

Using a Balanced Scorecard in a Nonprofit Organization

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Since its invention in the 1990s, the balanced scorecard has won acceptance as a management tool in the for-profit sector. Now, nonprofits are becoming familiar with, and trying to use, balanced scorecards. This white paper explains what balanced scorecards are and gives critically important tips about how to adapt them successfully into the nonprofit world.

“Balanced Scorecard” has been a corporate management buzzword for about a decade. Like many management movements before it, balanced scorecard is migrating from corporate management into the offices of nonprofit management.

The transition of a balanced scorecard concept from for-profit to nonprofit organizations is not direct. The basic ideas behind creating a balanced scorecard are as valid for nonprofits as they are for corporate businesses, but the implementation of this idea needs to be modified a bit to make it work effectively in the nonprofit world. In this article, we will look at what a balanced scorecard is all about and how to apply the idea to a nonprofit organization.

The Reason for a Balanced Scorecard

Historically, organizations have measured their performance primarily, if not exclusively, with measures derived from financial data. In the 1990s, a group of researchers and consultants from the Nolan Norton Institute, the research arm of the accounting firm KPMG, began to study commonly used organizational performance measures. Their hypothesis was that organizations were being hindered by these measurement practices because the measurement focus was too narrow.

After working with a number of ideas, the researchers suggested that companies ought to balance the way they assess their organizations by looking at more than simply financial performance. For the best single summary of this research, get a copy of *The Balanced Scorecard* by Robert S. Kaplan and David P. Norton (Boston: Harvard Business School Press, 1996).

The original balanced scorecard formulation, which has been carried forward formulaically by most companies that use it today, was organized around four perspectives that were given these labels: financial, customer, internal, and innovation and learning. To reinforce the idea of balance, the authors also promoted the use of lagging and leading indicators and performance measures that were external as well as internal.

Another innovative idea emerging from this work was to tie performance measures closely to a company’s strategic plan. In short, start with planning; then create a measurement process to gauge how well you are executing against your plan. By doing this, the measures graduated from simply providing descriptive data to being the basis for a management tool.

While this sounds straightforward, indeed almost simple minded, it was not a common practice in the early 1990s. Nor, I suspect, is this common practice today.

Balanced Scorecard Pitfalls

As a manager and consultant, I have worked at or with a half dozen large organizations that were (or at least claimed to be) using a balanced scorecard. Only one of them (a county government) had any real success with it. In that group, I attribute the success to the presence of one very bright young woman who truly understood the process, had complete intellectual and budgetary support from her senior management and whose job was 100 percent committed to the balanced scorecard process.

Rather than understanding what a balanced scorecard is supposed to accomplish, why, and how, many managers simply implement a balanced scorecard as if it were a recipe. While the technique described in professional literature accumulates the wisdom and experience of many people and represents a form of best practice, it should not be copied blindly under the assumption that one size fits all. In particular, the four major dimensions (financial, customer, internal, and innovation and learning) can and should (in my opinion) be modified to fit an organization. This is particularly true when the organization is a nonprofit.

Another problem that organizations frequently make is jumping into a measurement program too fast and making the program too complicated. Deriving meaningful measurements, gathering reliable data, developing useful analytical techniques, and educating managers about how to use the data are all difficult steps. Doing all this at one time with a bucket full of 50 different measures is doomed to failure. Organizations in which managers do not have experience with measurement programs, or fail to heed the warnings of those who do, typically underestimate the difficulties of implementing a balanced scorecard program.

Creating Organizational Metrics¹

Despite the pitfalls, balanced scorecard is a useful management tool. It can be done successfully if managers take a careful and thoughtful approach to the process.

