

Map business strategy and develop performance measures that matter: Developing a strategy map



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Neale G. O'Connor details one of the key parts of the implementation process of the balanced scorecard - the strategy map.

According to Kaplan and Norton (2004), strategy maps help firms to *communicate* and *focus* their strategies. They do this by depicting various causal links in the business model in which learning and growth activities provide the human resource and information systems capabilities that are necessary to support value creation processes. In this first of a two part series I explain how a simple strategy map can be produced, using the example of a firm operating in China.

What is a strategy map?

Strategy maps are summarised depictions of the main parts of a business system that link to drive a firm's sustainable competitive advantage. They consist of objectives, such as developing staff product knowledge, frequent communication between the head and branch offices, high quality products or satisfied customers, which are generally part of the firm's value chain. These objectives are mapped according to a system of cause and effect. For example, the development of staff product knowledge will lead to higher sales, or more frequent customer service follow-up will lead to greater customer satisfaction. Within the system of objectives there are indicators (or measures, such as inputs or outputs), and these are referred to as lead indicators (coming before other indicators) and lag indicators (coming after, or being caused by, lead indicators). Following on from the previous example, the number of hours spent training staff may be identified as a lead indicator of the amount of product sales. Likewise, the number of customer service follow-ups may be a lead indicator of the level of customer satisfaction.

The benefits of having a strategy map

The strategy map provides a simple and effective way of communicating the key value drivers in the firm: (i) why a firm is in business (financial returns that result from providing value to the

customer); and (ii) how the firm is able to deliver this value (internal business processes) and sustain it over time (learning and growth) in the face of competition. In this way the strategy map merges the firm's strategic plan with its business system (see Figure 1). The strategy map provides added structure for the organisation's participants to understand the business model. It also provides guidance for the allocation and management of resources in the firm. There are three main benefits of using a strategy map in the strategy setting and performance management process.

Timing - finding out how long it takes for the change in one lead indicator to have an influence on the change in a corresponding lag indicator. For example, management might wish to know how long it will take for training in particular customer relationship skills to feed through to satisfied customers and possibly higher levels of sales or retained customers.

Magnitude - finding the magnitude of the influence that a change in one lead indicator has on the change in a corresponding lag indicator. Here, management can decide how many resources to devote to a particular lead indicator, such as when it needs to choose between higher levels of skill training and the hiring of more customer representatives. By understanding which factor has a greater influence on customer retention, management can prioritize its resource commitments.

Learning about the business model of the firm. If management finds that the relationships between the various lead and lag indicators do not exist, then it may need to reconsider the expected relationships in the business model. For example, the lack of a relationship between higher investment in customer service training and higher levels of customer satisfaction may have several reasons. From an external perspective, the firm may be targeting the wrong type of customer. For example, a particular banking customer group may prefer quick basic service with

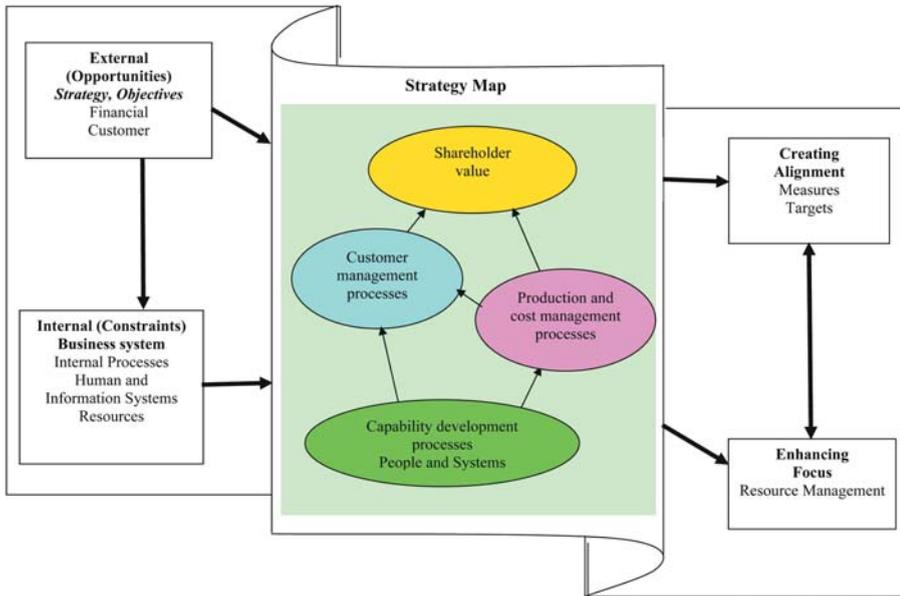


Figure 1. The Strategy Map merges the firm's strategic plan with the firm's business system

little queue time. In this case, the amount of resources that are devoted to expanding the number of customer service officers may be the strongest lead indicator of customer satisfaction and retention. From an internal perspective, the firm may be devoting resources to developing the wrong skill set, or to the wrong type of information systems to support the internal sales and service processes. It may be that the firm has not changed the customer service reward system to fit its customer service strategy.

