

Balanced Approach By Bill Roberts

Usually focused on conventional measures, the Balanced Scorecard can be extended to knowledge management metrics

Until about a year ago, Alterra Health Care Corp. of Milwaukee mainly paid attention to hard numbers: occupancy rates at its assisted living facilities for the elderly and corporate budgets, revenues and profits. But in 2000, faced with a net annual loss of \$117.8 million on revenue of \$466.5 million, a falling stock price and heavy debt, the company decided to look for sources of value beyond the tangible measures.

Alterra found that its financial success depends on three factors it was not measuring or monitoring. "We concluded that we are about customer satisfaction, employee satisfaction and operational effectiveness," says Andrea Peck, senior vice president of employee services. "If we are to hit our numbers, we have to think about customers and employees and operate effectively."

After further analysis, Alterra decided that these three factors in turn depend on another: its employees. In this light, the company, whose industry relies on people, had to acknowledge that it was managing its human capital poorly. Even in a business known for high turnover, Alterra was bleeding knowledge assets faster than most—last year there was a 145 percent turnover among its staff of 14,000. That means the company had to hire more than 20,000 workers to replace those who left, most of them among the 12,000 rank-and-file caretakers.

President Steven Vick decided it was time to find ways to measure employees' knowledge, skills and attitudes and to align them with Alterra's mission. After a few months of background work, Peck says, it became clear that if the company paid enough attention to its human capital, other improvements would follow, including increases in occupancy and revenue. To build its strategy, objectives and measures for human capital, Alterra used the Balanced Scorecard (BSC), a tool for integrating financial and non-financial performance measures into an organization's management structure.

Since the BSC was first introduced in a 1992 *Harvard Business Review* article by Robert S. Kaplan, a Harvard Business School professor, and David P. Norton, an information technology consultant, hundreds of companies have claimed to use it. Many observers suspect, however, that most of those companies only pay lip service to the scorecard system.

Organizations such as Alterra that use the BSC to measure intangible assets such as human capital are rare. And there is debate about how the BSC meshes with other efforts to monitor intangibles (see the sidebar "Duelling Theories," bottom).

In name only

BSC is a tool that CEOs and other top executives can use to articulate a strategy and objectives and to translate strategy into an actionable, measurable plan. It also can help in communicating goals to the staff members who are responsible for components of the strategy. An ideal BSC is balanced between tangibles and intangibles, short- and long-term measures, and leading and lagging indicators across four perspectives: financial, customer, internal business and learning and growth. (For an example, see the table "ECI's Balanced Business Scorecard.")

In practice, few scorecards meet the definition, according to Michael Mount, who works on BSC implementations as a managing consultant at R.J. Rudden Associates Inc. in Hauppauge, N.Y. "Most scorecards we see are not balanced," says Mount. "They tend to be focused on financials, deadlines and other traditional objectives and measures. And commonly they only look at historical or lagging indicators, not at leading indicators."

For any management tool, the devil is in the details. Marcos Ampuero, a vice president in the Newton, Mass., office of consultants Cap Gemini Ernst & Young Inc., claims that the BSC made a splash because it is deceptively simple. "When Norton and Kaplan wrote the article, they wanted to appeal to a broad range of executives, but they didn't tell all the details," he says, adding that two follow-up books by the pair provided additional information but were hard to understand.

The result, in his view, is a concept not fully translated into action. "The BSC has become part of management vocabulary," says Ampuero. "But we mostly see an ad hoc collection of financial and non-financial indicators. That's not what the BSC was meant to do, but that's what most people think it is."

Ampuero explains that the BSC was meant to prod a company to look at its strategy and re-examine its assumptions about the strategy's effectiveness. If the company has no strategy or the strategy is unclear, the first step is to spell it out, much like Alterra had to do before it could analyze how human capital drives revenue. "A good BSC should tell the story of your strategy," Ampuero says. Next the company should set a small number of objectives across the scorecard's four perspectives that

spell out the few things it must learn to do well. A BSC should also identify who is responsible for fulfilling each objective.

Ampuero offers the following example of a BSC used properly: The strategy of a company whose success depends on a large professional staff is to create a "people first" culture. One objective in this strategy might be to maintain a lifetime relationship with former workers. A measure of how well this is working might be the number of ex-employees who rejoin the firm each year. The accountable party in this case might be the director of human resources.

BSCs tend to focus on and begin at the corporate level. "By creating a BSC first at the upper levels, then cascading the strategic direction into scorecards more closely aligned with specific business units or projects, it benefits the lower levels," says Mount of Rudden Associates.

