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The Balanced Scorecard and IT Managment

by Robert S. Gold



Introduction

In 1993, Robert S. Kaplan of Harvard Business School and consultant David Norton developed the Balanced Scorecard (BSC) management discipline to provide senior executives a strategic tool to measure and improve organizational performance. Kaplan and Norton recognized that traditional accounting-based performance measures such as return on investment and earnings per share—while effective for reporting results—had limited value to executives seeking to make more effective strategic decisions.

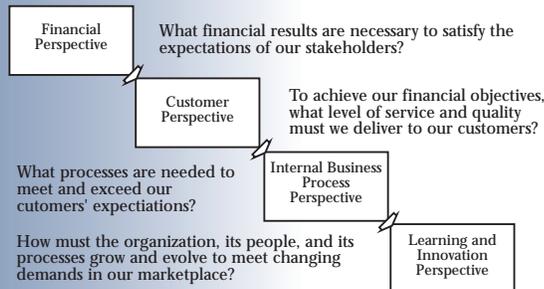
Today, the BSC enjoys increasing attention and is likely to become as ubiquitous in senior management circles as was business process reengineering earlier this decade. Much of the BSC's appeal stems from its ability to integrate financial and operational measures into a single comprehensive framework that can "translate a company's strategic objectives into a coherent set of performance measures."¹

The BSC approach lends itself especially well to one of the fundamental challenges facing CEOs and IT executives—namely, how to measure, improve, and understand the value that information technology delivers to the business.² The BSC can help managers identify opportunities for improvement in IT, and track the impact of improvement initiatives through a wide range of performance indicators. This Compass white paper discusses the basics of the BSC methodology, and examines how it can be applied to IT operations at both a strategic and tactical level.

The Scorecard Perspective

The BSC offers four perspectives on performance measurement.

- The Finance Perspective includes traditional measurements such as profitability, revenues, and sales growth.
- The Customer Perspective focuses on both objective measurements such as customer retention rate, as well as more subjective criteria such as market research and customer satisfaction surveys.
- The Internal Process Perspective comprises measurements of critical operational indicators such as the labor hours spent opening a new account, reviewing an insurance claim, or filling an order.
- The Learning and Innovation Perspective addresses the basic competitive imperative faced by every business—the need to constantly change and adapt to new challenges and new environments. Specific measurement criteria include investments in training and processes designed to institutionalize innovation.



The power of the BSC model lies in the linkages between these four core measurement perspectives. Consider, for example, a business experiencing poor performance from a financial perspective (as measured by low sales growth) and from a customer perspective (as measured by low customer retention and satisfaction). Using the BSC approach, management can examine measures from the learning and innovation perspective

and from the internal process perspective to identify root causes as well as potential solutions to the problem. Are customer service training programs inadequate, compared to industry leaders? Are internal processes that affect customers inordinately slow or inefficient? By identifying imbalances that exist in these measurement areas, the scorecard can be used to take corrective action.

The Balanced Scorecard and IT Management

In the IT organization, the BSC approach can be used to link IT financial performance to operational effectiveness, thereby providing a meaningful high-level picture of IT performance. The model also creates a common language to communicate IT performance to stakeholders throughout the organization, thereby addressing what should be a critical concern of CIOs.

According to a recent survey of 100 chief executive officers conducted by *Computerworld* magazine, 68 percent of CEOs were either “completely displeased” or only “somewhat satisfied” with the information they received from their top IT executives. Perhaps more significantly, 56 percent of the respondents said that IT executive could do a better job articulating the business ramifications of IT investments.³

The scorecard can also be a valuable diagnostic thermometer that indicates that a problem exists. However, like a thermometer, the scorecard is not, in and of itself, a diagnostic tool. The scorecard can help management establish priorities



by identifying where to focus improvement efforts. Subsequently, the scorecard facilitates tracking the progress in implementing improvement initiatives.

Strategic and Tactical Perspectives

Another benefit of the model is its adaptability to both strategically and tactically oriented organizations. According to Kaplan and Norton, “Different market situations, product strategies, and competitive environments require different scorecards. Business units devise customized scorecards to fit their mission, strategy, technology, and culture.”⁴ From an IT-centric perspective, BSC principles can be applied to the impact of organizational performance, to IT operations in general, or to specific IT operational areas such as data centers, networks, or application development shops.

At each level, the BSC enables performance measurement within and across the four core perspectives.

