Right now, the board advises, and that's the limit of our involvement.

Building the scorecard, however, while a search process for a new president was being conducted, had raised concerns. Ashby reported:

Everyone on the staff wonders whether the new president will buy into the BSC. We've made such an investment in the document that it would be very hard for a new person to come in and just dump it. People would just not have the energy to start work on another model. So a lot depends on the style and mindset of the new person who walks in this door. That is the enormous question mark. The staff wants to go forward, and somebody will have to pay a high price to discard the scorecard.

Moser, however, felt that an opportunity may have been missed:

Several presentations were made to the board about the BSC, but the members did not have any involvement. Our board is a brain trust of people with great understanding, and we missed an opportunity to use that resource and get a perspective that was not available from a purely staff-driven project.

Ashby commented on the impact of the BSC on the current search process:

The board's search committee is reluctant to say to an incoming executive, "You must use this document." They want to give the next executive the opportunity to shape his or her own systems, initiatives, and management processes. Had the scorecard been in place at the time of the search process, I believe it would have been quite helpful to the board. But these two events were happening concurrently.

Plotkin, who was chairing the search committee for Ashby's replacement, wondered how the scorecard project should influence the search for the new chief executive:

I think the new CEO should welcome the BSC with open arms and not feel threatened by it. We certainly want leadership that values quality and new ideas. Then again, the new CEO might not like to have his or her hands tied in this way. This could become an issue because of the commitment that senior and middle management now have to the BSC.

Ultimately, the BSC should improve UWSENE and help it to push out the envelope of performance. Board involvement with the BSC is the key to its long-term success. The board must be part of the process, because the BSC defines the strategy of the organization.

MOBIL USM&R (A1)*

From what I can see, we had a good quarter even though financial results were disappointing. The poor results were caused by unusually warm winter weather that depressed sales of natural gas and home heating oil. But market shares in our key customer segments were up. Refinery operating expenses were down. And the results from our employee-satisfaction survey were high. In all the areas we could control, we moved the needle in the right direction.

Bob McCool, executive vice president of Mobil Corporation's U.S. Marketing and Refining (USM&R) Division, had just commented on first quarter 1995 results. One ex-

*Professor Robert S. Kaplan prepared this case. Mr. Ed Lewis of Mobil's Business and Performance Analysis group provided invaluable assistance.

ecutive thought to himself: "This is a total departure from the past. Here was a senior Mobil executive publicly saying, 'Hey, we didn't make any money this quarter but I feel good about where the business is going.'"

Mobil U.S. Marketing & Refining

Mobil Corporation, headquartered in Fairfax, Virginia, and with operations in more than 100 countries is, with Exxon and Shell, among the world's top three integrated oil, gas, and petrochemicals companies. Mobil's 1995 return-on-capital-employed of 12.8% ranked it fourth among the 14 major integrated oil companies; its 19.1% average annual return to shareholders from 1991 to 1995 was the highest among the 14 major oil companies and exceeded the average annual return on the S&P 500 by more than 2 percentage points. Summary sales and earnings information are shown in Exhibit 1.

The corporation consists of five major divisions: Exploration & Producing (the "upstream" business), Marketing & Refining (the "downstream" business), Chemical, Mining & Minerals, and Real Estate. The Marketing & Refining (M&R) Division processes crude oil into fuels, lubricants, petrochemical feedstocks and other products at 20 refineries in twelve countries. M&R also distributes Mobil products to 19,000 service stations and other outlets in more than 100 countries. Total product sales had grown more than 5% per year over the past five years.

The United States Marketing & Refining (USM&R) Division was the fifth-largest U.S. refiner. It operated five state-of-the-art refineries, and its more than 7,700 Mobil-branded service stations sold about 23 million gallons per day of gasoline. This represented a 7% national share (number four in the United States). Mobil's retail network was highly concentrated. In the eighteen states where it sold nearly 95% of its gasoline, Mobil had a 12% market share. Mobil was also the largest marketer of finished lubricants in the United States, with a 12% market share and recent growth rates of about 3%, especially in premium quality blends.

In 1992, USM&R had reported an operating loss from its refining and marketing operations, and ranked 12 out of 13 oil companies in profitability from U.S. marketing and refining operations.[1] A profit tunaround started

[1]"Benchmarking the Integrated Oils, 1995," U.S. Research (Goldman Sachs, July 15, 1996), pp. 83, 85.

EXHIBIT 1 Mobil Summary Financial Information, 1991–1995 (000,000)

REVENUES, JUNE 19, 1997	1991	1992	1993	1994	1995
Revenues	$63,311	$64,456	$63,975	$67,383	$75,370
Operating earnings	1,894	1,488	2,224	2,231	2,846
Capital and exploration expenditures	5,053	4,470	3,656	3,825	4,268
Capital employed at year-end	25,804	25,088	25,333	24,946	24,802
Debt-to-capital ratio	32%	34%	32%	31%	27%
Rates of return based on:					
Average S/H equity	10.9%	8.8%	13.2%	13.2%	16.2%
Industry average				10.0%	14.0%
Average capital employed	9.4%	7.5%	10.2%	10.3%	12.8%
Industry average				8.1%	10.0%

EXHIBIT 2 U.S. Marketing and Refining: Financial Summary, 1991–1995 (000,000)

	1991	1992	1993	1994	1995
Sales and services					
Refined petroleum products	$10,134	$10,504	$10,560	$10,920	$ 2,403
Other sales and services	3,879	3,702	3,481	3,522	3,698
Total sales and services	$14,013	$14,206	$14,041	$14,442	$16,101
Excise and state gasoline taxes	2,421	2,606	2,957	3,663	3,965
Other revenues	80	118	90	88	108
Total revenues	$16,514	$16,930	$17,088	$18,193	$20,174
Operating costs and expenses	16,304	17,125	16,822	17,792	19,796
Pretax operating profit	210	$ (195)	$ 266	$ 401	$ 378
Income taxes	94	(50)	115	160	152
Total USM&R earnings	$ 116	$ (145)	$ 151	$ 241	$ 226
Special items	(96)	(128)	(145)	(32)	(104)
USM&R operating earnings	$ 212	$ (17)	$ 296	$ 273	$ 330
Assets at year-end	$ 6,653	$ 7,281	$ 7,248	$ 7,460	$ 7,492
Capital employed at year-end	4,705	5,286	5,071	5,155	5,128
Earnings: gasoline and distillate					
(cents/gallon)	3.6	0.2	3.7	4.1	4.6
(Industry average)	3.5	2.2	4.0	3.6	2.6
Return on assets	4.2%	(0.2%)	5.2%	4.8%	5.9%
(Industry average)	7.0	4.5	7.6	6.8	4.9
Gasoline market share (top 18 states)			11.4%	11.6%	11.9%

in 1993, and earnings and return-on-assets, which had been depressed in 1991 and 1992, soon exceeded industry averages. Summary financial data of the USM&R Division are presented in Exhibit 2.

Until 1994, USM&R was organized functionally. The supply group obtained crude oil and transported it to one of Mobil's refineries. The manufacturing function operated refineries that processed crude oil into products like gasoline, kerosene, heating oil, diesel fuel, jet fuel, lubricants, and petrochemical feedstocks. The product supply organization transported refined petroleum products, through pipelines, barges, and trucks, to regional terminals around the country. The terminal managers received, stored, and managed the extensive inventories of petroleum products and distributed the products to retailers and distributors. The marketing function determined how USM&R would package, distribute, and sell Mobil products through wholesalers and retailers to end-use consumers.

Reorganization: 1994

In the early 1990s, USM&R faced an environment with flat demand for gasoline and other petroleum products, increased competition, and limited capital to invest in a highly capital-intense business. McCool recalled:

> In 1990 we weren't making any money; in fact there was a half-billion-dollar cash drain. Expenses had doubled, capital had doubled, margins had flattened, and volumes were heading down. You didn't need an MBA to know we were in trouble.

McCool spent the next couple of years attempting to stabilize the business to stop the bleeding: "We succeeded, but then we had to

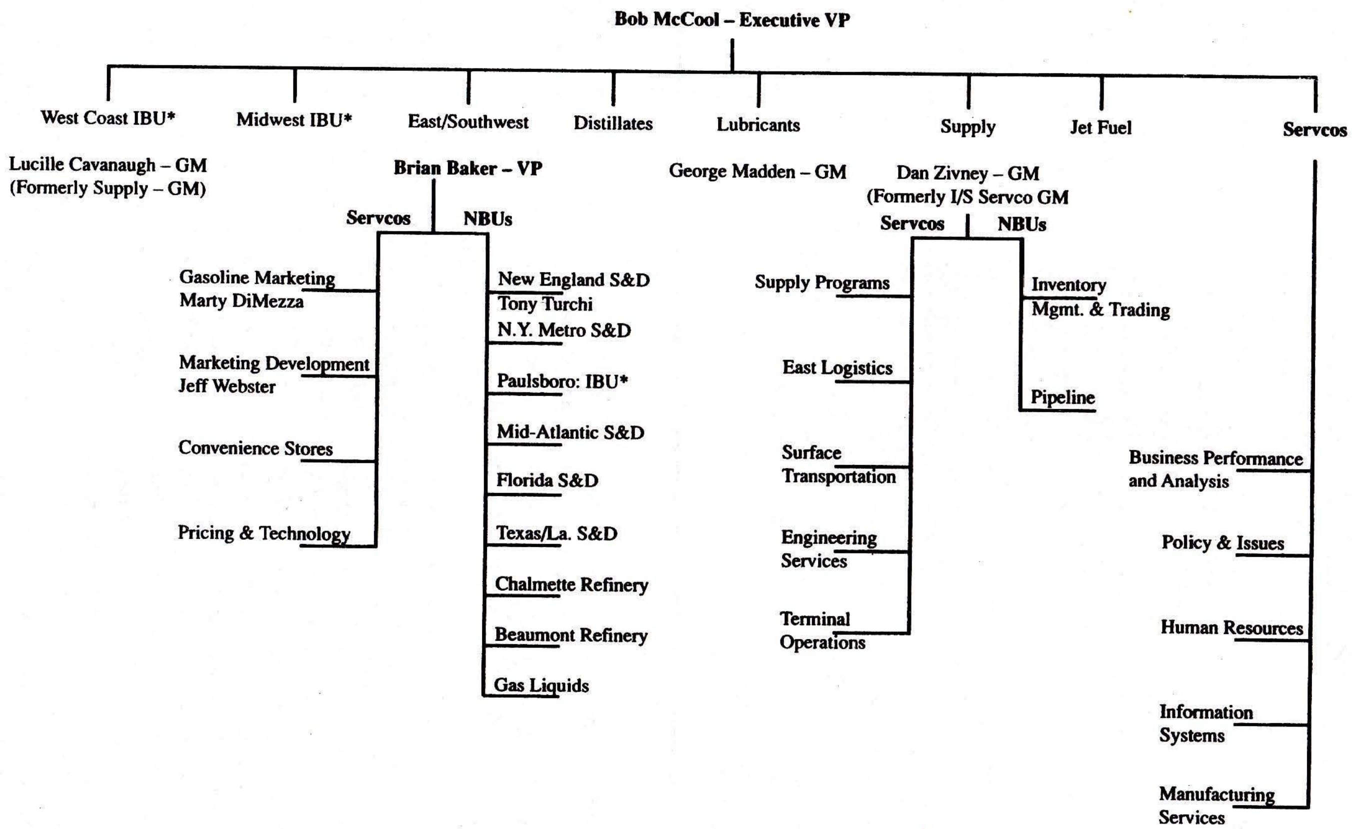

EXHIBIT 3 USM&R Natural Business (NBUs) and Service Companies (SERVCOs)

*IBU: Integrated Business Units (Refinery, Sales, Distribution) confront how we could generate future growth."