The real trick behind any measurement program is to figure out first what you want to measure, and then to figure out how to measure it. Many times, managers who want to evaluate their work groups simply jump into collecting measures, not because the measures relate to organizational attributes in which they are interested, but more because the measures are simple and available. So it is that managers build assessments based upon measures such as: attendance data; production and fulfillment records; budget deviances; and computer system up-time. When you

¹ The words “measures” and “metrics” are often used as synonyms. Technically, they are not. A measure is a basic quantitative or qualitative evaluative label, derived through a specified process, and assigned to a fundamental attribute of a concept that we are trying to characterize. A metric is a derivation and/or combination of one or more primary measures. For example, a category 3 hurricane earns its designation by being in a certain spot on the earth, and having winds that rotate in a particular direction with speeds over a predetermined threshold. For the hurricane, the category designation is a metric; the location, wind direction, and wind speed are primary measures.

build an assessment program around the measures you have available, instead of building metrics around the concepts you need to measure, then you have a classic case of the tail wagging the dog.

You can tell what is important to measure by referring to your organization's strategic plan. The plan lists your goals and the strategies by which you hope to achieve them. Generally speaking, goals relate to outcomes and strategies relate to procedures. Measures can and should relate to both. Process measures can be used to reflect how well your organization is executing its strategies. Outcome measures can be used to indicate how well your strategies actually accomplish their intended results.

For example, your organization's leadership might have decided it is important for your nonprofit to have a larger base of active donors. In your strategic plan, you might have set a goal of expanding your donor mailing list by 25 percent over the year. As one of your strategies, you planned to do aggressive acquisition mailings using several new rental lists you think will give you good results.

You can collect *process* measures indicating how many acquisition mailings you do and how many use the targeted prospecting lists. You can examine the resulting increase in your house file as an *outcome* measure. These are excellent measures because they relate directly to what you intended to do and what you hoped to accomplish.

Your mail list manager also might give you many statistics describing the demographics of your donors. What about using those data for a balanced scorecard? Sure, these measures are readily available; but do you need them? The question is not, "What statistics are available?" The question is, "What have we planned to do this year and how have we planned to do it?" and then, "Does this statistic help us answer either of those questions?" For a balanced scorecard, you should use only metrics that relate directly to your organization's planned processes and targeted outcomes.

The Balanced Scorecard Categories

A balanced scorecard is a management tool. Like any tool, it is supposed to be a means to an end, not an end in itself.

In some organizations, a higher power simply and thoughtlessly mandates that the organization shall implement a balanced scorecard. In this case, the balanced scorecard foolishly becomes the end in itself. For this event, simply go to the literature and follow the balanced scorecard recipe as best you can. Eventually, the management group will realize that the benefits accruing from the balanced scorecard (as they have implemented it) are too few to justify the work going into it.

If you understand the ideas behind a balanced scorecard, you will be free to modify the classic formula so it becomes a better tool for your organization. In particular, I think a nonprofit organization should make some fundamental changes to the four basic measurement perspectives. Specifically, I suggest using an approach based on these six categories, which are

clearly related to the four measurement categories originally formulated by the balanced scorecard research group:

- Revenue and funding
- Resource allocation (including budgets)
- Donors and Board members
- Product and service recipients
- Internal operations
- Staff development

The first two categories are a refinement of the classical perspective of “financial.” The goals and strategies around revenues (the first category above) are extremely important for any nonprofit organization. These are primarily external-facing goals and strategies, aimed at the question of how best to bring in monetary resources. For most organizations, this includes questions of fundraising strategies, investment strategies, alternative funding sources, costs of fundraising, use of fundraising consultants, and so on.

The second category above relates to monetary and perhaps other non-financial resources from an internal perspective. The question is resource allocation. Organizations always start the year with a spending plan (a budget), which should have been created in order to support the organization’s program plan, and reflecting the organization’s policies and priorities for the upcoming year. Alas, every year brings with it unforeseen events, changes in priorities, emergency allocations, and the like. Therefore, a complete budget plan also should include principles and practices for budgetary reviews and, as necessary, reallocations. That is the focus for this category of measurement.