This adaptability is critical, in light of the spectrum of objectives IT organizations must—often simultaneously—address. Although demonstrating the strategic value of IT has become something of a mantra for CIOs, many IT organizations are tactically oriented, with a role that is not strongly linked to the organization’s core business strategy. In the real world CIOs must often deal with operational issues and put high-level strategic concerns on a back burner. Under such circumstances, the BSC can be used to address immediate issues of operational efficiency, while at the same time charting

a course towards defining and understanding a strategic role for IT.

The Balanced Scorecard in Practice

A Strategic (“Classic”) Application

Chart I on the following page illustrates a scorecard that measures the business benefits of a hypothetical online banking initiative. The bank’s retail customers are producing low profit margins because of the high overhead and service costs of managing each account. Electronic banking is seen as a way to address this problem. If a strategic goal of the initiative is defined as increasing account profitability, performance indicators such as numbers of accounts managed per full-time employee and cost per transaction are relevant measures. Relationships can be drawn between these measures—hours spent training support staff can have an impact on customer complaints.

Through analysis of these types of indicators, the strategic benefits of the online banking initiative can be assessed.



A Tactical Perspective

Chart II shows another scorecard implemented at a more tactical level. In this scenario, an organization seeks to enhance the efficiency of its data center operation, thereby reducing costs and increasing corporate profitability. While the objective in this case is focused on operational issues, the four BSC perspectives and the links between them still apply. For instance, the return on investment in personnel training can be traced to other indicators such as enhanced customer satisfaction, improved mainframe disk utilization, and lower unit costs.

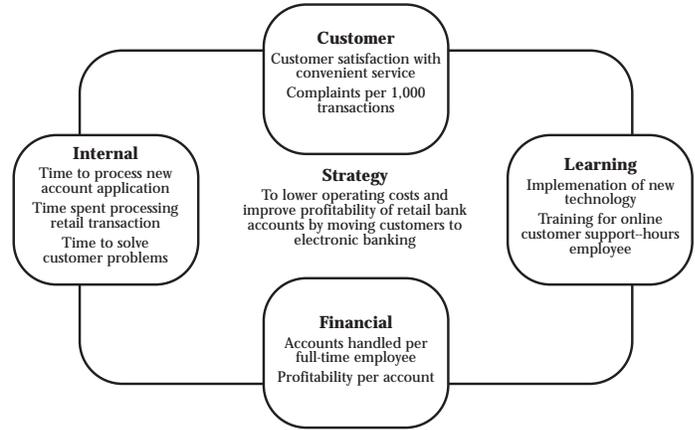


Chart I

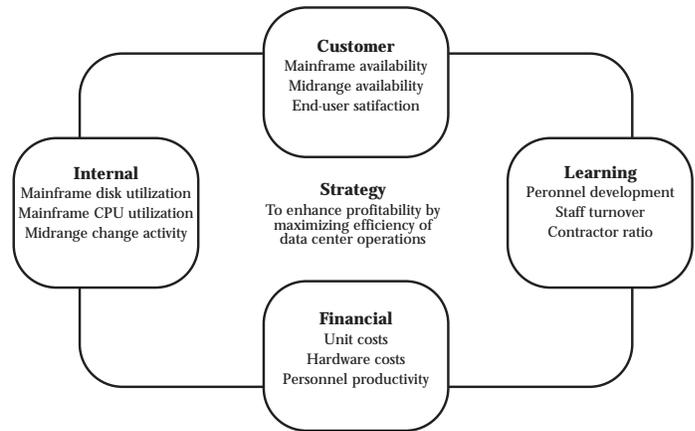


Chart II

Designing BSC Indicators and Measures

A basic challenge of implementing the BSC at an any level is defining appropriate performance indicators, metrics, and targets. Specifically, how do you know if the indicators link to the strategic objective? Do the measurements accurately gauge performance? Are the targets realistic?

The key question: How do BSC perspectives, performance indicators, and measures enable action that results in positive change?

According to Kaplan and Norton, "A Balanced Scorecard must retain a strong

emphasis on outcomes, especially financial ones." However, they add, "it is easy to become preoccupied with such goals as quality, customer satisfaction, innovation, and employee empowerment for their own sake...Many managers fail to link programs to specific targets for improving customer and, eventually, financial performance."⁵

From the Compass perspective, the use of activity-based costing (ABC) measures in BSC initiatives is essential to maintaining a focus on meaningful and actionable indicators and measures.