A climate survey in 1993 revealed that employees felt internal reporting requirements, administrative processes, and top-down policies were stifling creativity and innovation. Relationships with customers were adversarial, and people were working narrowly to enhance the reported results of their individual, functional units. McCool, with the assistance of external consultants, initiated major studies of business processes and organizational effectiveness. Based on the studies, McCool concluded that if USM&R were to grow, it had to make the most of its existing assets and to focus more intensively on customers, giving motorists what *they* want, not what the functional specialists in the organization thought motorists should want.

In 1994, McCool decided to decentralize decision making to managers and employees who would be closer to customers. He reorganized USM&R into 17 Natural Business Units (NBUs) and 14 Service Companies (see Exhibit 3). The NBUs included (1) sales and distribution units, (2) integrated refining, sales and distribution units, and (3) specialized product (e.g., distillates, lubricants, gas liquids) and process (stand-alone refinery) units. McCool commented on the need for the reorganization:

> We had grown up as a highly functional organization. We had a huge staff, and they ran the business. We needed to get our staff costs under control. But more important, we had to learn to focus on the customer. We had to get everyone in the organization thinking not how to do their individual job a little bit better, but how to focus all of their energies to enhancing Mobil products and services for customers.

Brian Baker, vice president of USM&R, concurred:

> We were a big central organization that had become a bit cumbersome and perhaps had lost touch with the customer. We didn't have the ability to move quickly with new marketing programs in various parts of the country.

USM&R's reorganization occurred simultaneously with a newly developed strategy on customer segmentation. Historically, Mobil, like other oil companies, attempted to maintain volume and growth by marketing a full range of products and services to all consumer segments. The gasoline marketing group had conducted a recent study that revealed five distinct consumer segments among the gasoline-buying public (see Exhibit 4 for descriptions of the five segments):

- Road Warriors (16%)
- True Blues (16%)
- Generation F3 (27%)
- Homebodies (21%)
- Price (20%)

USM&R decided that its efforts should be focused on the first three of these segments (59% of gasoline buyers), and not attempt to attract the price-sensitive but low-loyalty Price Shopper segment that accounted for only 20% of consumers. The new strategy required a commitment to upgrade all service stations so that they could offer fast, friendly, safe service to the three targeted customer segments. It also required a major shift in the role for Mobil's on-site convenience stores (C-stores). Currently, C-stores were snack shops that catered to gasoline purchasers' impulse buying. USM&R wanted to redesign and reorient its C-stores so that they would become a destination stop, offering consumers one-stop, convenient shopping for frequently purchased food and snack items.

USM&R Balanced Scorecard

The newly appointed business unit managers had all grown up within a structured, top-down, functional organization. Some had been district sales managers, others had man-

EXHIBIT 4 Five Gasoline Buyer Segments

Road Warriors (16%)	Generally higher-income middle-aged men who drive 25,000 to 50,000 miles a year, buy premium gasoline with a credit card, purchase sandwiches and drinks from the convenience store, will sometimes wash their cars at the car wash.
True Blues (16%)	Usually men and women with moderate to high incomes who are loyal to a brand and sometimes to a particular station; frequently buy premium gasoline and pay in cash.
Generation F3 (27%)	(F3—fuel, food, and fast) Upwardly mobile men and women—half under 25 years of age—who are constantly on the go; drive a lot and snack heavily from the convenience store.
Homebodies (21%)	Usually housewives who shuttle their children around during the day and use whatever gasoline station is based in town or along their route of travel.
Price Shoppers (20%)	Generally aren't loyal to either a brand or a particular station, and rarely buy the premium line; frequently on tight budgets; the focus of attention of marketing efforts of gasoline companies for years.

aged a pipeline or a regional distribution network. McCool anticipated problems with the transition:

> We were taking people who had spent their whole professional life as managers in a big functional organization, and we were asking them to become the leaders of more entrepreneurial profit-making businesses, some with up to a $1 billion in assets. How were we going to get them out of their historic area of functional expertise to think strategically, as general managers of profit-oriented businesses?

McCool realized that the new organization and strategy required a new measurement system. Historically, USM&R relied on local functional measures: low cost for manufacturing and distribution operations, availability for dealer-based operations, margins and volume for marketing operations, and environmental and safety indicators for the staff group in charge of environment, health, and safety. McCool was unhappy with these metrics:

> We were still in a controller's mentality, reviewing the past, not guiding the future. The functional metrics didn't communicate what we were about. I didn't want metrics that reinforced our historic control mentality. I wanted them to be part of a communication process by which everyone in the organization could understand and implement our strategy. We needed better metrics so that our planning process could be linked to actions, to encourage people to do the things that the organization was now committed to.

Baker also noted the need for new metrics:

> Our people were fixated on volume and margins at the dealer level. Marketing didn't want to lose gasoline dealers. But we didn't have any focus or measurement on dealer quality so we often franchised dealers who didn't sustain our brand image. Also, we drove so hard for short-term profits that when volumes declined, our marketing people attempted to achieve their profit figure by raising prices. You can do that for a while if you have a strong brand, which we have, but you can't sustain this type of action for the long term.

In mid-1993, Ed Lewis, formerly the financial manager for U.S. marketing, was on a special assignment with Dan Riordan, deputy controller of USM&R, to examine the effectiveness of financial analysis for the entire division. They concluded that a lot of excellent financial analysis was being done—plenty of measures, plenty of analysis—but none of it was linked to the division's strategy. In late

1993, Lewis saw an article on the Balanced Scorecard[2] and thought,

> This could be what we are looking for. We were viewed as a flavor-of-the-month operation. Our focus shifted frequently so that if you didn't like what we were doing today, just wait; next month we will be doing something different. Nothing we did tied to any mission. The Balanced Scorecard seemed different. It was a process that tied measurement to the organization's mission and strategy. It could start us on the journey to implement USM&R's new organization and strategy by keeping us focused on where we were heading.

Lewis and Riordan recommended to McCool that USM&R develop a Balanced Scorecard [BSC]. McCool was receptive since he had heard of the concept in a briefing he had received earlier that year. USM&R's senior management team launched a BSC project in early 1994. They hired Renaissance Solutions, the consulting company founded by David Norton, a co-author of the Balanced Scorecard article, to assist in the process.

A senior-level executive leadership team (ELT), consisting of McCool, Baker, the vice presidents of all staff functions, the division controller, and the manager of financial analysis of downstream operations, provided oversight and guidance for the BSC project. The actual project team was led by Lewis and Riordan, assisted by Renaissance consultants.

Starting in January 1994, Lewis and his project team conducted two-hour individual interviews with all members of the ELT to understand each person's thoughts on the new strategy. The team synthesized the information received from the interviews and, with David Norton facilitating, led several workshops to develop specific objectives and measures for the four Balanced Scorecard perspectives: financial, customer, internal business process, and learning and growth. The workshops always involved active dialogues and debates about the implications of the new strategy. Lewis noted:

> Forcing the managers, during the workshops, to narrow the strategy statements into strategic objectives in the four perspectives really developed alignment to the new strategy. You could just see a consensus develop during the three-month period.

Among the new aspects of the USM&R scorecard was a recognition that the division had two types of customers. The immediate customer was, of course, the extensive network of franchised dealers who purchased gasoline and petroleum products from Mobil. The other customer was the millions of consumers who purchased Mobil products from independent dealers and retailers. The project team wanted the customer perspective on the scorecard to incorporate strategic objectives and measures for both types of customers.

By May 1994, the project team had developed a tentative formulation of the USM&R scorecard. At that point, they brought in more managers and split into eight subteams to enhance and refine the strategic objectives and measures: a Financial team (headed by the VP of Strategic Planning); two Customer teams—one focused on dealers, the other on consumers; a Manufacturing team, focused on measures for refineries and manufacturing cost; a Supply team, focused on inventory management and laid-down delivered cost; an Environmental, Health and Safety team; a Human Resources team; and an Information Technology team. Each sub-team identified objectives, measures, and targets for its assigned area.

The financial perspective subteam had extensive discussions to fine-tune the financial objectives developed as a strawmodel by the executive leadership team (ELT). They even-

[2] R. S. Kaplan and D. P. Norton, "The Balanced Scorecard: Measures That Drive Performance," *Harvard Business Review* (January–February 1992).

EXHIBIT 5 USM&R Strategic Objectives: Financial

Return on capital employed	Earn a sustained rate of return on capital employed (ROCE) that is consistently among the best performers in the U.S. downstream industry, but no less than the agreed corporate target ROCE of 12%.
Cash flow	Manage operations to generate sufficient cash to cover at least USM&R's capital spending, net financing cost, and pro rata share of the Corporate shareholder dividend.
Profitability	Continually improve profitability by generating an integrated net margin (cents per gallon) that consistently places us as one of the top two performers among the U.S. downstream industry.
Lowest cost	Achieve sustainable competitive advantage by integrating the various portions of the value chain to achieve the lowest fully allocated total cost consistent with the value proposition delivered.
Meet profitable growth targets	Grow the business by increasing volume faster than the industry average and by identifying and aggressively pursuing profitable fuels and lubes revenue opportunities that are consistent with the overall division strategy.

tually chose objectives that retained the historic focus on cost reduction, and also highlighted profitability and growth objectives (see Exhibit 5). The subteam then found it relatively easy to gain consensus on an appropriate set of measures:

- Return on capital employed
- Cash flow
- Profitability (cents per gallon before tax, relative ranking among competitors)
- Total operating expense (cents per gallon)
- Volume growth for gasoline retail sales, distillate sales, lubricants

The learning and growth subteams worked hard to refine the high-level objectives already established by the ELT. The teams eventually proposed that USM&R should strive to increase:

- Organizational involvement
- Core competencies and skills
- Access to strategic information

(See Exhibit 6 for definitions of these three objectives.)

