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Strategy Maps

Converting Intangible Assets into Tangible Outcomes

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Introduction

No two organizations think about strategy in the same way. Even within corporations, thinking can be narrow or one-dimensional. CFOs view strategy from a financial perspective, sales and marketing executives from a customer perspective, human resources professionals focus on investment in people, and operations people are concerned with quality, cycle time and other process perspectives. Few have a holistic view of strategy.

Strategic doctrines exist around shareholder value, customer management, process management, quality, core capabilities, innovation, human resources, information technology, organizational design, and learning. While each provides deep insights, none provides a comprehensive and integrated view for describing a strategy. Even Michael Porter's approach, based on positioning for competitive advantage, doesn't supply a general representation of strategy.

Executives who have successfully executed strategy — Lou Gerstner at IBM, Jack Welch at GE, Richard Teerlink at Harley-Davidson, Larry Bossidy at GE, Allied Signal and Honeywell — offer a wealth of experiential insights but not a consistent way to represent strategy. A generally accepted method of describing strategy doesn't exist.

The Balanced Scorecard offers an answer to that vacuum, because in order to establish the popular measurement system, a general model of strategy was needed and developed. It has a four-perspective model for describing an organization's value-creating strategy and provides a language that executive teams can use to discuss the direction and priorities of their enterprises.

The Balanced Scorecard process can be used to create a series of cause-and-effect linkages that form a map of the organization's strategy. The strategy map, a visual representation of the relationships among the components of an organization's strategy, is as big an insight to executives as the Balanced Scorecard itself.

Key Principles

The strategy map is based on several principles:

1. Strategy balances contradictory forces. Private sector organizations, for example, must invest for the long term in intangible assets such as human, informational and organizational capital, but must at the same time show improved results in the short term.

Thus the starting point in describing the strategy is to balance the short-term financial objective of cost reduction and productivity improvements with the long-term objective of profitable revenue growth.

2. Strategy is based on differentiated customer value propositions. It requires a clear articulation of targeted customer segments and the value

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proposition required to please them. Clarity of the value proposition is the single most important dimension of strategy.

Organizations tend to use one of four value propositions: low total cost, product leadership, complete customer solutions, or system lock-in, where the customer is pressured to continue to deal with the company because the cost of switching over to somebody else is high.

3. Value is created through internal business processes. Companies must focus on the critical few internal processes that deliver the differentiating value proposition and that are most critical for enhancing productivity and maintaining the organization's franchise to operate. Internal processes can be classified into four clusters:

• *Operations management* — producing and delivering products and services to customers.

• *Customer management* — establishing and leveraging relationships with customers.

• *Innovation* — developing new products, services, processes and relationships.

• *Regulatory and social* — conforming to regulations and societal expectations, and building stronger communities.

Each of those clusters can have literally hundreds of sub-processes that create value in some way. Executives practicing the art of strategy must identify the critical few processes that are the most important for creating and delivering the differentiating customer value proposition. Those critical few processes can be called strategic themes.

4. Strategy consists of simultaneous, complementary themes. Each cluster of internal processes delivers benefits at different points in time.

Improvements in operational processes generally deliver short-term results through cost savings and quality. Benefits from an enhanced customer relationship start to phase in six to 12 months after the initial improvement in customer management processes. Innovation processes generally take even longer to produce higher customer revenues and operating margins, and the benefits from enhanced regulatory and social processes can occur even further in the future. Strategies should be balanced, incorporating at least one theme from each of the four internal clusters.

5. Strategic alignment determines the value of intangible assets. Learning and growth form another element of the strategy map, grouping together the firm's intangible assets:

• *Human capital* — employees' skills, talent and knowledge.

• *Informational capital* — databases, information systems, networks and technology infrastructure.

• *Organizational capital* — culture, leadership, employee alignment, teamwork and knowledge management.

The value of these intangible assets derives from their ability to help the organization implement its strategy. But research shows that two-thirds of organizations don't create strong alignment between their strategies and their HR and IT programs. The considerable investments by these unaligned organizations in HR and IT programs are off target.

The Four Perspectives

The strategy map brings those ideas together into a linked series of activities or perspectives. It can be seen visually as four stages, one on top of the other, like a four-storey building. From the top of the map down, it's:

• *Financial Perspective* — "If we succeed, how will we look to our shareholders?"

• *Customer Perspective* — "To achieve our vision, how must we look to our customers?"

• *Internal Perspective* — "To satisfy our customers, which processes must we excel at?"

• *Learning and Growth Perspective* — "To achieve our vision, how must our organization learn and improve?"

Financial Perspective

The ultimate objective for profit-maximizing companies is the financial perspective. (For non-profits, often the financial perspective is the foundational element, sketched in at the bottom, since raising money gives rise to the other processes and goals associated with the organization.)

Basically, financial strategies are simple: companies can make more money by (a) selling more and (b) spending less. Everything else is background music.

Any program — customer intimacy, six sigma quality, knowledge management, developing disruptive technology — creates more value for the company only if it leads to selling more or spending less. Thus, the company's financial performance can be improved through two basic approaches: revenue growth and productivity.

Companies can generate profitable growth by deepening relationships with existing customers, enhancing their profitability. Banks, for example, can attempt to get their checking account customers to use a bank-issued credit card as well, and to borrow from the bank to purchase a home or a car.

Companies can also enhance revenue opportunities by developing new sources of revenue through new products, new markets or partnerships. Amazon.com now sells CDs and electronic equipment in addition to books. Mobil encourages its customers to buy from its stations' convenience stores in addition to filling their cars with gasoline.

