SUCCESSFUL STRATEGY EXECUTION— PART I: WHAT DOES IT LOOK LIKE?

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Robert Kaplan and David Norton have written extensively about how organizations can use the Balanced Scorecard (BSC) as the central organizing concept for an integrated strategy management system. In this two-part article, Norton shares his latest thoughts and observations about how the most successful adopters of this management tool—members of the Balanced Scorecard Hall of Fame—use this approach to achieve improvements in financial performance. Norton explores the role of execution measures—and achievement measures—within each of the four BSC perspectives. He also provides a detailed discussion of the role of these measures in both the financial and customer perspectives. In Part II, Norton will complete this analysis for the process, and learning and growth perspectives. A case example based on Minor Food Group accompanies this discussion.

On May 6, 1954, one of the great athletic achievements of all time took place. Roger Bannister, a British medical student, ran a mile in less than four minutes (3:59.4). This event, long considered impossible by informed observers, was the culmination of years of improved performance by athletes around the world. For Bannister, it was a response to a disappointing performance at the 1952 Olympics. Contemplating whether it was time to retire and pursue his medical studies, Bannister set himself a new goal: to run a mile in less than four minutes. The four-minute target emerged because "it was a nice round number" and the previous world record had stood for nine years. Bannister developed an innovative, low-mileage training strategy to pursue the goal and . . . the rest is history.

Leaders of business organizations, attempting to excel and exceed, face similar challenges. Successful strategy execution has been unachievable for most—nine out of 10 organizations fail to execute their strategies. Like Bannister, a leader needs to create a target that will inspire and stretch the organization. Although inspiration to achieve a highly ambitious stretch target is important, targets must also be used for mundane tasks like allocating investments, setting personal goals, and communicating with stakeholders. Thus, the targets should be demanding but achievable.

Limited work has been done on the subject of target setting for strategies, most of it dealing with the development of visions.[1] The leader's role is to (1) show the need for change, (2) develop a vision and strategy, and (3) establish a sense of urgency.[2]

Without credible targets, executives cannot deal with questions that enable transformational change to take place within their organizations:

- How can I set the expectation that we can be the leaders in our markets?
- How can I convince my organization that a new way of managing will produce a significant payoff?
- How much should I be willing to invest in this new approach?
- How do I set targets for my Balanced Scorecard?

Operational management systems like budgets, cost

1. R.S. Kaplan and D.P. Norton, "Develop the Strategy," chapter 2 in The Execution Premium (HBS Press, 2008).
2. John Kotter, Leading Change (HBS Press, 1996).

management, and quality management have long used benchmarking as a target-setting methodology. We need an analogous framework for the setting of targets in strategy management systems.

We recently embarked on a research project to develop a set of such strategic benchmarks. Using our Balanced Scorecard Hall of Fame (HoF) database,[3] we selected a sample of 30 private sector organizations that had recently been evaluated and selected for the HoF award. Each presented a detailed statistical profile of the results that it had achieved. Each used the Balanced Scorecard/Strategy Map measurement framework, which assured us that a consistent methodology was applied. Our hope was that by analyzing the measures and results achieved by these organizations, we could create a generic profile of what successful strategy execution would look like, what it would be worth, and how it would be managed. The research showed us that the typical Balanced Scorecard (BSC) Hall of Fame organization achieved the following results over a three-year period:

• A growth in shareholder value of 150%, driven by a 180% growth in profits and a 120% growth in revenue. Financial performance was frequently complemented with an improvement in the Moody's or Standard and Poor's rating.

• A 50% improvement in customer satisfaction frequently complemented by a #1 ranking by an external agency in brand value and market share.

• A 50% improvement in key process effectiveness, complemented by external performance awards for quality, safety, or environmental performance.

• A 25% improvement in employee satisfaction, leading to a 50% reduction in employee turnover, complemented by external awards for workplace effectiveness.