The two subteams then required many more meetings to decide how to measure these new strategic objectives. McCool maintained special interest in these deliberations since he believed that USM&R's new strategy required a significant upgrading of leadership skills and an enhancement of critical employee capabilities. The teams eventually suggested three measures for human resources and information technology capabilities:

- Climate survey index
- Strategic competency availability %
- Strategic systems availability

The measures were somewhat generic and several participants remained unsure whether there weren't better measures to drive behavior and describe success. Much of the data for these measures already existed in the organization, but none of the proposed measures was currently being used by senior managers.

The remaining subteams, responsible for determining the objectives and measures for the customer and internal perspectives (for consumers, dealers, manufacturing, supply, and environmental, health and safety), were also working to devise objectives and measures that would reflect the new customer-based strategy, and also satisfy the high-level financial objectives. For example, the con-

EXHIBIT 6 USM&R Strategic Objectives: Learning and Growth

Organizational involvement	Enable the achievement of our vision by promoting an understanding of our organizational strategy and by creating a climate in which our employees are motivated and empowered to strive toward that vision.
Core competencies and skills	
Integrated view	Encourage and facilitate our people to gain a broader understanding of the marketing and refining business from end to end.
Functional excellence	Build the level of skills and competencies necessary to execute our vision.
Leadership	Develop the leadership skills required to articulate the vision, promote integrated business thinking, and develop our people.
Access to strategic information	Develop the strategic information support required to execute our strategies.

sumer subteam knew that the strategy to delight consumers in the three targeted market segments required that all Mobil gasoline stations deliver a speedy purchase, have friendly, helpful employees, and recognize consumer loyalty. At the time, however, several businesses had no measures for evaluating dealer performance on these now critical processes.

In parallel with the consumer subteam, the dealer subteam was working to choose objectives and measures that would communicate the importance of creating win-win channel partnerships with its dealers.

MOBIL USM&R (A2)*

By August 1994, the Balanced Scorecard development process at Mobil U.S. Marketing & Refining (see Mobil USM&R [A1] case) had made considerable progress. Managers had formulated the strategic objectives for the four Balanced Scorecard perspectives and selected the initial set of measures for these objectives. Building the initial scorecard had consumed two to three full-time equivalent weeks from all members of the Executive Leadership Team (McCool and all his direct reports, including the managers of the business units). . . .

Between June and August 1994, while the subteams had been refining the strategic objectives and measures, the Steering Committee went through each perspective to identify one or two critical themes. The project team produced a brochure to communicate these strategic themes to USM&R's several thousand employees.

Linking the Balanced Scorecard to NBUs and Servcos

While the USM&R scorecard was still being developed in April 1994, the project team launched pilots to develop business unit scorecards (in the West Coast and Midwest NBUs [natural business units]). Senior management wanted the NBUs to work from the strategic themes established at the USM&R Division level and to translate the division strategy into local, NBU objectives and measures that would reflect the particular oppor-

*Professor Robert S. Kaplan prepared this case. Mr. Ed Lewis of Mobil's Business and Performance Analysis group provided invaluable assistance.

tunities and competitive environment encountered by each NBU. This was part of McCool's belief that NBU managers had to learn to take responsibility for the strategy of their business units.

Ed Lewis, with consultant support, went to the NBUs and replicated the scorecard development process with their personnel:

> We did the interviews, conducted the workshops, and, over a six week period, developed a local scorecard. We used the USM&R scorecard as a guiding light, but that's all it was, a light. When an NBU developed a scorecard, it was their scorecard and they would live by it.

McCool concurred:

> Mobil in the Midwest is not the same as Mobil in New England, or on the West Coast. In each market, the consumer looks at us differently, our competition in each region is different, and the economics of operating in each market are different. I don't want to dictate a solution from Fairfax. We have a basic strategy and set of support programs that we can roll out to each NBU. We do have a few constraints: we want our dealers to operate under a sign that says "Mobil," there's a basic design for the station and for the C-store that we want to share across regions, and we think we have a winning segmentation strategy with fast and friendly service. But if an NBU thinks it has a better driver for success, I'm willing to hear it. I want the NBU head to tell me, here's my business, this is my vision and strategy, and this is how I am going get there from here. Our job in Fairfax is to approve (or disapprove) the strategy and ask what additional resources they might need to get the job done.

The NBU scorecards, in general, mirrored the USM&R scorecard, though with slightly fewer measures, particularly in the internal perspective since the NBUs were focused on particular functions—such as regional marketing and sales, refining, and distribution—so the full range of internal measures were not relevant to each NBU.

Several of the NBUs devoted a section of their monthly newsletters to Balanced Scorecard information. In the first few issues, the section reviewed a single scorecard perspective, explaining the importance of the perspective, articulating the reasoning behind the specific objectives that had been selected, and describing the measures that would be used to motivate and monitor performance for that perspective. After communicating the purpose and content of the scorecard in the first few issues, the content of the newsletter section shifted from education to feedback. Each issue reported recent results on the measures for one of the perspectives. Raw numbers and trends were supplemented with the human stories on how a department or an individual was contributing to the reported performance. The vignettes communicated to the workforce how individuals and teams were taking local initiatives to help the organization implement its strategy. The stories created role models of individual employees contributing to strategy implementation through their day-to-day activities.

Servco Service Agreements

The Steering Committee also wanted the servcos to be accountable for their performance. Previously, each staff function operated from the Fairfax headquarters, providing strategy, direction, and services to the field organization. After the reorganization, staff functions were now free-standing service units that had to sell services to the NBUs and get agreement from them on prices and level of service provided. USM&R established buyers' committees, consisting of three to five representatives from the NBUs, to work with each servco. In this way the offerings from every servco would be linked to the mission and strategy of NBUs and to USM&R. Eventually, each servco and its buyers' committee agreed on the priorities and prices for the offerings it would provide.

Dan Zivny, manager of Finance and Information Services, endorsed the new process:

> Discussions with the buyers committee helped us to communicate to the NBUs about what we do and what our deliverables will be. Previously, the NBUs would complain about the costs and charges for information services. Now the NBUs are part of the process that specifies the outputs we will produce and the prices we will charge.

Several of the servcos began to develop their own Balanced Scorecards. Marty Di Mezza, manager of the Gasoline Marketing servco, noted:

> The service agreement with the buyers committee and our Balanced Scorecard have enabled my organization to become more customer focused. People now realize they have to sell their services and that we have to fit into the entire picture of USM&R.

In addition to developing their own BSC's, key servco people were assigned to collect the data and report on each measure on the USM&R scorecard. Each measure was assigned to a "metric owner." The metric owners verified that the measures appropriately reflected the strategic objectives, and could, based on feedback from the field, make recommendations to the Executive Leadership Team for modified or new measures. People within the metric owner's servco collected the actual data from operations and reported current values of the measures to the metric owner.

Linking the Balanced Scorecard to Compensation

All salaried employees of USM&R were tied to the Mobil corporate award program. This program was based on performance relative to Mobil's top seven competitors on two financial measures: return-on-capital employed and earnings-per-share growth [EPS] (see Exhibit 1). This program awarded up to a 10% bonus if Mobil ranked number 1 on ROCE and EPS growth.

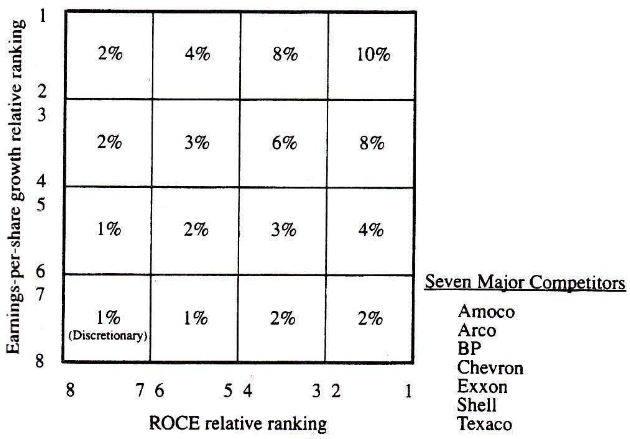

EXHIBIT 1 Corporate Performance Share (CPS)—Salary Groups 13–19 Metrics and Award % (of Reference Salary)

McCool initiated an additional program within USM&R that awarded bonuses up to 20% to managers in each business unit. NBU employees got 30% of the award based on USM&R performance, and 70% based on their NBU performance. Servco employees also got 30% on USM&R performance, 20% on the linkages to other business units, and 50% on their servco BSC. The linkage measures for servcos represented the objectives and results they could influence either in the NBUs or at USM&R.

The bonus plan was part of a new variable pay compensation program. Employees' base pay reference point had been set at 90% of competitive market wages. The remaining 10% of compensation could be achieved with average performance on three factors:

- A component based on the two corporate financial performance competitive rankings
- A division component based on the USM&R Balanced Scorecard metrics
- A business unit component based on key performance indicators, from the NBU or servco Balanced Scorecard metrics

An additional 20% of compensation could be received for exceptional performance along these three components. The theory for the variable pay plan was simple: award below average compensation for below average performance, average pay for average performance, and above average pay for above average performance.[1]

McCool wanted each business unit to work with the metric owners to develop its own targets for the scorecard measures. In addition, the BUs assigned a percentage weight associated with achieving this target. This percentage, which summed to 100 across all the targeted measures, would determine the relative contribution of each scorecard measure to the bonus pool. Most business units chose to weight all measures on their scorecards; the remaining ones still weighted most of their scorecard measures. Only one business unit put more than a 50% weight on its financial measures.

The business units, beyond establishing targets for each scorecard measure, also assigned a performance factor that represented the perceived degree of difficulty of target achievement (see Exhibit 2). The perfor-

[1]In addition, the plan included individual awards, administered within a narrow range, to adjust for performance not captured by the metrics. Business unit managers were awarded a fixed "pot of money" for such individual awards, but this allowance could not be overspent.

Performance Factor	Qualitative
1.25	Best in class
1.20	
1.15	Well above above
1.12	
1.09	
1.06	Above average
1.03	
$\boxed{1.00}$	$\boxed{\text{Average}}$
0.90	
0.80	Below average
0.70	
0.60	
0.50	Needs improvement
0.40	

How to think about performance factors:

1. Objective:
   External Benchmark
   1.00 means target equals the average of competition
   1.25 means target equals the top of the competitive group
2. Subjective:
   Internal Benchmark
   1.00 means the difficulty of the target is average

EXHIBIT 2 Metrics—Performance Factor

mance factor would be multiplied by the weight assigned to the measure to arrive at a total performance amount, much the way a diving competition is scored (absolute performance on a dive gets weighted by the dive's degree of difficulty). The maximum index score of 1.25 occurred when the target would put the Mobil unit as best in class. An average target received a performance factor of 1.00, and a factor score as low as 0.7 would be applied when the target represented poor performance, or was deemed very easy to achieve. The individual business units proposed the performance factors for each measure, but these had to be explained and defended in a review with the Executive Leadership Team and metric owners. Business unit managers also were able to see (and comment on) the targets, weights, and performance factors proposed by the other BUs.