The Scorecard and External Measures

By definition, the BSC sets goals and targets from internally generated criteria. However, when external benchmarks and a comparative analysis methodology are applied to a balanced scorecard, the Compass perspective of continuous improvement to achieve 'best of breed' performance.

Compass believes that detailed data on top performers and knowledge of best practices can be used effectively in the context of a balanced scorecard. External measures help define realistic performance targets for each of the four perspectives. The scorecard then facilitates an iterative process of continuous improvement. On an ongoing basis, the BSC can measure progress against increasingly ambitious goals—goals which take best practices into account.

Conclusions

Kaplan and Norton's Balanced Scorecard is a powerful and increasingly popular tool for managing organizational direction and strategy.

The BSC methodology involves measuring performance from four perspectives and understanding linkages between the different indicators.

The BSC methodology is relevant to IT management at both a strategic and tactical level.

Activity-based costing measurements are essential to linking a BSC to actionable performance improvement initiatives.

Although the BSC models are predicated on internally generated goals and targets,

industry best practices and comparative analysis, based on external criteria, can enhance the BSC approach.

Robert S. Gold (Robert.Gold@usa.compass-analysis.com) is practice leader for integrated services at Compass America. He has performed numerous consulting engagements for FORTUNE 500-sized clients across a variety of industries. His areas of expertise include IT effectiveness, data center management, business process design, and disaster recovery strategy.

Footnotes

- 1 Robert S. Kaplan and David P. Norton, "Putting the Balanced Scorecard to Work," *Harvard Business Review*, January-February 1996.
- 2 "IT Efficiency and Business Value," Compass White Paper, July 1998.
- 3 Rochelle Garner, "CEOs to IT: Teach Us," *Computerworld*, October 19, 1998.
- 4 Kaplan and Norton, "Putting the Scorecard to Work."
- 5 Kaplan and Norton, *The Balanced Scorecard: Translating Strategy into Action* (Harvard Business School Press, 1996), p. 150.



Case Study

Applying the Balanced Scorecard to Demonstrate ROI

Scenario: *Acme Company is a major global manufacturer of consumer goods. During the past ten years, Acme's IT budgets have increased substantially relative to revenue growth. Senior management has called a meeting with IT executives. The agenda: Explain this increase in IT spending and quantify the ROI Acme gets from IT.*

To respond to senior management's concerns, Acme's IT executives developed a balanced scorecard to establish performance measures that tie IT expenditures to business objectives. The first step was to identify issues and challenges related to the four scorecard perspectives, and to then establish cost, efficiency, and quality indicators that addressed organizational objectives at both a tactical and strategic level. This was achieved through a series of interviews with Acme's IT management and staff, facilitated by a team of consultants.

The scorecard that emerged from this process identified increasing productivity as a core objective from the financial perspective. Scorecard indicators included a variety of IT operational unit cost measures, such as desktop hardware and software costs, ERP application costs, and personnel productivity. From the customer perspective, improving IT responsiveness to business units was a key issue. Application availability, support quality, and end-user satisfaction were among the indicators that the scorecard team established. Internal process indicators, meanwhile, included CPU utilization, IT personnel productivity, and problem-solving activity. These were designed to enhance productivity and standardization, and to manage rapid growth. Finally, staff turnover and personnel development were established as indicators for the learning and growth perspective, since knowledge capture was identified as a critical issue for Acme in this area.

Acme's IT team then worked with consultants to "wire" the scorecard into a repeatable process that enables systematic and periodic measurement of the scorecard's indicators and comparisons against external benchmarks. This comparative process enabled the team to gauge performance for each indicator, and to set realistic improvement targets. Moreover, links were established between indicators from different perspectives. For example, customer perspective issues such as client satisfaction were related to internal process perspective measures such as support effectiveness. On a more strategic level, measures of contractor ratios and staff turnover were applied to address skill retention and knowledge management issues.

As for the fateful meeting with senior management, Acme's IT executives used the scorecard to demonstrate significant unit cost reductions, despite an overall increase in IT spending. By linking IT performance to business issues, moreover, the scorecard provided senior management with a deeper—and more quantifiable—understanding of IT value. Looking ahead, Acme plans to apply the scorecard methodology to a variety of strategic and tactical issues and to thereby facilitate measurement, management, and organizational communications.

This case study is based on an actual Compass engagement. For additional information, contact Michael Burnett, relationship manager at Compass America, at 314.230.8593, or send email to Michael.Burnett@usa.compass-analysis.com.