Making the knowledge connection

Although the BSC was not designed as a knowledge management tool, KM is usually an implicit or explicit part of a scorecard. "Often the basic enablers identified as crucial to achieving objectives are centered on knowledge issues," Mount says. Ideally, he adds, knowledge-related measures will appear in the three non-financial perspectives.

Some professionals believe that a BSC can be used to measure knowledge initiatives. Mount says it is possible, but he knows of no companies that are doing so.

Knowledge management efforts typically measure how much knowledge is collected and shared, but they don't measure the value of that knowledge, according to Cynthia Raybourn, senior knowledge management consultant at the American Productivity & Quality Center, a nonprofit organization in Houston. "We're trying to create a BSC that looks at knowledge management activity from the four scorecard perspectives," she says.

Her effort focuses on identifying a few key measures of knowledge management and business performance, then correlating them according to the BSC model to get a complete picture. So far, Raybourn has worked with just one client in this quest, whom she declines to name. "Many of our best-practice companies say they need to apply BSC to their knowledge management efforts, but so far only this one is doing it," she reports.

Mount says that the books and articles that BSC originators Kaplan and Norton published reinforce the sense that knowledge management is an

organizational characteristic underlying the scorecard. Cap Gemini's Ampuero agrees. "We always saw the scorecard as the front end of knowledge management," he says. "The card itself was never intended as a knowledge management tool, but companies that embrace the BSC are clearly taking a step toward knowledge management."

A learning perspective

Some proponents argue that the BSC's learning and growth perspective (originally called innovation and learning) should be used to measure human capital and other knowledge assets. Randall Russell, director of research at Balanced Scorecard Collaborative Inc., a consultancy led by Kaplan and Norton in Lincoln, Mass., says learning and growth has always been the least developed of the four perspectives, with fewer examples of objectives and measures. "This area is harder to measure, but we assume human resources will never get anywhere until it can describe the role human capital plays in producing value," he says.

Late last year, Russell set up a working group of executives from 22 corporations and nonprofit organizations, including Alterra's Peck. Its purpose was to investigate the skills and knowledge people need to do their work, how to describe and measure those elements and how they impact financial results. As a first step, members fleshed out and began to test new categories for describing and measuring human capital.

The group delineated the learning and growth perspective into two categories and five measurable areas. The first category, short-term assets, includes strategic skills and leadership. Strategic skills in turn include the work force's accumulated competencies and capabilities, the staff's readiness to deliver these competencies and the potential for delivering specific skills. Leadership is the skill that brings all other skills together, directs them and enables them to have impact.

The second category is long-term assets, which include strategic awareness, strategic alignment and strategic integration. Awareness deals with how well employees understand company culture and values. Alignment pertains to how well employees understand the mission and whether rewards and incentives support it. Integration is about knowledge sharing, teamwork and collaboration.

By mid-2001, according to Russell, half of the group members were implementing at least some aspects of the new framework so they could share what they learned to improve the methodology. As for the other half, he says, "Many still don't understand how complex this is and haven't

gotten much done. One company had trouble even getting started because it couldn't agree internally on terminology."

New objectives

Alterra's BSC effort hasn't been easy, but the organization has made progress, Peck says. She admits that Alterra previously had an unbalanced scorecard "only in the finance department." When managers tackled the learning and growth perspective, it took rigorous intellectual work to determine how its human capital impacts financial results. Their work illustrates how the BSC process is not just about gathering data but about devising a blueprint for action. (For a sample, see the table "Alterra's Human Capital Strategy.")

Alterra determined that the resident directors of its 493 care facilities and the management level just above them were the keys to success. Turnover among resident directors was 50 percent annually. "We were reinventing half the company each year," Peck says. Alterra looked at possible causes of turnover, such as hiring the wrong people, inadequate training or unreasonable performance expectations.

The company had judged its resident directors on how well they met occupancy quotas and stayed within budget. Corporate management decided to de-emphasize these measures and concentrate on hiring the right sort of resident directors, giving them proper training and letting them manage their own staffs. The two important objectives were to lower turnover among staff to less than 100 percent and among resident directors to 15 percent.

At the time, two levels of management—district and regional directors—existed above resident directors. Each district manager supervised 15 to 20 resident directors. Alterra collapsed the two higher management levels into one, with the result that each new district manager had to supervise only eight resident directors. "This would help district managers mentor and coach resident directors in a different way than they had been doing," Peck explains. With district managers coaching and training, the company expects resident directors also to do more coaching and training of rank-and-file caregivers.