The results are summarized in Figure 1. Although financial performance loomed large as an absolute indicator of success and its value, the impact of the performance drivers was critical. The leverage of 50% improvements in employee retention, key process effectiveness, and customer satisfaction into 150% improvements in shareholder value provides a guideline to executives as to where strategic investments should be made (the drivers) and the order of magnitude of the payoff. It also provides a framework to set targets, to manage expectations, and to monitor returns.

HALL OF FAME STRATEGICPERFORMANCE COMPOSITE

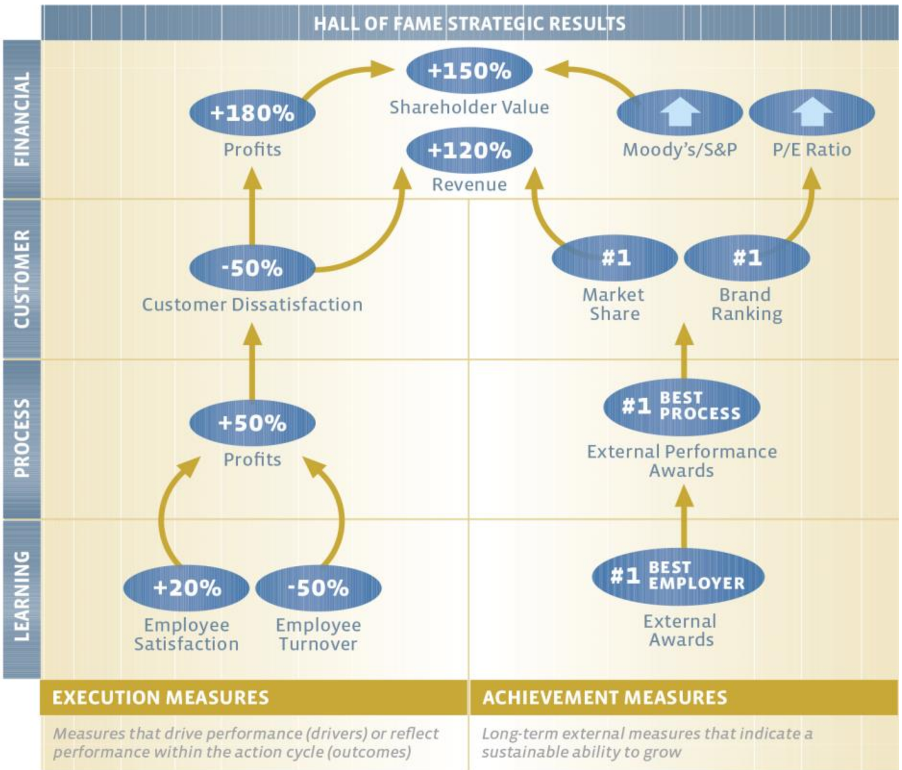

FIGURE 1:

This figure shows the composite results that include both execution measures and achievement measures. Execution measures reflect the internally derived accomplishments that result from pursuing the strategic objectives within the strategy map and Balanced Scorecard. The achievement measures reflect the improvements that were acknowledged by external agencies.

3. The Balanced Scorecard Hall of Fame for Strategy Execution comprises more than 160 organizations that have used the Kaplan/Norton BSC approach to successfully execute their strategies, thereby achieving breakthrough results.

STRATEGIC GOALS AND BHAGs (BIG, HAIRY, AUDACIOUS GOALS)

Setting strategic goals is as much about motivation and inspiration as it is about economics. In their book Built to Last,[4] James Collins and Jerry Porras describe how "highly visionary companies often use bold missions as a particularly powerful mechanism to stimulate progress." They introduce the term "BHAG" (Big, Hairy, Audacious Goals) as a mechanism to describe such a vision. A BHAG is more than a goal. It is a compelling and inspirational description of the desired future state. Examples of effective BHAGs are General Electric's commitment to "be #1 or #2 in every market we serve" or John F. Kennedy's challenge "to put a man on the moon and return him successfully to earth by the end of the decade." Hall of Fame organization TNT Express (European package delivery services company) framed its BHAG as follows:

> "Grow the profits of the business by 50% in the next three years."