The strategy map helps in applying systems thinking to the key value creating processes and objectives in the firm. The systems approach aids in understanding the cause and effect links between the processes (and the activities that comprise them) in the firm. These links form the firm's value chain. Following this perspective, the strategy map generally includes four areas, which are similar to the four perspectives of the balanced scorecard: shareholder value, value creating processes, operations management processes and staff and systems development processes. Figure 2 shows these areas as different colours.

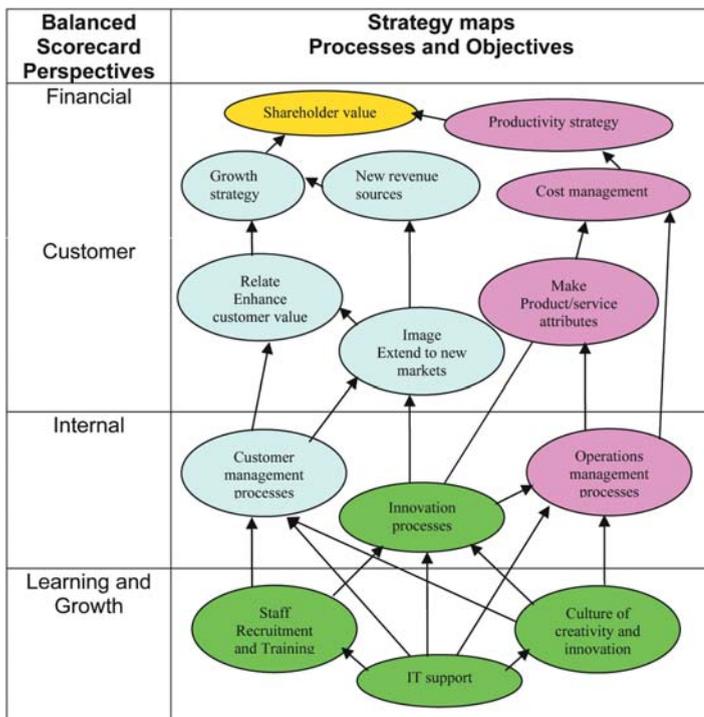


Figure 2. Strategy Map - helps in applying systems thinking (cause & effect) to the key processes & objectives. Green = capability development processes; pink = production and cost management processes; blue = customer management processes.

Steps in developing a strategy map

The first step in developing a strategy map is to map the system of processes or value chains that deliver the good or service to the customer (see Figure 3). There are two reasons for this step. First, a foundation should be established - the system is what currently works, and every step in the system is there for a purpose. Later on in the strategy mapping process we may find that certain steps are not important and can be modified or removed. For now, the purpose is to diagram the whole value chain. Second, common ground should be provided for everyone at the beginning of the strategy mapping process. One of the biggest hurdles in developing a strategy map is in obtaining agreement or consensus over what has to be included or excluded from the final map. Beginning on common ground can help to build a consensus or at least work through disagreements over what makes up the business system.

The second step in developing a strategy map is to formulate objectives that describe a set of activities or processes in the value chain and to identify the inputs and outputs of each key objective. The third step is to map these objectives in a diagram that shows the expected cause and effect links between the objectives. Finally, as part of the balanced scorecard performance system, various indicators (taken from the inputs and outputs that were identified in step two) are nominated for each objective. These indicators are generally measures of inputs or outputs of the key processes or activities that comprise each objective. These measures are used to set targets for communicating and motivating performance within the firm.