Brian Baker was a strong advocate for the indexed targets:

> Historically, people were rewarded for meeting targets and penalized when they missed a target. So sandbagging targets became an art form around here. I prefer the current system where I can give a better rating to a manager who stretches for a target and falls a little short than to someone who sandbags with an easy target and then beats it.

Managing with the Balanced Scorecard

McCool reflected on the experience to date with the Balanced Scorecard:

> It's enabled us to teach the NBU managers about strategy; about lead and lag indicators; and to think across the organization, not just in functional silos. It's exposed the managers to issues outside their expertise and to understand the linkages they have with other parts of the organization. People now talk about things that are outside their immediate responsibility, like safety, environment, and C-stores. The scorecard has provided a common language, a good basis for communication.

> We were also fortunate that when Mobil asked us to go to a pay-for-performance plan we could use our scorecard measures. Variable pay plans only work if you have a good set of metrics. Managers accepted the compensation plan based on the scorecard since they believed the measures represented well what they were trying to achieve.

> The learning and growth perspective has been the biggest problem. Ultimately, that perspective will be the differentiator for the company, our people's ability to learn and to apply that learning. The good news is at least we now talk about learning, as much as we talk about gross margin. But we are struggling to get good output measures for the learning objective.

McCool commented on the changes in the meetings he conducts with NBU managers:

> For a meeting with an NBU manager, like West Coast, I have the manager plus representatives from various servcos, like supply, marketing, and C-stores. And we have a conversation. In the past we were a bunch of controllers sitting around talking about variances. Now we discuss what's gone right, what's gone wrong. What should we keep doing, what should we stop doing? What resources do we need to get back on track, not explaining a negative variance due to some volume mix.

> The process enables me to see how the NBU managers think, plan, and execute. I can see the gaps, and by understanding the manager's culture and mentality, I can develop customized programs to make him or her a better manager.

Baker commented on the reviews he recently conducted with the managers of nine NBUs and four servcos that reported to him:

> I went into these reviews thinking they would be long and arduous. I was pleasantly surprised how simple they were. Managers came in prepared. They were paying attention to their scorecards and using them in a very productive way—to drive their organization hard to achieve the targets. How they weighted their measures spoke clearly about their priorities of relative importance up and down the four perspectives.

Basically, there's no way I can understand and supervise all the activities that report to me. I need a device like the scorecard where the business unit managers are measuring their own performance. My job is to keep adjusting the light I shine on their strategy and implementation, to monitor and guide their journeys, and see whether there are any potential storms on the horizon that we should address.

Baker felt that relying on only a single financial measure, like earnings or return-on-capital-employed, was dangerous.

A big shareholder may not care about local business conditions or competitive environments. Just achieve a 12% ROCE, produce the money, and don't tell me about your problems. That's his right as the shareholder, and some people would say, "Those are the rules, and let's set strict earnings objectives for each of our business units and that's it."

But there's another side of me that says to motivate people there are things managers can influence and things they cannot. In a strong market, you can do a bloody bad job and have a great year. And you can do a superb job and fall way short of earnings because the market was so weak. The scorecard has several elements that help me understand how well a manager performs against the market. Without the understanding we now have from the scorecard, we would force people to do some pretty bizarre things to make short-term earnings targets, and they could be gone before the problems fall in.

Managers do seem to be using the scorecard for their management processes. They're not just doing it because McCool and I have imposed it on them. It's a system they know that everyone is using; all the other business units are living by the same set of rules. That's incredibly important. Also, the degree of difficulty index allowed them to be more ambitious and aggressive in setting their targets.

McCool concluded:

In three to four years, we have come from an operation that was worst in its peer group, draining a half billion dollars a year, to a company that ranks number 1 in its peer group and generates hundreds of millions of dollars of positive cash flow.[2]

The Balanced Scorecard has been a major contributor. It's helped us to focus our initiatives and to keep them aligned with our strategic objectives. It's been a great communication tool for telling the story of the business and a great learning tool as well. People now see how their daily job contributes to USM&R performance. Our challenge is how can we sustain this performance. We have just seen the tip of the iceberg. I want people to use the scorecard to focus attention on the great opportunities for growth.

[2]USM&R's 1995 income per barrel of $1.02 greatly exceeded the industry average of $0.65. Global operating return from refining, marketing and transportation operations of 10.1% per dollar of assets was the highest in the industry (up from 8.6% and fifth place in 1994) ("Benchmarking the Integrated Oils, 1995," U.S. Research [Goldman Sachs, July 15, 1996], pp.7, 9).

MOBIL USM&R (B): NEW ENGLAND SALES AND DISTRIBUTION*

The New England Sales & Distribution (NES&D) was one of seven regional sales and distribution business units within Mobil's U.S. Marketing and Refining (USM&R) operations. NES&D's responsibilities included:

- The 1,400 branded Mobil stations in the six New England states—Maine, New Hampshire, Vermont, Massachusetts, Connecticut, and Rhode Island
- Terminal operations in New England that received and stored gasoline and home heating oil brought in by ship from Canada, Europe, and Venezuela

*Robert S. Kaplan prepared this case. Mr. Ed Lewis of Mobil's Business and Performance Analysis group provided invaluable assistance.

- Three pipelines that transported petroleum products to regional terminals, such as at Boston's Logan Airport
- A fleet of delivery trucks, including the unionized truck drivers, that transported gasoline and heating oil to dealers and wholesalers

Tony Turchi, general manager of NES&D, had held a series of assignments in finance and planning before becoming marketing manager for New England region. He was appointed general manager in the 1994 reorganization (see USM&R [A1] case). Turchi recalled the rules under the old regime: "It was pretty simple. Our goals were to increase sales volume and reduce controllable costs. We had lots of measures, and they all related to these two goals."

In early 1994, shortly after NES&D had been established as an independent business unit, its senior management team conducted a strategic planning exercise. The exercise started with a traditional SWOT analysis [strengths, weaknesses, opportunities, threats]. The team then developed a high-priority list of strategic opportunities that blended national strategies, such as fast-friendly-serve and On-the-Run convenience stores, with regional strategies, for example dealer development, felt to be critically important for the future success of New England. Turchi recognized, however, that the strategic planning exercise had two gaps.

> We now had a vision, we had clearly identified strategic opportunities, and we had developed some strategic initiatives. But we didn't have a good measurement tool. We were still just measuring, in fact overmeasuring, volume and costs. Second, a climate survey of our employees revealed a real hunger for a reward and recognition system. It didn't have to be big money, but our people wanted to understand where we were taking the business and to be more actively involved with that direction.

Turchi had not participated in the development of the USM&R Balanced Scorecard.

> In retrospect, I wish that could have been involved in the process to understand better why some of the measures were placed on the scorecard. On the positive side, however, it was great to be able to see the thought process spelled out: how McCool and the ELT [Executive Leadership Team] were going to be measuring the performance of the overall business, how a regional sales and distribution business unit fit into the overall picture, what measures were important to the ELT, and what strategies they were recommending. Even more important, the USM&R scorecard gave us a great template to follow. It took a lot of the guess work out of what the ELT meant by a Balanced Scorecard.

A NES&D team worked in the second half of 1994 to develop a New England Balanced Scorecard. The project team talked to employees in the terminals, the truck drivers, and to NES&D's channel partners, the independent gasoline dealers and wholesalers. The team also coordinated with USM&R servcos[1] to get their input for the New England strategic objectives and measures.

By the end of 1994, the effort produced NES&D's first Balanced Scorecard (see Exhibit 1). The group also linked the strategic issues and opportunities it had identified from its SWOT exercise to the Balanced Scorecard measures (see list in Exhibit 2). Turchi felt it was important for people to see how the Balanced Scorecard could measure progress along the strategic issues they had identified.

> Our first opportunity [see Exhibit 2] was to integrate the best client experience with our franchise offerings, like fast-friendly-serve,

[1]Servcos are the service organizations within USM&R, such as gasoline marketing, communications, finance, and information systems that provided support services to the operating business units. The operating business units, such as NES&D, had very little internal staff support.

EXHIBIT 1 The New England Scorecard

		OBJECTIVE	MEASURES
Financial			
	F1	Return on capital employed	ROCE
	F2	Cash flow	Cash flow
	F3	Profitability	Net margin Net profit after tax
	F4	Lowest cost	Full cost per gallon
	F5	Meet profitable growth targets	Gasoline volume growth rate Existing oil, gas, and lubricant growth rate Premium product growth rate
Customer			
	C1	Delight the customer	Mystery Shopper rating Customer complaints Customer compliments
	C2	Dealer/wholesaler marketer profitability	Dealer/distributor gross margins
Internal			
	I1	Marketing and product development	Alternative Profit Centers (APC) gross profit/store
	I2	Salesforce focus	Number of oil, gas, and lubricant units meeting upgrade standards Number of "our commitment" stations
	I3	Manage the business	Gasoline runouts Distillate runouts Station runouts
	I4	Improve Health, Safety, and Environment	Environmental incidents Days away from work due to injuries Accidents
	I5	Quality	Percentage of stations scoring 100% in quality assessment program
Learning and Growth			
	L1	Organization involvement	Climate surveys
	L2	Core competencies and skills	Progress on developmental plans—focus on leadership
	L3	Access to strategic information	Availability of profit and loss data, BSC, cash flow, field marketing tools

destination C-store, and our car care and maintenance services. If we succeeded in this opportunity with our dealer-partners, we would hit our targets for F5 (profitable growth), C1 (delight the customer), I1 (marketing and product development) and 12 (focus salesforce). Number 3 on our hit parade was one of our most important objectives—to provide awesome new training and development for our people and partners. This was one of our most critical leading indicators. It would show up in two of our learning and growth measures (L1, L2), but it would also impact C1, the Mystery Shopper rating.