Nemours, a U.S. nonprofit healthcare system for children had a more comprehensive BHAG:

> "By 2015, Nemours will be a leading health system for children, being in the top 5% of institutions for patient satisfaction as well as in health and quality outcomes."

In each of these cases, a BHAG describes the outcome that an organization desires and a date by when to achieve it. A strategy describes how the organization will achieve that outcome. Although a BHAG is a useful (and, we believe, an essential) part of the goal-setting process, it must be complemented with the subsidiary goals (the drivers) that will achieve the audacious objective.

Figure 1 illustrates our structure for setting strategic goals. The BSC framework, proven in practice for nearly two decades, asserts a cause-effect logic between desired outcomes and performance drivers. Financial performance, the ultimate measure of success (in the private sector), is derived from the creation of satisfied customers who are, in turn, satisfied through focused and excellent processes delivered by exceptional people. Our Hall of Fame research shows the kind of value that is created by successful companies in each perspective of the framework.

STRATEGIC FINANCIAL GOALS

The financial framework, as shown in Figure 1, is dominated by shareholder value. The creation of value for the owners of the organization is the ultimate measure of success in the private sector. There was no single common measure used by the HoF companies. For organizations that were building a management system for their entire enterprise, measures like "market value," "stock price," and "earnings per share" were used. For organizations building a system for a subset of the enterprise (e.g., a division or a group), measures like "return on invested capital" were used. Shareholder value is generally a derivative of two drivers—growth in profits and growth in revenue. For example, the classical DuPont ROI model divides performance into these two components:

$$\left(\begin{matrix}\text{RETURN}\\\text{ON}\\\text{ASSETS}\end{matrix}\right) = \frac{\text{PROFITS}}{\text{SALES}} \times \frac{\text{SALES}}{\text{ASSETS}}$$

Reviewing the performance of our Hall of Fame companies, we noted that Infosys Technologies, the Indian IT services firm (outsourcing, consulting, systems integration, etc.) embarked upon a growth strategy intended to make it the top provider in its niche. During its four-year performance period, revenue jumped 310% while profits grew by 289%. Earnings per share (the surrogate for shareholder value) grew by 305%, approximately the average of the revenue growth and profit growth. Grupo Modelo, the Mexico-based brewer and distributor of beer and bottled water, saw sales increase by 46% and profits (EBITDA) grow by 38% over the three-year performance period. The stock price (shareholder

4. *James Collins and Jerry Porras, p. 93 in* Built to Last: Successful Habits of Visionary Companies *(Harper, 1994).*

value) grew by 50% over the period, approximately the average of the sales growth and profit growth.

Figure 2[5] summarizes the financial performance of 11 Hall of Fame organizations. There are three takeaways in this data set:

(1) Level of Improvement. The absolute level of improvement in both sales and profits was impressive. The average sales growth was 120% (over three years) while the average growth in profits was 180% (four years).

HALL OF FAME FINANCIAL PERFORMANCE

	Company	Three-Year Profit Growth	Three-Year Sales Growth	Three-Year Shareholder Value Growth*	Profit to Sales Growth Ratio
A / Manufacturing	Lakshmi	500%	250%	375%	2.0
B / Financial Services	Mapfre Brazil	445%	158%	300%	2.8
C / Process	Mineras	270%	200%	235%	1.35
D / IT Service	Infosys	216%	232%	230%	0.93
E / Consumer	Rainbow Stores	170%	140%	155%	1.2
F / Consumer	Minor Food Group	114%	150%	132% Median	0.76
G / Pharma	Millipore	84%	60%	72%	1.4
H / IT Service	DataCraft	100%	25%	62%	4.0
I / Consumer	Grupo Modelo	38%	46%	50%	0.8
J / Process	AKSA	34%	29%	31%	1.2
K / Pharma	Merck	19%	21%	22%	0.9
AVERAGE		182%	120%	150%	1.5

FIGURE 2:

This figure shows profit-to-sales growth ratios, over a three-year period, for eleven Hall of Fame organizations.