In the classical for-profit company, a major goal is to satisfy the wants and needs of customers, since customers are the primary source of revenues. So, a balanced scorecard can focus simply on customers. The situation is more complex for nonprofits. Most nonprofits deliver some type of product or service, which often is the source of only a portion of revenues, and may be a source of no revenue at all (e.g., a charity kitchen). In a drug treatment facility, for example, the customer (i.e., an abuser) not only does not pay for the treatment, but arguably his or her personal satisfaction with the facility’s treatment may be irrelevant to the most important measures of organizational performance. Nonetheless, even in this type of case, the nonprofit is most likely concerned about how it interacts with its service recipients and it will want to measure that somehow.

For the nonprofit, donors and Board members are more often treated as though they were the customer even though they may not be recipients of the nonprofit’s services or products. These are the people who contribute with dollars, labor, and advice to support the nonprofit. It is their satisfaction, often more than that of direct service recipients, that is crucial to keeping a nonprofit operation going. It is therefore totally appropriate to separate out these two types of customers (i.e., service recipients vs donors and Board members) within an organization’s strategic plan and thus within the balanced scorecard.

The last two balanced scorecard categories are fairly similar for for-profit and nonprofit organizations. These are internal operations and staff development.

For-profit organizations are concerned, of course, about the efficiencies of internal operations. Yet, they plan to operate with a margin of profit, which, in poorly performing years, can simply slim down or disappear to cover the effects of less-than-optimal performance. In contrast, many nonprofits work on virtually no margin of error. A year of poor performance efficiency can result in dramatic cutbacks in staffing or program, since many nonprofits have no safety buffers built into their budgets. While the category is the same for both types of organizations, it is probably a more critical management issue for nonprofits.

The final category in the classical balanced scorecard scheme was called innovation and learning. Where the first three measurement categories focus on an organization as it is today, the final category addresses the fact that organizations need to continuously grow, adapt, and improve. For most companies, future development is tied inherently to the organization's staff. Within nonprofits, innovation is not usually the compelling market force that it is in the world of competitive, for-profit enterprise. For most nonprofits, developing the organization means, in a literal sense, developing its employees. In this spirit then, for nonprofits, it seems more straightforward to call this final category staff development.

Putting It All in Play

Once you understand what a balanced scorecard is all about, you are ready to implement it. This is a multi-step process that is not for the weak of heart or the short of patience. While it does, in theory and over time, lead an organization to more efficient and effective practices, the balanced scorecard requires an organization to invest substantial time, energy, and talent up-front to make it work well. Worse, if the balanced scorecard technique is not planned and implemented smartly, the result is likely to be a disappointing waste of time, energy, and talent with little to show for it.

If you are up for the challenge, here are your basic steps:

1. Get your Board of Directors and managers educated on the basics and committed to the effort.
2. Appoint someone on staff to be in charge of creating and maintaining the balanced scorecard.
3. Depending on your organization's size, and the knowledge of the person you have placed in charge, you may need to hire a consultant to assist in this effort.
4. Build your scorecard categories to match what is in your strategic plan. Or, build your strategic plan around the categories you will use for the scorecard. Or, modify your existing strategic plan so its matches the scorecard categories.
5. Derive the balanced scorecard measures, metrics, and analytical techniques and implement them in test mode for two or three months.

6. Use the test experience to improve the balanced scorecard measures and processes.
7. Begin to collect, analyze, report, and archive scorecard measures on a regular (e.g., monthly or quarterly) basis.

For a balanced scorecard, as with all management buzzwords, the devil is in the details. Balanced scorecard is an easy concept to understand and highly appealing in theory. In practice, it is a serious challenge to implement correctly. If you can do it, though, the benefits will be substantial and fully demonstrable.

*For further information about Strategic Planning, Balanced Scorecards, or CDR's Management Consulting services for nonprofit organizations, feel free to contact Dr. Zimmerman at Creative Direct Response, Inc. or read his book on Strategic Planning: **"Management Walkabout: Discovering Your Organization's Strategic Readiness."***

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