Turchi worked with his leadership team, consisting of the top managers in NES&D plus three representatives from key USM&R servcos, to set targets and weights for linking the scorecard measures to the bonus plan for the entire New England team (see Exhibit 3). The linkage included the performance factor [degree of difficulty] for each measure to reflect how close the target was to best-in-class capabilities. Turchi recalled:

> I had to estimate many of these factors midway through the year, because the process wasn't

EXHIBIT 2 Linking Strategic Opportunities and Initiatives to Balanced Scorecard Measures

STRATEGIC OPPORTUNITY	BALANCED SCORECARD MEASURES
1. Integrate the best buying opportunity with our franchise offerings	F5, C1, I1, I2
Target our C-stores, service bays, gasoline offering service to Road Warriors, Generation F3, True Blues	
2. Address the deadly gap (against key competitor)	
Aggressive marketing tactics	F3, F5
Managing distributor consolidation of "Have-Nots" into "Haves"	F5
Partnering in product supply and logistics—improve asset utilization	F4
3. Provide comprehensive training and development for our people	C1, I2, L1, L2
4. Improve the climate: Open communication, feedback, rewards, and recognition	L1
5. Improve health, safety, and environmental performance	I4
6. Premium products	F5
7. Legislation/regulation—potential threat to volume and profit	F3, F5
8. Improve cost structure	F4, L2

EXHIBIT 3 New England S&D—1995 Compensation Linkage

	1995 WEIGHT	"NET" WEIGHT	1995 PERFORMANCE FACTOR	1995 GOAL*
Financial (30%)				
Net profit after tax	15%	5%	1.00	22
Full cost per gallon	30%	9%	1.00	6.8
Gasoline volume growth	15%	5%	1.06	103%
Existing oil, gas, and lubricant growth rate	30%	9%	1.06	101.5%
Premium product	10%	3%	0.96	100%
Customer (15%)				
Mystery Shopper rating	60%	9%	1.10	82
Customer complaints	40%	6%	1.00	824
Internal (35%)				
APC gross profit/store	20%	7%	0.96	12,500
No. of "Our Commitment" stations	20%	7%	1.00	527
Environmental incidents	20%	7%	1.06	19
Days away from work due to injuries	20%	7%	1.06	16
Accidents	20%	7%	1.06	20
Learning and Growth (20%)				
Climate survey	50%	10%	1.03	4
Developmental plans	50%	10%	1.00	2
Total index		100%		
Performance factor			1.03	

**Numbers disguised to maintain confidentiality.*

> set up at the beginning of 1995. But I tried to be honest; I gave a 0.96 on several measures. Overall I came out with a performance factor of 1.03. I worked this through with Brian Baker, who's my ELT coach, and defended the weights at a meeting with a whole bunch of servco representatives.

Turchi felt, however, that the scorecard was too complicated to communicate to his 300 employees in the field.

> In 1995, we were doing Balanced Scorecard 101. We had to learn to walk before we could run. We needed to make it simple and understandable to all our people. We also wanted to create some fun and excitement.

In late January, the weekend after the Super Bowl, the NES&D leadership team organized a major meeting in Waterville Valley, New Hampshire. They decorated a meeting hall like a football field, gave everyone football sweatshirts, showed video-tapes of the great teams like the Green Bay Packers and Pittsburgh Steelers, and had an announcer from NFL films describe how the great football teams had all the elements—offense, defense, coaches, the support groups—working together. The leadership team then announced the New England region's Super Bowl for 1995. The team had selected five critical measures from NES&D's Balanced Scorecard:

- Gasoline volume
- Return on capital employed
- Customer complaints
- Mystery Shopper rating
- Our commitment to dealers

These five measures would serve as the scorecard for the New England Super Bowl. The Super Bowl metaphor became clearer when the team stretched the targets on these five measures beyond the levels communicated to USM&R's Fairfax headquarters. For example, the official ROCE target for the New England region required a net income after tax of $22 million.[2] The Super Bowl target, however, was set at $27 million in net income, an additional $5 million stretch. The team set similar stretch goals for sales volume, mystery shopper ratings, customer complaints, and dealer commitment. For the NES&D organization to win the Super Bowl, it would have to hit the stretch targets on all five measures. If it hit all five, everyone would get a cash bonus of $250 and a great weekend next winter at a resort hotel in Vermont. If it failed in any one, no reward.

The leadership team then rolled the Super Bowl program out to all the people in the field. Dan Quinn, NES&D field logistics manager, described the process:

> We talked to the drivers, the union people and took them through the strategy, the Super Bowl concept, and asked for their support to help us achieve our goals, how they could impact the measures. The truck drivers didn't believe us. They said, "the marketing guys get all the good rewards and go out and have a good time; they never include the terminal guys." We had to convince them that we were serious. They were going to get the same reward as the marketing people.
>
> Then they started to ask us about the threats and the weaknesses, and told us how they had tried to make improvements over the years. They wanted to know how they could continue to help. How do you explain ROCE to a truck driver? We talked about the components of ROCE they could impact, like how their safe driving could affect expenses and productivity. If they could deliver when there's snow on the ground, while other drivers had an accident with their trucks lying on the side of the road, that would mean a lot to our customers in terms of product availability and satisfaction. We explained the Mystery Shopper program and how we would rate stations that were doing great and how we would deal with stations that could be a problem.

By the end of the first quarter 1995, all 300 employees in NES&D understood the vi-

[2]Numbers have been disguised for confidentiality.

sion, the strategy, and the main business threats as well as the stretch targets for the five Super Bowl elements. The employees began to use this information to set priorities for their work, and to stop doing work that didn't directly relate to these issues. The NES&D project team maintained communication through the year in meetings, e-mail, voice mail, and newsletters. The information included up-to-date reports on the five Super Bowl measures. In every meeting that Turchi and his senior leadership people had with people in the field, they discussed performance against the Super Bowl targets. Turchi saw the impact:

> We had drivers calling in with concerns about a dealer they had just visited somewhere in New Hampshire that would flunk if a mystery shopper showed up. Half the lights were out at night and the Mobil sign was down. The drivers also were generating volume opportunities. They would ask us why we didn't have a station in a certain middle- to high-traffic area.

During 1995, Turchi had three strategic reviews with Brian Baker, the USM&R representative on the Executive Leadership Team who oversaw NES&D. Baker included, in these meetings, key people from servcos that were supporting programs in the region. Turchi recalled:

> The headquarters people were completely focused on our Balanced Scorecard. That sent a strong signal. The discussions also helped the servco people understand from our leadership team how their national programs were working or not working in the region.

By the end of the year, NES&D had greatly exceeded the stretch targets on four of the five Super Bowl measures. Only on the mystery shopper rating was performance short of the target. People acknowledged that the Super Bowl targets and the associated individual goals and objectives had driven this outstanding performance. But Turchi faced a dilemma:

> I had set our Mystery Shopper Super Bowl target at 85% even though my commitment to the ELT at Fairfax was to hit 82%. The actual score came in at 83.3%. We had started the year at about 75% so we had made an 8 percentage point increase in our 1,400 stations, and exceeded our commitment to the ELT. But we didn't hit our stretch goal. We had lots of discussion about what to do. Some said that the rules we established at the beginning required us to hit all five, or get nothing. But others argued that we exceeded four of the five, and came close on the fifth. This issue was a concern to me because we were about to enter 1996 with another set of very stretched targets, and I wanted people to feel good about these targets, and be motivated to achieve them.

The NES&D leadership team was also updating the Balanced Scorecard for 1996. The five Super Bowl measures were retained but other measures got modified. Turchi explained:

> The scorecard objectives and about 80% of the measures remained the same. We deleted some measures and added 20% new measures. We found that if something was not measured on the Balanced Scorecard, it wasn't perceived as being important and we lost focus on it. For example, our 1995 volume measure related to total gasoline sales volume and we hit the target. But we did not sell enough of the higher grades that are critical for our regional and national strategy. So we added a measure of the percentage sold of special and super unleaded, the premium higher octane products.
>
> We are, in 1996, going to drive the variable pay bonus plan based on scorecard percentages and weights down to individual and teams. We will have to explain this to all the people. I think we'll use a baseball analogy; have them think about what sets the salary for a star player: a weighted average of various statistics, like home runs, batting average, runs batted in, reducing number of strike-outs, etc.
>
> The only exception will be the union people, since the new contract, covering about 100 people, doesn't allow this type of variable pay

compensation plan. So we will probably have another Super Bowl program for them, using a subset of the measures that everyone else is being paid on.

Turchi concluded:

You can see the difference in our people. Pre-BSC, the scorecard for an area manager was pretty simple: sales, sales, and sales. For the manager of a terminal, it was cost, cost, cost, and perhaps a little safety. Now we are trying to have the people in both positions be mini–general managers, to have them think broadly about our entire business. People in these positions are the ones that are absolutely critical for the success of our organization.

MOBIL USM&R (C): LUBRICANTS BUSINESS UNIT*

In an ideal world, you pick up a scorecard and it tells you the five or ten things you need to do every day. That's what we're working towards.

George Madden, General Manager, Mobil Lubricants Business Unit

The Lubricants Business Unit was an operating division within Mobil's U.S. Marketing and Refining Group (USM&R). The Lubes unit had about $1 billion in sales and 900 employees of whom 350 were unionized. Mobil's Lubes Division was the largest marketer of finished lubricants in the United States with a 12% market share and strong growth, especially in the premium quality blends, Mobil 1 and Delvac 1300 Super. New products included an Environment Awareness Lubricant product line that was used with ozone-safe refrigerants in industrial refrigerant compressors. This product had a more than 50% US market share.

Since 1991, the Lubes Division had been integrating and consolidating operations that were formerly scattered among Mobil's functional organization. The division received input product from the Beaumont and Paulsboro refineries. It then processed the product through blending and packaging plants. Lubes also had its own operations for sales, order fulfillment, product development, and product management.

George Madden, the General Manager of the Lubes Division, was on the USM&R Executive Leadership Team that developed the division scorecard during the first half of 1995. Madden recognized that the Balanced Scorecard could provide focus and direction to his complex business.

We have four very different businesses: industrial, automotive, base stock, and specialty products such as wax, asphalt, and petroleum coke. Each business has its own strategy. We sell through distributors, through retail, and direct to customers. Cutting across these diverse businesses and selling arrangements are our business processes like order management, base stock manufacturing, finished product manufacturing, and logistics/distribution.

We had been working on initiatives to help get a handle on our cost drivers: activity-based costing, process management, process reengineering, complexity cost, you name it. As I came to understand the Balanced Scorecard, I saw the opportunity to tie all of our business operations together, to have focus and to run the business on an integrated basis.

In mid-1995, Madden launched a Balanced Scorecard project for the Lubes busi-

*Robert S. Kaplan prepared this case. Ed Lewis and Todd d'Attoma of Mobil USM&R provided invaluable assistance.

ness to be completed by December 1995. The scorecard process would affect the first three levels of the organization, about 50–60 people. In mid-October 1995, however, Madden called in Todd D'Attoma, one of his business analysts, and gave him a challenging assignment:

> If the scorecard project is really going to have an impact, everyone has to be on board. I want you to put together a team to have all of our 550 non-unionized employees understand and be part of the Balanced Scorecard process.

D'Attoma formed a seven person cross-functional/cross-level team. It included a blend plant manager, a blend plant shift supervisor, representatives from industrial and automotive marketing, the customer response center, and headquarters people like himself. The team developed a mission and a small set of simple and focused deliverables:

Mission	Deliver a Balanced Scorecard process that challenges each individual and team to link their goals to the Lube Business vision and strategies, and drive their skill development.
Deliverables	Cause and effect tree Criteria Build team scorecard Create link to performance appraisal Implementation tool kit

The team started by constructing its own Balanced Scorecard for the project (see Exhibit 1). The team spent two weeks in Fairfax launching the project. Ryan England, a consultant from Renaissance Solutions, encouraged the team to develop and validate a cause-and-effect tree that linked high-level business unit objectives down to positions or tasks for every individual in the organization. The team created a comprehensive cause-and-effect tree that filled a large wall (a simplified version is shown in Exhibit 2). The internal perspective contained nearly 100 individual processes.