(2) Balance. The growth rate in profits exceeded the growth rate in sales for two thirds of the companies. This ratio, shown in the right-hand column of Figure 2, seems to reflect the nature of the company's assets and the way they are competitively deployed. The average company in our Hall of Fame sample showed a profit-to-sales growth (PSG) ratio of 1.5.

Companies with PSG ratios greater than 1 tend to have either excess capacity or intangible assets that can be converted to profits relatively quickly. Consider Lakshmi (PSG = 2.0), an Indian manufacturer of textile machinery. With 3,500 employees, it serves 60% of India's $35 billion textile market. The primary barrier to success was the cyclicality of the market. Lakshmi developed a strategy to sustain domestic market leadership by providing competitive products with cost-effective solutions. Key to creating this "recession-proof" strategy was getting everyone in the company's divisions, businesses, and support units to work toward the same corporate-level objective—a job for the Balanced Scorecard.

DataCraft (PSG = 4.0) is another example. This Singapore-based provider of IT solutions and services employs 2,500 people at 55 locations in 13 Asia-Pacific countries. Its strategy was to reposition itself from a product reseller to a solutions provider. Key to the strategy was to standardize the company's business model and management metrics across multiple countries—a job for strategy maps and Balanced Scorecards. These tools and frameworks allow DataCraft to rapidly reposition intangible assets and create impressive financial results.

On the other hand, companies with PSG ratios less than 1 tend to have strategies that are capital intensive or that have significant dependence on channel partners. These, in turn, tend to see slower growth in profits than the aforementioned companies. For example, Grupo Modelo (PSG = 0.8) has a strategy that involves the construction of a new brewery and restructuring a convenience-store chain in addition to the comprehensive development of new management processes. The capital intensity of its breweries and real estate holdings gave it a competitive advantage but at a slower pace than was observed in Lakshmi and DataCraft.

(3) Growth in Value. The HoF companies were not required to provide balance sheet data relative to shareholder investment. Thus, it was not possible to create an absolute picture of shareholder value. Instead of the absolute level, we focused on the rate of change in value. We further assumed that the change in value of an organization is, in part, a function of the change in the level of sales and a change in the level of profits. Our approximation of growth in value is the average of three-year growth in sales and in profits. Using this

5. *The Balanced Scorecard Hall of Fame Report, 2007–2010 published by Palladium Group, Inc., and Harvard Business School Press*

convention, Figure 2 shows the average three-year growth of shareholder value to be 150%. As a point of reference, one of the definitive research studies on the value of strategy execution showed that typical Balanced Scorecard users achieved three-year growth in shareholder value of 43% (compared with shareholder value growth of 15% in non-BSC users).[6] The 150% achieved by the Hall of Fame companies, a subset of the general population of BSC users, is 3.5 times greater.

The financial performance of the companies in the Hall of Fame sample provides a useful point of reference for organizations to set strategic targets and expectations. We offer the following guidelines for setting financial targets for BSC-based strategies:

> "The logic of the Balanced Scorecard approach is that successful financial performance results from the creation of satisfied customers. All the Hall of Fame organizations in our study had some way of measuring customer satisfaction."

• Set a financial BHAG that will double or triple shareholder value over a three-year period (Norm: 150%)

• Develop financial drivers for revenue growth (120%) and profit growth (180%) that support the BHAG

HALL OF FAME CUSTOMER PERFORMANCE

Company	CUSTOMER SATISFACTION		CUSTOMER DISSATISFACTION*	
	Before » After (3 years)	% Improvement	Before » After (3 years)	% Improvement
SOHO	40 » 80%	100%	60 » 20%	67%
Deposit Trust	73 » 91%	25%	27 » 9%	67%
Minor Food Group	92 » 97%	5%	8 » 3%	60%
Borusan	57 » 81%	42%	43 » 19%	56%
DataCraft	82 » 92%	12%	18 » 8%	55%
AKSA	81 » 91%	12%	19 » 9%	52%
AAFES	62 » 72%	16%	38 » 28%	25%
Dongwha	58 » 67%	16%	42 » 33%	21%
Rainbow Stores	78 » 80%	3%	22 » 20%	10%
AVERAGE		24%		46%

* Customer Dissatisfaction (CDS): The percentage of customers who do not identify themselves as "satisfied" (CS); (CDS = 1 – CS)

FIGURE 3:

This figure shows improvements in customer satisfaction and reductions in customer dissatisfaction for nine Hall of Fame organizations.

