Article 3: Balanced Scorecard and Customer Measures

In the last issue of Stakeholder Satisfaction, Ray Robertson explained how balanced scorecard aligns employee performance measures and rewards with the organisation's vision, strategy and values. Devised by Kaplan and Norton (Ref1), the scorecard comprises four perspectives: financial, operational, people and customer. This article examines how customer measures are incorporated into balanced scorecards.

The importance of customer measures

On all standard balanced scorecard frameworks, such as Malcolm Baldrige or EFQM, customer measures form the largest single element of the scoring system because:

1. The fundamental purpose of any organisation is to meet the needs of its customers. If it isn't, what other purpose does it serve?
2. Commercial businesses generate revenue from customers. Consequently customers' attitudes about the organisation comprise the best lead indicator of their future propensity to spend money on its products or services.

Most balanced scorecard users therefore focus heavily on the lead indicator aspect of customer measures as well as linking customer attitudes with their consequences in terms of tangible behaviours such as the 3Rs of repeat purchase, related sales and referrals.

Customer measures as lead indicators

A fundamental element in many organisations' failure to manage customer satisfaction effectively is their inability to distinguish adequately between customers' attitudes and behaviour. Since the organisational benefits of customer satisfaction derive from the ways customers behave we will examine that concept first.

Customer behaviour

Customers can behave in ways that are good for organisations or bad for them. There are many desirable behaviours that companies want customers to display. They want customers to stay with them for a long time, they want them to spend lots of money – perhaps by buying more often, buying a wider range of products or services from the supplier or by becoming less price sensitive. They want customers to recommend them to other people, to make constructive suggestions for service or business improvement and to fit in with the company's normal operating procedures. There is evidence that the most satisfied and loyal customers display all the desirable behaviours – even "thinking like owners". Illustrated in (Figure 1 on the right), Frederick Reichheld (Ref2) has quantified the financial benefits of these desirable customer behaviours.

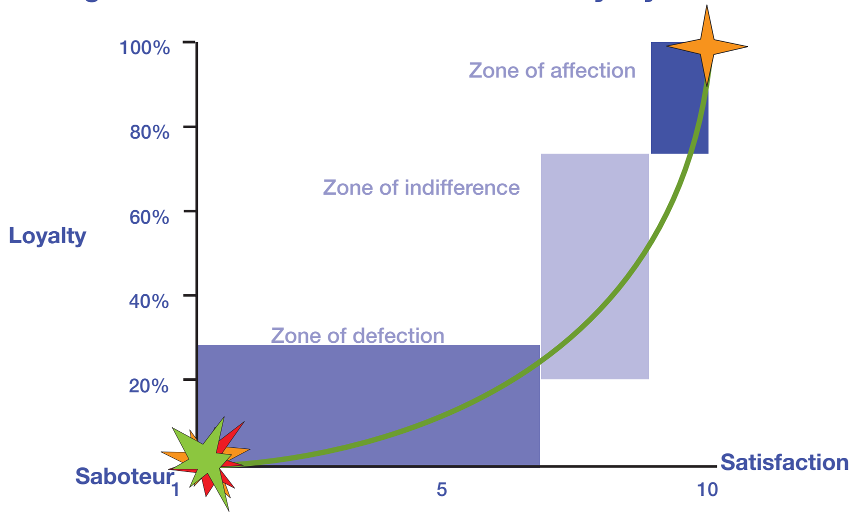
The link between desirable customer behaviours and business perfrormance is both intuitive and well supported by empirical evidence. The challenge is getting them to behave in those ways. In recent years many organisations have developed the misguided notion that they can somehow use software or other tools to 'manage the customer relationship'. Even assuming your customers do want a relationship with you (unlikely if you're a utility, a local authority or an insurance company for example), why would they abdicate its management to the supplier? Only if human behaviour is determined by the most basic of Pavlovian instincts would this be credible. On the contrary, the vast majority of customer-supplier relationships are driven by rational customers who make judgements about the benefits to them of deploying the various behaviours outlined in the preceding paragraph. Suppliers have to respond to customers not manage them. If they concentrate on fully understanding customers' requirements, follow the customers' agendas and succeed in meeting or exceeding customers' requirements, most customers will judge that they have more to gain than to lose by sticking with the supplier and the desirable behaviours will follow. But how do they form those judgements?