The link to strategy in this financial perspective occurs as organizations choose a balance between the often-contradictory levers of growth and productivity. Actions to improve revenue growth generally take longer to create value than actions to improve productivity.

Customer Perspective

A revenue growth strategy requires a specific value proposition that's shown in the customer perspective section of the strategy map, one level down from the financial perspective. It outlines how the organization will create differentiated, sustainable value to targeted segments.

The customer perspective typically includes several common measures of the successful outcomes from a well-formulated and implemented strategy:

- *Customer satisfaction.*
- *Customer retention.*
- *Customer acquisition.*
- *Customer profitability.*
- *Market share.*
- *Account share.*

These common customer outcome measures can themselves be viewed as cause-and-effect relationships. For example, customer satisfaction generally leads to customer retention and, through word of mouth, the acquisition of new customers. By retaining customers, the company can increase the share of new business — the account share — with its loyal customers.

Company strategies should identify specific customer segments that are being targeted for growth and profitability. The company will try to take advantage of:

- *Product/service attributes* — price, quality, availability, selection or availability.
- *Relationship* — service and partnership.
- *Image* — the brand.

Southwest Airlines offers low prices to satisfy and retain price-sensitive customers. Neiman Marcus, on the other hand, targets customers with high disposable incomes who are willing to pay more for high-end merchandise.

Companies such as Wal-Mart that operate out of a best-total-cost value proposition try to offer products that are consistent, timely and low-cost. They seek to be the lowest-cost supplier while offering consistently high quality, speedy purchases and appropriate but not bountiful selection.

Companies following a product-leadership strategy — such as Sony, Mercedes and Intel — develop products and services that expand existing performance boundaries into the highly desirable. They produce high-performance products based on speed, size, accuracy, weight or other attributes. They aim to be first to market. And they penetrate new market segments.

Companies with a complete-customer-solution strategy — such as IBM and Goldman Sachs — try to provide the best total solution to their customers. They focus on the quality of solutions provided, the number of products or services available for customers, the importance of customer retention, and expanding the customer lifetime profitability.

The systems lock-in strategy can follow two different paths. Companies can develop high switching costs to end-use consumers through broad selection and convenient access, or by providing a widely used standard or innovation on a stable platform. The second strategy is to add value to users by providing a large customer base and an easy-to-use platform and standard, as eBay has done.

Internal Perspective

The internal perspective, the third level down in the strategy map, looks at how the strategy will be accomplished.

It involves four elements:

1. *Operations management processes.*
2. *Customer management processes.*
3. *Innovation processes.*
4. *Regulatory and social processes.*

Operations management processes are the basic, day-to-day processes by which companies produce their existing products and services and deliver them to customers. They involve supply, production, distribution and risk management.

Customer management processes expand and deepen relationships with targeted customers. There are four steps to be considered:

- Select targeted customers.
- Acquire the targeted customers.
- Retain customers.
- Grow business with customers.

Innovation processes develop new products, processes and services, often enabling the company to penetrate new markets and customer segments. Managing innovation involves four sets of processes:

- *Identify opportunities for new products and services.*
- *Manage the R&D portfolio.*
- *Design and develop new products and services.*
- *Bring the new products and services to market.*

Regulatory and social processes help organizations continually earn the right to operate in the communities and countries in which they produce and sell. National and local regulations impose standards but many companies seek to go beyond those minimal standards to develop a reputation as an employer of choice.

Companies manage and report their regulatory and social performance along a number of critical dimensions: environment, safety and health, employment practices and community investment.

Learning and Growth Perspective

The fourth perspective — the foundation for the four-tier model of strategy — deals with learning and development through human capital, informational capital and organizational capital.

Human capital deals with skills, training and knowledge. Informational capital encompasses systems, databases and networks. For organizations, the choice is often between transactional processing applications — such as an ERP system, which automates the basic repetitive transactions of the firm — and analytical applications, which promote analysis, interpretation and sharing of information and knowledge. Organizational capital is an amalgam of culture, leadership, alignment and teamwork.

Whereas all organizations attempt to develop their people, technology and culture, most don't align these intangible assets with their strategies. The key to creating this alignment is granularity — to move beyond generalities such as "developing our people" or "live our core values" and focus on specific capabilities and attributes required by the critical internal processes of strategy.

Conclusion

Typically, the objectives developed in the four perspectives of a strategy map lead to about 20 to 30 measures being required in the associated Balanced Scorecard. Some people have criticized that arrangement, arguing that people can't focus on 25 different measures. But those aren't 25 independent measures, since they're linked into a single strategy.

The strategy map provides a visual and intellectual framework for developing strategy in an organization and integrating the various elements that too often are thought about separately. The various perspectives, and chunks within them, provide a common language and format for attacking strategy. **e**

About the Authors: Robert Kaplan is a professor at the Harvard Business School and chairman of the Balanced Scorecard Collaborative. David Norton is co-founder and president of the Balanced Scorecard Collaborative. Kaplan and Norton are co-authors of The Balanced Scorecard *and* The Strategy-Focused Organization.

Related Reading

Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results, by Paul R. Niven, John Wiley & Sons, 2002, ISBN 0471078727.

The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment, by Robert S. Kaplan and David P. Norton, Harvard Business School Press, 2000, ISBN 1578512506.

The Innovator's Solution: Creating and Sustaining Successful Growth, by Clayton M. Christensen and Michael E. Raynor, Harvard Business School Press, 2003, ISBN 1578518520.