CUSTOMER PERFORMANCE

The logic of the Balanced Scorecard approach is that successful financial performance results from the creation of satisfied customers (Figure 1). All of the Hall of Fame organizations in our study had some way of measuring customer satisfaction. For example, AKSA (the Turkish manufacturer of acrylic fiber) measures customer loyalty and market share. Cisco (the U.S. developer of software platforms) measures "Products that do not meet customer expectations." Culligan (the Argentine retailer of bottled water) measures the attrition of small and large customers. The measures selected tend to reflect the nature of the industry. For example, consumer retail businesses (like Rainbow Stores of China and Minor Food Group of Thailand) find mystery shopping to be a useful measure for evaluating franchises or stores. Merck, the global pharmaceutical company, measures the number and quality of its partnerships that create greater market access.

Although significant diversity exists for monitoring the customer, virtually every organization used some indicator of customer satisfaction. This measure is defined as "the percentage of customers who voice satisfaction with the product and/or the experience." This measure is generally developed through customer surveys, administered by external agencies (e.g., J.D. Power, mystery shopping). The ultimate objective for customer satisfaction is 100%, a number that can be approached but is seldom achieved. Figure 3 shows the customer satisfaction scores of nine BSC Hall of Fame companies. The post-BSC scores show a high of 97% for Minor Food Group and a low of

6. DeBusk and Crabtree, "The Effects of Adopting the Balanced Scorecard on shareholder Returns," Advances in Accounting, incorporating Advances in International Accounting, 24 (2008) 8-15.

67% for Dongwha (a South Korean manufacturer of particle board.) SOHO (Indonesian pharmaceuticals) showed the greatest percentage increase (from 40% to 80%), while Rainbow Stores (the Chinese retailer) showed only a 3% improvement (from 78% to 80%). The average rate of improvement for the nine companies was 24% (three-year interval).

The ability to interpret these performance data is clearly biased by the base-level performance. SOHO's base of 40% will permit higher rates of improvement than Minor Food (a base of 92%). To provide a framework more conducive to performance comparisons and target setting, we shifted the focus of the measure from "customer satisfaction" (CS) to its converse, "customer dissatisfaction" (CDS). Customer dissatisfaction is the percentage of customers who do not identify themselves as satisfied:

(CDS = 1 – CS)

Figure 3 shows the performance numbers in this new framework. Performance-level improvements range from 67% for SOHO and Deposit Trust Clearing (the U.S.-based post-trade clearinghouse) to 10% for Rainbow Stores. The average rate of improvement (a reduction in the level of dissatisfaction) was 46%.

Our conclusion, based on analysis of the customer satisfaction metrics, is that organizations using the BSC to drive financial performance (increased value of 150%) begin by reducing the level of customer dissatisfaction by approximately 50%. We offer the following guidelines for setting customer targets for BSC-based strategies: reduce the percentage of dissatisfied customers by 50% every three years.

Guidelines for Target Setting: Financial

• Set a financial BHAG that will double or triple shareholder value over a three-year period (Norm: 150%)

• Develop financial drivers for revenue growth (120%) and profit growth (180%) that support the BHAG

Guidelines for Target Setting: Customer

• Reduce the percentage of dissatisfied customers by 50% every three years

AUTHOR

David P. Norton, along with Robert S. Kaplan, created the Balanced Scorecard concept. The two have coauthored five books (most recently, The Execution Premium, 2008) and eight articles for Harvard Business Review, and dozens of articles for Balanced Scorecard Report. They have also been named among the world's most influential business thinkers by Sun-top Media's "Thinkers 50."

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