Customer attitudes

Customers' judgements about how to behave with organisations are based on what they think about them and these attitudes are based mainly on their direct experience with the organisation – 'the deliveries were often late from that company in the past so there's a strong possibility they won't meet their delivery promise if I order again'. Secondly they're based on what other people say – 'my colleague at the trade association told me how their production schedules were disrupted by a late delivery from company X'. Thirdly, they can be affected by what the supplier says – 'the latest newsletter from company X suggests that their 'delivered on time' stats have gone up a lot, and customer satisfaction's improved too'.

In competitive markets very few perform badly enough to dissatisfy a significant proportion of their customer base over a long period of time. They'd be dead if they did. That may be progress compared with a couple of decades ago, but customers' expectations have also risen since then. In most markets suppliers need to do much more than not dissatisfy customers if they want to maximise the benefits of customer satisfaction. As Harvard point out in their conclusions on the relationship

Figure 2: Satisfaction attitudes drive loyalty behaviours



Source: Professor J. Heskett, Harvard Business School

between satisfaction and loyalty (Ref3), the zone of indifference just isn't good enough (see Figure 2). Why would customers in the zone of indifference stay with a supplier other than through inertia? Why would they buy an additional product or service or recommend the business. They wouldn't. These days most people think they can do better than 'OK', 'average' or 'good enough'. To keep customers, suppliers have to deliver such great results that rational customers will conclude that it would be difficult to do better elsewhere.

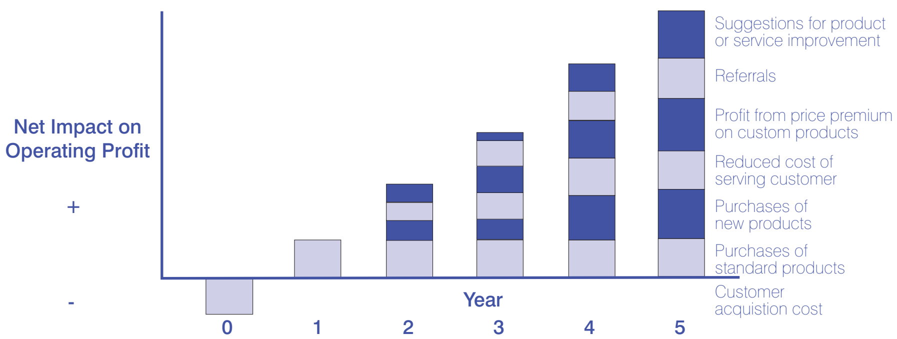
Balanced scorecard measures

To monitor these vital predictive attitudes, a balanced scorecard must record measures of:

- Overall customer satisfaction based on a composite customer satisfaction index
- The extent to which customers' specific requirements are being met
- Progress on increasing customer satisfaction in areas where their requirements are not being met – the PFIs (priorities for improvement)
- Customers' beliefs about their likely future behaviours such as likelihood of remaining a customer, buying related products and recommending.

Balanced scorecard measures of actual customer behaviour will vary across different types of organisation. Typically they would include measures of sales, broken down by product line, market segments or geography as relevant, and as many customer lifetime value measures as the organisation can produce. These are dependent on an extremely good database but should include cohort measures of customer retention / defections, sales growth, share of wallet, referrals and customer profitability. (See Stakeholder Satisfaction October 2004 pages 8-9). S

Figure 1: Components of Customer Lifetime Value (Source: Harvard Business Review September 1990)



References

1. Kaplan & Norton "The Balanced Scorecard", Harvard Business School Press, 1996
2. Reichheld & Sasser "Zero Defections: Quality Comes to Services", Harvard Business Review September-October 1990
3. Heskett et al "The Service-Profit Chain", Free Press 1997

To see how balanced screcard works at David Lloyd Leisure see Ray Robertson's artical on page 30