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Figure 3. Mapping the system of processes or value chain (step 1) Customer Support and Service Delivery Value Chain

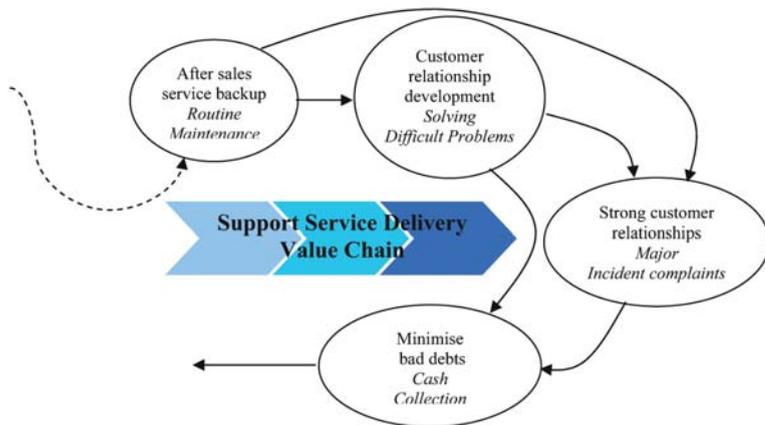


Figure 4. Formulating key objectives and identifying their inputs and outputs (step 2)

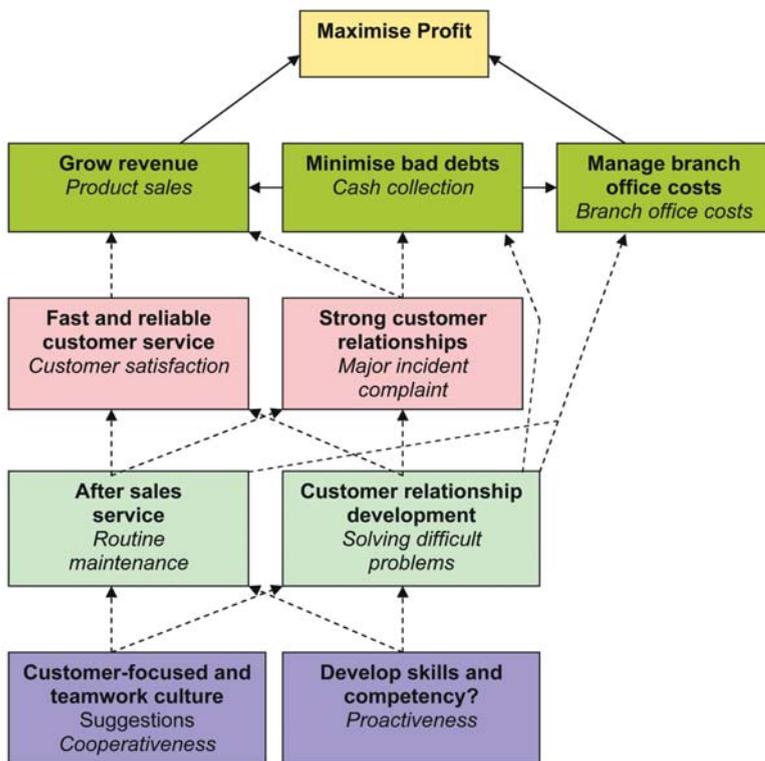


Figure 5. The various objectives (step 3) and related indicators (step 4). Strategy map for XYZ Ltd
Casual hypotheses between latent strategic objectives in bold (—); measures used in the incentive scheme are in italics.

Mini case study of a strategy map

XYZ Ltd runs a distribution network in China, and the supply of electronic component materials to state-owned enterprises is its main source of revenue. Two factors are critical to the company's profit growth strategy: increasing reliance on the sale of higher margin products, and cash collection. First, as all of XYZ's customers are state-owned enterprises, the number of customers does not grow dramatically. Therefore, XYZ has to rely on the sales of new products with increasing numbers of features. Second, as state-owned enterprises are effectively controlled by the government, they hold significant bargaining power over payment for sales. Therefore, XYZ relies heavily on the development of customer relationships and on targeting higher quality (paying) customers. With the increasing introduction of new products and the growth in sales, XYZ needed to change its incentive plan to direct management effort towards these objectives.

Figure 3 provides an example of the customer support and service delivery value chain in which requests for service support drive the priority system for delivering services. Finally, follow-up in terms of customer relationship development helps to manage customer impressions and the communication flow that can help to reduce future major incident complaints and bad debts. Figure 4 shows the inputs and outputs of each of the key processes in the value chain. These inputs and outputs are useful in guiding the types of measures that will ultimately be used in the performance measurement system.

Figure 5 provides a basic strategy map of the casual business model in terms of the strategic factors that are expected to most affect the financial performance of the firm. Also shown are the relevant measures that XYZ used to help ensure enhanced communications and goal congruence amongst its employees.

Concluding remarks

Strategy maps provide a dynamic way of bringing a firm's business plan into the day to day communications of its people. Strategy maps also facilitate the implementation of the business plan and help participants to understand where each role fits in the big picture of the firm's strategy. There are further considerations that this article has not covered, such as the development of parallel strategies, different customer value themes and other implementation issues. The reference list below offers directions for further reading on these issues. ■ ■

References

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