The team then took to the field. During the next 12 working days, the team held about 40 meetings in 20 different locations to help individuals and teams implement their own scorecards.

D'Attoma described a typical meeting:

> Most of the people had never heard of the Balanced Scorecard. We started off telling them what it was, our objectives in using the scorecard, and the role of the scorecard in the organization. Then we walked them through the tree, we talked about the alignment of objectives and strategies and about cross-functional relationships, which the tree allows you to do. And then we asked them, "where do you fit on the tree?" They were generally excited to find how their job fit into our overall strategies and objectives. They went up to the tree, pointed to their box, saw what they affected, and traced how their job or position affected everything, eventually impacting ROCE. It was powerful for individuals to see that. Once we found their location on the tree, we broke that task down further, and helped them develop some objectives and measures.

The team developed specific criteria for individuals to follow in building their scorecards:

- Personal scorecard must support supervisor/manager's scorecard
- Scorecard must include an objective and measure that supports another part of the business
- Every supervisor/manager must have an objective and measure related to coaching, counseling, or employee development
- Scorecard must include a mix of lead and lag indicators
- Minimum of one objective/measure per quadrant [perspective]
- Do not exceed 15 measures
- Any change must be agreed to by both supervisor and employee

EXHIBIT 1 Lubes Team Balanced Scorecard

STRATEGIC THEME	OBJECTIVE	MEASURE	MINIMUM 1995	1996 ACTUAL RESULTS CURRENT	YTD	AS OF	TARGET	% OF TARGET	× WEIGHT	= SCORE
Financial										
Reward our shareholders by providing a long-term return which exceeds our peers'	Control team cost	Dollar savings		6,590	6,590	Dec. 19	N/A	0%		
Customer										
Become easy to do business with Deliver on our promises	Deliver the BSC process	Percent employees with BSC	85%	86%	86%	Jan. 1	100%	86%	45%	0.39
Internal										
Develop market-focused strategies	Effective presentations	Survey feedback	3.5	3.8	4.2	Dec. 19	4.0	105%	25%	0.26
	Deliver on process	Deliverables by Jan 1 '96	Yes	Yes	Yes	Dec. 19	Yes	100%	10%	0.10
Support cost-effective P&D	Educate Lubes organization	Presentations made per plan	90%	100%	100%	Dec. 19	100%	100%	10%	0.10
Learning and Growth										
Create a high-performance organization by equipping our people to succeed	Start GAP analysis process	Develop template for GAP	Yes	Yes	Yes	Dec. 19	Yes	100%	10%	0.10
								Total	100%	0.95
		Peformance factor 1.12 ×	unfactored score 0.95	= adjusted score = 1.06						

The Performance Factor indicates how difficult it will be to achieve the stated objectives/measures and associated plan or outcome. Performance factors may range as follows: 0.7 for plan which is easy to obtain; 1.0 for average plans, 1.12 for plans which are difficult to achieve; and 1.25 for plans that are exceptionally hard to achieve.

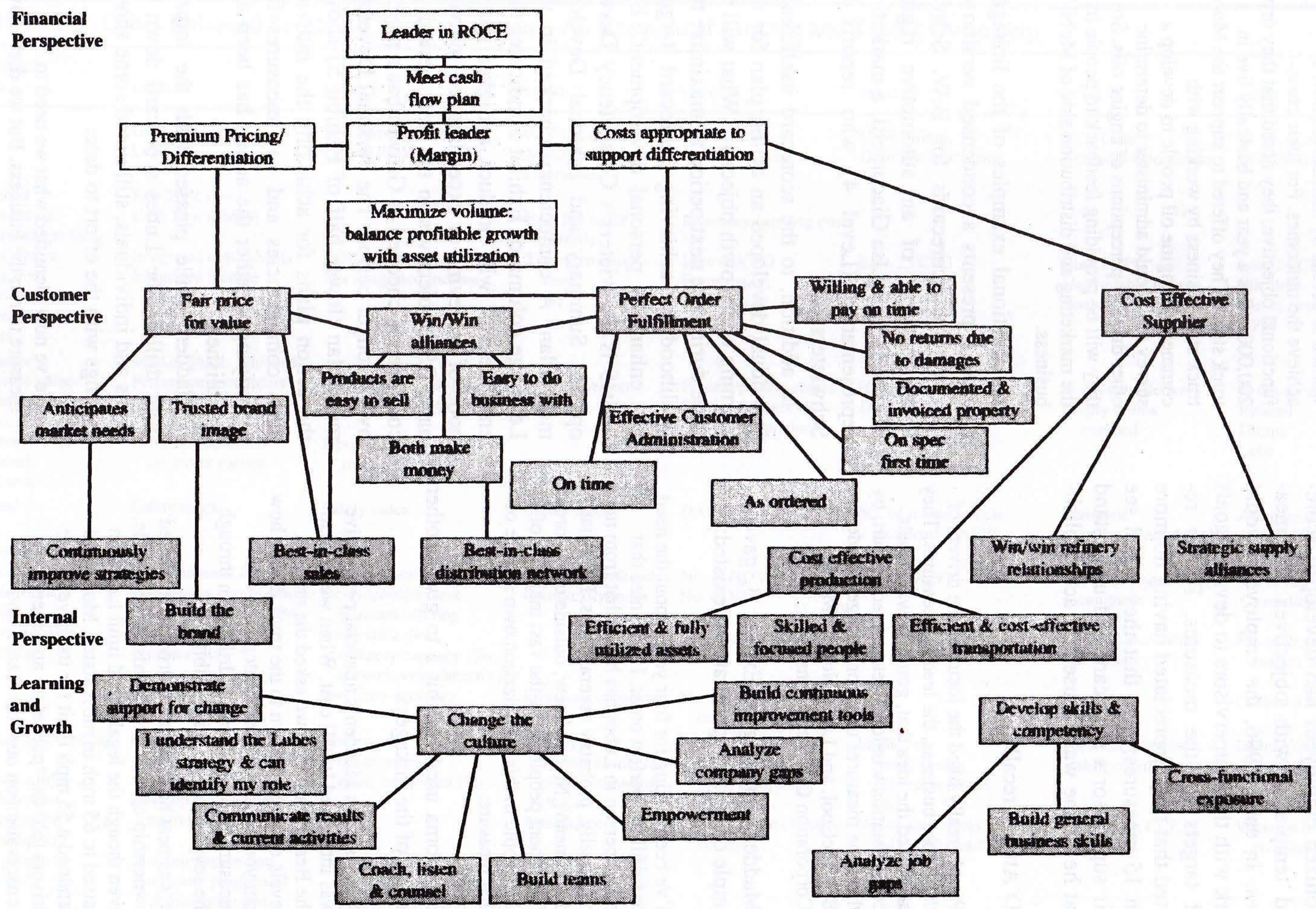

EXHIBIT 2 Mobil Lubes Balanced Scorecard Cause-and-Effect Tree: Summary

By the end of 1995, 86% of the 550 non-unionized employees had developed scorecard templates, with objectives and measures. In early 1996, the employees would work with their supervisors to develop goals and targets for the measures. People reported that they appreciated having no more than 15 measures; also that they could see their supervisor's scorecard and understand what he or she was focused on accomplishing.

D'Attoma recalled:

> People really liked the focus on the drivers of the Lubes business, the leading measures. They also liked the idea that, going forward, their compensation would be determined, in part, by the same measures used for George Madden, Bob McCool, and Lucio Noto's [Mobil Corporation CEO] compensation.

Madden, pointing to Exhibit 3, gave an example of the linkages that now existed:

> I've been talking for four years about the need to fulfill the perfect order. I guarantee that every person in Lubes has heard that from me personally, probably several times. But what did it mean? No one knew, outside of the order fulfillment people. Now the vast majority of the people in this organization own a piece of that measure.

D'Attoma used Exhibit 3 to give another example of the linkages:

> A measure in Madden's financial perspective was integrated [total] cost. When we went to the Beaumont plant, we asked the next six levels of people, down to the truck driver, how can you affect Madden's integrated cost measure? You can see the drill down through the seven levels in this exhibit.
>
> It was neat how the truck drivers developed ownership of their scorecards. For example, even though the legal speed limit had been raised to 65 mph in most states, Mobil had retained a 55 mph limit for its drivers. The drivers told us, "put safety and energy conservation on our scorecards, and let us decide how fast we can legally drive." They wanted to decide by themselves how to achieve the outcomes. For their cross-functional objective, they noted that they drive 200,000 miles a year and basically live in truck stops. They offered to support the Mobil truck stop business by working with commercial engine oil people to develop a survey they could administer to determine other drivers' perceptions of engine oils. So they will be providing feedback to people in the marketing and distribution side of Mobil's business.

As additional examples of the linkages, Exhibit 4 presents a condensed version of the personal scorecards for B.W. Schwieters, manager of an automotive region (Level 3), and Lisa Giacometti, a marketing representative (Level 4) who reports to Schwieters.

In addition, to the scorecard itself, each individual developed an action plan for the learning and growth objective: What will be done during the next period to maximize the likelihood of achieving scorecard targets and enhancing personal development? Exhibit 5 is Schwieters's Competency Development Summary and Personal Development Plan. A competency checked in the Leverage column of Exhibit 5 indicates that enhancement will produce a higher likelihood of achieving or exceeding the individual's BSC objectives in the next period. A competency checked as Growth has a payoff over a longer period. The Personal Development Plan (lower half of Exhibit 5) shows the action plans for achieving the individual's competencies and key measures for identifying whether the action has been accomplished.