Turnover among resident directors has remained at 50 percent, but now most of those who leave are simply not suited to the job, and the company is trying to hire people who are. The most recent monthly turnover rate among caregivers has dropped to 125 percent when annualized, which is approximately the industry average. By 2002, Peck says, Alterra expects

to achieve its objectives of 15 percent turnover among resident directors and less than 100 percent among caregivers.

The company also adopted several new measuring tools. It now conducts monthly customer satisfaction surveys, and it recently began to benchmark employee attitudes. It also hired a consultant to develop a test for residential director candidates, based on norms for success and failure created from testing existing residential directors. Over time Alterra hopes to craft a test that will be increasingly accurate in predicting candidate success.

As part of its BSC efforts, Alterra still looks at occupancy rates, revenue and standard measures such as quality assurance. But for the first time the company is correlating those results with the new measures of customer satisfaction and employee attitudes. "We never used to correlate anything," Peck says. She asserts that the company has only begun to integrate human capital into its scorecard. Eventually she wants to measure how much knowledge is transferred among caregivers. "We think there is a correlation between the transfer of knowledge among caregivers and customer satisfaction," she says.

Peck expects to use the BSC for a few years or until the company finds something better. But she points out that despite the way Alterra uses this tool, it doesn't explicitly think of itself as a knowledge company. "We never talk about knowledge management," says Peck. "We don't know how to. We just know we need to share best practices and successes and not reinvent the wheel."

Sidebar: Dueling Theories

The Balanced Scorecard (BSC) resembles the Intangible Assets Monitor (IAM) developed by Karl-Erik Sveiby, noted KM theorist and consultant. "There are a lot of similarities," says Nick Bontis, professor of strategic management and director of the Institute for Intellectual Capital Research at McMaster University in Hamilton, Ontario, Canada. "BSC has gotten more PR and play because of the people behind it."

The two tools are similar in their frameworks and categorization schemes. The BSC has four perspectives: financial, customer, internal business and learning and growth. IAM has four categories: tangible assets and three intangibles--external structure, internal structure and people's competence.

The BSC measures tangibles and intangibles, but BSC experts admit that its weakest aspect is the learning and growth perspective, which covers the most intangible asset: human capital. Some critics say that the BSC's customer perspective as originally conceived is too narrow. It has been broadened in recent years to include others outside a corporation, such as suppliers and partners. Sveiby's external category covers customers, suppliers and other outsiders.

Even so, proponents of IAM insist that the tools are different in principle and in practical application. "I don't know of any companies that have used the BSC specifically to measure intangible assets, although I know that BSC proponents argue that it can be used for doing so," Sveiby says.

In a paper on his Web site, he compares the two, admitting the similarities. But Sveiby argues that his IAM takes "a knowledge perspective" of companies, insisting that people are "an organization's only profit generators." The BSC, he contends, accepts the traditional definition of the corporation as mostly a financial entity and "can therefore be seen as rooted in the Industrial Era."

Predictably, Balanced Scorecard proponents believe their tool also is suited for the Knowledge Age. "The scorecard says the new economy--which is really about knowledge and speed--is about intangible and tangible assets," says Marcos Ampuero, vice president of Cap Gemini Ernst & Young Inc. in Cambridge, Mass. "The big emphasis is on intangibles."

Which side of this debate--if either--a company comes down on will depend on its orientation and goals and perhaps on whose advice it solicits. But both camps provide strong evidence of the need to seek and measure intangible assets.--B.R.

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Goals

Measures

Survive

Cash flow

Succeed

Quarterly sales growth and operating income by division

Prosper

Increased market share and return on equity

Goals**Measures**

New products
Percent of sales from new products
Percent of sales from proprietary products
Responsive supply
On-time delivery (defined by customer)
Preferred supplier
Share of key accounts' purchases
Ranking by key accounts
Customer partnership
Number of cooperative engineering efforts

Goals**Measures**

Technology capability
Manufacturing geometry vs. competition
Manufacturing excellence
Cycle time, unit cost, yield
Design productivity
Silicon efficiency
Engineering efficiency
New product introduction
Actual introduction schedule vs. plan

Goals**Measures**

Technology leadership
Time to develop next generation
Manufacturing learning
Process time to maturity
Product focus
Percent of products that equal 80% sales
Time to market
New product introduction vs. competition

Source: "The Balanced Scorecard: Measures That Drive Performance" by Robert