Madden, while pleased with the impact from drilling the Lubes scorecard down to teams and individuals, still noted some shortcomings with the effort to date:

> We've now identified what we need to measure to run the business. But we don't have

EXHIBIT 3 Lubes Balanced Scorecard Implementation—An Example of Linkage and Taking Ownership

STRATEGIC THEME	LEVEL 1	LEVEL 2	LEVEL 3	LEVEL 4	LEVEL 5	LEVEL 6	LEVEL 7
	G. D. Madden, Lubes	M. L. Mullins, Order Fulfillment	A. J. Giaquinto, Manager of Plant Operations	K. F. Goode, Facility Manager	C. W. Slimp, Delivery Supervisor	J. G. Lege, Terminal Coordinator	G. W. Stewart, MV Driver
Financial Reward our shareholders by providing a long-term return which exceeds our peers'.	ROCE (%) Cash flow ($MM)		FA&Inv value ($MM)	Inventory carrying cost			
	Integrated cost ($MM) Integrated income	LOB integrated cost Net integrated income	Transformation cost	Line 44/CPG Formulation giveaway	Line 25 CPG Backhaul $	Line 2 CPG Unavailable hours Backhauls savings	Line 24 CPG Idle time Out of route miles GPM
Customer Provide value-added business solutions to our customers and channel partners.	Market Share: Finished Percent perfect orders Distributor survey	Percent perfect orders Distributor survey	Percent perfect orders	Percent perfect orders Service failures of strategic product lines	% On-time delivery Develop CEO market info survey	% On-time delivery Empty drums returned	% On-time delivery Returns Drums Lube
	Develop/implement customer survey	Develop/implement customer survey					
Internal	Safety index	Safety index	Safety index	DAFW	No. of motor vehicle accidents DAFW	Complete environmental self-audit	Accurate reporting rept. 731, 601, 727
Develop market-focused strategies and become operationally excellent.	Environmental index Continuous improvement cost reduction ($MM)	Enviromental index Develop/implement standard offering	Environmental index Complexity index	No. of NOV No. of hits	No. of NOV	No. of safety meetings complete	No. of log book violations
	Develop/implement capital plan	Asset utilization /refinery/capacity (%), network vs optimum (5)		No. of off-spec receipts		% attendance safety meeting	No. of completed CEO market surveys
		Inventory accuracy	Inventory accuracy	No. of transfers to move excess base stock			Customer assessment
Learning and Growth Create a high-performance organization by equipping our people to succeed.	Employee development plans completed (%) Develop inclusiveness metrics (3/31)	Employee development plans completed (%)	Employee development plans completed (%) Attendance	Employee development plans completed (%) Develop plant climate survey	Employee development plans completed (%) No. of employees trained ISO 9000 certification	Vacation relief for shift coordinator Training on CCE	Develop personal improvement plan Vacation relief: term. coordinator
	Develop/implement/ measure progress of change programs	Develop/implement marketing comp. plan, product mgt. comp. plan, distr/logistics comp. plan					

EXHIBIT 4 Personal Balanced Scorecard, Automotive Lubes*

STRATEGIC THEME	OBJECTIVE	B. W. SCHWIETERS, AUTO REGION MANAGER — MEASURE	LISA GIACOMETTI, MARKETING REPRESENTATIVE — MEASURE
Financial			
Reward our shareholders by providing a long-term return which exceeds our peers.	Improve profit results	Sales volume: Branded motor oil Net profit: Branded motor oil	Region 2 sales volume: Branded motor oil Region 2 net profit: Branded motor oil Expenses: Line 5 Line 13
	Product differentiation	Sales volume: Premium motor oil	Region 2 sales volume: Premium motor oil
Customer			
Become easy to do business with. Deliver on our promises.	Grow target market	Market share: Branded motor oil	Region 2 market share: Branded motor oil Targeted customers sales volume
	Maintain/grow existing market	Develop/implement customer satisfaction plan	
Internal			
Develop market focused strategies. Support cost effective P&D.	Strategy implementation Optimize distribution network	Investment $ in distribution network Distribution strategy: % implemented Implement basic offering	Investment $ in distribution network Distribution strategy: % implemented
	Perfect order fulfillment	Perfect order % Demand forecast accuracy	Perfect order %
Learning and Growth			
Create a high-performance organization by equipping our people to succeed.	Strategic reskilling	Personal improvement plan: % implemented	Attend AMA course
	Cross-functional exposure	% workforce with experience outside line of business	Spend time learning other aspects of lubes business
	Empowerment/innovation	Develop something that doesn't exist today	Participate on the Installed Strategy Workteam

**Data omitted for confidentiality.*

EXHIBIT 5 1996 Key Performance and Growth Areas

COMPETENCY DEVELOPMENT SUMMARY

Competency	Leverage	Growth	Comments
Effective communication	X	X	Critical to gain consensus/alignment of organizations strategies, tactics and deliverables.
Develops and coaches	X	X	Help people work more efficiently and effectively.

PERSONAL DEVELOPMENT PLAN SUMMARY

Development action	Plan/BSC measure	Practice	Critique
Develop and coach	Attend "coaching" seminar and develop appraisal/survey template Milestone dates: Attend seminar by June 30 Develop survey template by July 30	Preparation of 1996 SOR and profit plan	Survey assessment

all the information systems available to generate these measures, and that's a huge concern to me. We have had unstructured management information. We've had too much in some area, and too little in others. I have this dream of a streamlined information capability designed around what we really need to run the business. The Balanced Scorecard has given us a blueprint for designing such a streamlined information system.

MOBIL USM&R (D): GASOLINE MARKETING*

Gasoline Marketing (formerly known as Resale Services) was responsible for developing strategies for the sale of Mobil-branded gasoline in the US. Mobil conducted such sales through three channels: Lessee dealers operated stations for which Mobil owned or leased the underlying real estate. Non-lessee dealers were individuals who owned the real estate and operated the service stations under a contractual supply agreement. The third channel were distributors who sold Mobil products through their own network of dealers. In December 1995, Gasoline Marketing contained 165 people and an annual budget of $34 million.

Prior to 1994, operational relationships with dealers and distributors had been determined by senior executives operating from USM&R's Fairfax headquarters. The executives determined strategy and direction for all channels and drove their policies down through the sales organization. In June 1994, Mobil's US Marketing and Refining Division was reorganized to shift decision-making and profit responsibility from headquarters down to 17 natural busi-

*Professor Robert S. Kaplan prepared this case. Mr. Ed Lewis of Mobil's Business and Performance Analysis group provided invaluable assistance.

ness units (NBUs), responsible for refining, sales, and distribution of Mobil products. The previous top-down staff functions would now be performed in 14 free-standing service companies (referred to as servcos). In the short run, the NBUs would have to "purchase" services from the servcos. But by 1997, USM&R's Executive Leadership Team planned to allow NBUs to acquire services from an outside vendor if such an arrangement would be more cost effective for Mobil.

Marty DiMezza, a 30-year veteran at Mobil and former head of the Resale Services department, was appointed head of the new Gasoline Marketing servco. In the new decentralized organization, each servco had to develop and negotiate a service agreement, specifying service offerings and associated costs, with a buyers' committee consisting of four or five representatives from the 17 NBUs. DiMezza described the new challenge for his organization.

> We had to go through a major mental change: from a direction-giving organization to a service provider. Our people would have to learn how to partner with the NBUs [natural business units] to assist them in accomplishing their strategies.

EXHIBIT 1 Gasoline Marketing and Strategic Role

Mission

To build the best fuels franchise in the industry

Provide value-added, cost-effective consulting services, programs, functional expertise, and marketing strategies with the goal of providing the best buying experience for the consumer and assisting the NBUs and our channel partners in achieving their profitable growth objectives

Strategic Role

The role Gasoline Marketing plays in contributing to the achievement of the USM&R challenge is to:

Partner with the NBUs to develop and help implement national and regional strategies

- Offer effective tools to improve execution of new and existing programs
- Implement real estate acquisition, disposal, and lease management strategies
- Provide profitability analysis for potential N deals
- Evaluate, endorse, provide economics, and develop proposals for all new distributor opportunities
- Provide training to develop the skill sets and knowledge of sales associates, channel partners, and NBU personnel on delivery of front-line service, c-store expertise, and retail excellence

Serve a leadership role to provide channel management expertise within USM&R

Foster functional alignment across USM&R

- Ensure consistency of national wholesale and retail gasoline marketing programs
- Maintain brand and image standards

Provide administrative support that allows NBU personnel and channel partners to focus their energy on the delivery of the best buying experience by:

- Accurate and timely contract/lease administration
- Maintaining fiduciary responsiblity for accounts receivable
- Ensuring legal integrity of contracts and leases
- Servicing dealers and distributors needs for POS maintenance and inquiry resolution
- Managing the Trammell Crow outsource relationship for real estate services
- Provide financial analysis to ensure credit worthiness and security requirement for new and existing assets

Provide NBU/SERVCO learning interventions and associated follow-up to develop a core business leadership competence

Create a value-added working relationship. We will work with our clients in a way that reflects the following values:

• Customer driven	• Client oriented	• Cost-effective	• Trusted
• Expertise	• Innovative	• Value added	• Responsive

> Forging a service agreement with the buyers' committee created a lot of anxiety within our organization. For the first time in Mobil's history, we had to put together a bundle of services that someone else had to agree to buy. We had never before asked people whether they were willing buyers.

Gasoline Marketing set a mission to develop "the best fuel franchise within the oil industry" enabling it to increase the profitability of both franchisees and Mobil. The unit wished to shift away from its traditional arm's-length contractual arrangement with dealers to a more proactive alliance relationship. DiMezza's unit conducted benchmarking studies that examined the practices of 15 leading franchising companies, including McDonald's, Boston Markets, Goodyear, and Midas. The studies revealed the opportunity to forge innovative relationships that would attract the best entrepreneurs to become Mobil franchisees. The relationships included assistance in the training and development of dealers' front-line employees, customer-focused marketing programs, and new leasing and rental agreements. By December 1994, Gasoline Marketing had developed its first draft of a mission statement, and strategic role (see Exhibit 1) to support the NBUs. Shortly thereafter, it completed its first service agreement with its buyers' committee.

The effort by servcos to develop service agreements coincided with the USM&R's Balanced Scorecard project. DiMezza volunteered to have Gasoline Marketing be the pilot case study for developing a servco Balanced Scorecard: "I saw the scorecard as helping us achieve our mission to provide services to the field that would be competitive with those of any outside service organization."

Gasoline Marketing translated its overall mission into a set of strategic objectives organized around the four scorecard objectives: financial, client (the unit believed that the NBUs were more like clients than customers), internal, and learning and growth. The financial perspective focused on the cost of operating the unit and of the value created for the NBUs. The client perspective focused on services to the NBUs, as expressed through the service agreement negotiated with the buyers' committee, and also services provided to the executive leadership team (ELT) of USM&R. The internal perspective was geared to understanding the clients' needs, and the learning and growth perspective identified the needed commitments and strategies for developing Gasoline Marketing people to perform its new roles.

DiMezza noted the linkage between the service agreement and the scorecard:

> Several items we had identified in our menu of services were not perceived as valuable enough by the buyers' committee for them to purchase. If the buyers' committee didn't think the services were worth the price tag, we had to negotiate about whether to drop the service entirely or to reduce some of the bells and whistles we had incorporated. Conversely, we had not understood some of the areas that were high priority to them, and for which they wanted us to have more active programs. So it was an iterative process, revising our menu of services and reallocating our manpower and expense resources to the objectives that the field organization wanted to accomplish. But it was a learning and bonding process as we went through each iteration of the scorecard and service agreement.

Translating scorecard objectives to measures also proved challenging. Consultants from Renaissance Solutions facilitated the process of developing strategies and metrics for how servcos could help NBUs and USM&R attain their short and long-term strategic objectives. By the end of March 1995, the effort produced a Balanced Scorecard of objectives and measures for Gasoline Marketing (see Exhibit 2). The upper half (topside) of the scorecard, labeled "Link-

MISSION

To Build the Best Fuels Franchise in the Industry

		Strategic Objective	Measurement
USM&R/NBU Linkages	Financial	Support USM&R market share and profitable growth Support USM&R cost reduction	❑ Market share ❑ NPBRE ❑ Rent income ❑ Retail P&L ❑ Wholesale P&L ❑ COT sales results ❑ Class of trade expenses (cpg)
USM&R/NBU Linkages	Customer	Continually focus on delivery of the best buying experience	❑ Customer satisfaction ❑ Mystery Shopper rating ❑ Dealer/distributor satisfaction
Gasoline Marketing Scorecard	Financial	F1. Servco Operating Efficiency	❑ Budget variance ❑ Indirect/direct ratio ❑ Cost per hour
Gasoline Marketing Scorecard	Client	C1. Develop and maintain resale vision and strategies C2. Develop and support programs that enhance franchise value C3. Assist NBUs with strategy implementation C4. Provide relevant information and facilitate communication C5. Value-added working relationship	❑ Client satisfaction (Service Agreement feedback) • NBU • ELT ❑ Tracking vs. program/tool KPIs
Gasoline Marketing Scorecard	Internal	I1. Understand client needs I2. Reengineer the franchise offering I3. Excel in channel management I4. Enhance Servco operating efficiency I5. Support implementation of marketing plan I6. Optimize salesforce effectiveness	❑ Key initiative tracking vs. milestones ❑ Tracking vs. channel strategy KPIs ❑ Competitive assessment (best practices) ❑ $ of cost reduction initiatives originated within the Servco or jointly ❑ Area manager feedback
Gasoline Marketing Scorecard	Learning & Growth	L1. Core competencies and skills L2. Organizational involvement L3. Access to strategic information	❑ Strategic competency availability —% coverage by competency ❑ Climate survey ❑ I/T reliability

EXHIBIT 2 Gasoline Marketing Balanced Scorecard: 1995

ages," identified the NBU/USM&R financial and customer objectives that Gasoline Marketing could impact. In general, the topside of a servco scorecard focused it on areas where it had the greatest impact on the business. The bottom half of the scorecard identified the strategies and measures for the servco to achieve its mission. The financial objective focused on operating efficiencies. Data were readily available for measures in this perspective. For the other three perspectives, however, almost no data were available for the desired measures. Plans were put in place to develop preliminary data for the remaining measures during the next few months. A high priority, the client perspective, would draw upon a new semi-annual survey of field operations to assess how the unit was performing against its service agreement (see sample form for the unit's support of retail dealer operations, one of eight major subunits run by Gasoline Marketing in Exhibit 3).

DiMezza observed:

> The topside linkages have added a lot of clarity to our people in the unit about how what they do day-to-day links to overall USM&R scorecard objectives. Reporting quarterly on the client satisfaction metrics on the unit's scorecard communicates and adds clarity to the individual service agreements and commitments we had made to the field organization.

In 1995, the variable compensation of senior managers in Gasoline Marketing was tied 50% to achievement of USM&R's scorecard targets, and 50% to individual performance.

Not everyone in USM&R believed that servcos needed their own Balanced Scorecards. Lucille Cavanaugh the new general manager of the Western Region business unit had formerly served as head of two NBUs and four servcos. Cavanaugh questioned the role of the Balanced Scorecard for servcos. She felt that the buyers' committees were extremely useful and powerful in aligning servcos to business unit strategies. But having forged a service agreement, she had found the effort to translate the agreement to a servco Balanced Scorecard to be time-consuming and with little incremental payoff.

> Servcos should be focused on fulfilling their service agreement: did they deliver the service they committed to, and did they meet their cost target for the service? Either they did or they didn't so they don't require a Balanced Scorecard to communicate that information.

Dan Zivney, general manager (during 1995) of the Information Services servco felt, however, that the client satisfaction metrics provided better focus for his organization:

> The servco scorecard helps all our employees understand the importance of satisfying the customers who are the consumers of our projects. At the end of the day, did our project really do what the business unit wanted, in accordance with the efficiency, quality and responsiveness they expected? Were our people friendly, did we make errors, were we on time, within budget? All these attributes can be measured and incorporated into a servco scorecard. If I am held accountable to customer satisfaction, I will put in a greater effort, particularly at the front end, to understand what the customer is asking for in the first place, before I even start the project or activity.

Most servco scorecards had relatively light weight on the financial objectives, recognizing that once head count had been determined in the budgetary process linked to the service agreement, the financials during the year were largely determined. Much more weight was placed on measures in the client or customer perspective. But this introduced a new problem, identified by Jeff Webster, general manager of the Marketing Development servco: It's a little more difficult for servcos to develop Balanced Scorecards than the NBUs. The business units can use hard fi-

Client Service Agreement

Activities	Client	Resources: FTE*	Resources: Servco Totals	Resources: Non-Servco	Service Level Desciption
Develop and Maintain Resale Vision and Strategies for OG&L and N Channels	ELT/NBU COE	1.31	418		• Finalize N Dealer Scorecard by May 30
• Develop/Maintain OG&L & N Vision Strategies KPI's to Sustain Low Cost, Profitable Volume/Market Share Growth		0.45	129		• Update OG&L Vision/Scorecard by June 30 • Provide Ongoing Support
• Manage Retail Channels Including:					
• OG&L/N Franchise Stewardship/Channel Strategies		0.25	94		• Provide Ongoing Support
• Competitive Assessments/Best Practices		0.03	6		• Monthly Rent Income Summaries & Ongoing Analysis/Support
• Rent Income Strategy and Performance Analysis		0.05	10		• Provide Ongoing Support
• PMPA Compliance		0.02	4		• Provide Ongoing Support
• N Dealer Economics & Performance Analysis		0.12	19		• Assessment by April 25
• N Dealer Parity Assessment		0.10	16		• Ongoing Communications with NUB/NDAC and conduct 2 OG&L & N NDAC Meetings Per Year
• NDAC Coordination and Facilitation		0.29	140	xxx	
Develop and Support Programs to Enhance Franchise Value	NBU	1.25	304		
• Develop Tools/Alliances to Improve OG&L/N Dealer Health and Enhance Franchise Value					• Ongoing Support
• Merrill Lynch Financial Planner/MVIP		0.05	4		• Template by 4Q 1995
• Service Station Security Guidelines		0.05	10		• Develop Guidelines 3Q 1995
• Mystery Shopper		0.35	57	xxx	• Ongoing Support
• Dealer Insurance		0.15	37	xxx	• National Offer Due 4Q 1995
• Pegasus Circle of Excellence		0.12	41	xxx	• Quarterly Updates
• N Parity Upgrade (i.e. CATS)		0.10	22		• Dev. Support Tools 2Q 1995
• N Image Upgrade Program		0.11	58	xxx	• Ongoing Support
• N Aquisition and Retention Procedures		0.12	18	xxx	• Ongoing Support
• Citibank/Omega Financing		0.07	11		• Ongoing Support
• NBAM Seminar/Training/Toolkit		0.13	46		• Two Annual Work Sessions; Develop NBAM Training by 4Q 1995
Assist NBU's with Strategy Implementation	NBU	0.44	161		
• SFE Implementation & Support		0.13	43		• 1 A/M Meeting Develop Feedback & Refocus; 2 visits to each NBU to Reassess and Refine Program
• Evaluate SFE Effectiveness		0.13	43		
• SFE Toolkit Refinement & Coordination		0.10	62	xxx	
• Evaluate Turnpike Opportunities and Coordinate Proposal Preparation to Maximize Profit/ROCE		0.08	13		• Support as Required by NBU Needs
Provide Management Reports and Facilitate Communication	NBU	INCL.	INCL.		
• Resale Highlights					
• Track KPI's/Scorecard					
• Share Best Practices/Benchmarking					
• Policies and Procedures					

*FTE: Full Time Equivalent Persons

Client Feedback

	Client Oriented	Cost-Effective	Trust	Expertise	Innovation	Value-added	Responsive
Overall coverage							

Comments

Key:
1 = Fails to meet expectations
2 = Partially meets expectations
3 = Meets expectations
4 = Exceeds expectations
5 = Greatly exceeds expectations

EXHIBIT 3 Client Feedback—Retail Dealer Operations

nancial measures; servcos must use more subjective, softer measures.

Tony Turchi, general manager of the New England Sales and Distribution business unit (see Mobil USM&R [B] case) and a member of the Gasoline Marketing buyers' committee, raised an additional concern with the servco scorecards.

> The issue comes down to whether the people from the servco are focused on supporting the business unit or the parent organization. The greatest success stories have occurred when the servco people are completely focused on the service agreements we have established, especially with the individual business units. Some servco people, however, appear to be focused only on how well the NBUs are performing on the topside measures, such as volume and profit. That's my responsibility. I don't need them on my case on these measures. When some of the servco general managers visited NES&D, most of the discussion was on how the business unit was performing and not a lot on how their servcos were supporting my business unit. They should stay focused on the deliverables in the service agreement.

Cavanaugh supported Turchi's argument: "Servco people out in the field should be thinking about how well they are linked to the business units they directly support, and how that linkage supports overall divisional goals."

The Gasoline Marketing group used the feedback from NBU managers when they revised their scorecard for 1996. The 1996 scorecard also incorporated explicit weights and targets for the topside and servco components.

The 1996 variable compensation of senior managers in Gasoline Marketing would be based on four components:

- USM&R BSC performance
- Topside (NBU linkage) performance
- Gasoline Marketing BSC performance
- Individual performance

with the USM&R and Topside performance representing slightly more than 50% of the weight.

DiMezza commented on the experiences during 1995.

> It's been a learning process to understand what involvement Fairfax should have in the individual business units. Initially there was some ambiguity about all the linkages between the servcos, the business unit, and the entire division. The difficulties were probably inevitable as we shifted from an organization that had been top-down driven to one that must clearly be field-business-unit driven, with support from Fairfax. I think that the 1996 scorecards will more clearly emphasize client satisfaction along our service agreements.

DiMezza concluded by reaffirming his support for a servco Balanced Scorecard:

> The scorecard and service agreement played a critical role for our leadership team to implement the servco concept and become a strategic partner with the USM&R business units. My challenge for 1996 is to communicate even better through the Gasoline Marketing organization about our strategic direction and to keep everyone focused on satisfying clients' needs. Starting in 1996, all individuals in the unit, from secretaries through general managers, will have their variable compensation linked to achieving USM&R and Gasoline Marketing scorecard targets.