Chapter 3

Balanced Scorecard Development for Individual State-Owned Enterprises (SOEs)

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This chapter outlines a step-by-step process by which state-owned enterprise (SOE) executives and managers may create and implement the balanced scorecard (BSC) methodology in their organizations. The steps that follow will guide these leaders through the process of clarifying their organization's basic strategy and creating a BSC framework for measuring and managing implementation of that strategy.

This chapter outlines a step-by-step process by which SOE executives and managers may create and implement the balanced scorecard methodology in their organizations

1. Determine your organization's mission, long-term vision, as well as the strategic plan and areas for strategic focus for the state-owned holding company or enterprise
2. Describe the strategy of your holding company or enterprise by identifying high-level objectives for each BSC perspective. These high-level objectives should be organized into a one-page graphic, called a Strategy Map.[15] Strategy Maps for businesses usually illustrate objectives in four perspectives (Financial, Customer, Process, and Learning and Growth). Government organizations sometimes substitute a "stakeholder perspective" for the more traditional "customer perspective."

[15] For multiple examples of strategy maps in diverse industries and government organizations, see Robert Kaplan and David Norton (2004), *Strategy Maps: Converting Intangible Assets into Tangible Outcomes.*

3. Identify one or more measures that will drive improved performance on each objective. Your objectives and measures should be organized into a BSC. A truly "balanced" scorecard includes objectives and measures that reflect a balance in four areas: between long term and short term, financial and nonfinancial, enabling and outcome, and leading and lagging.
4. Review your Strategy Map and BSC to ensure the integrity of the cause-and-effect relationships across objectives in multiple perspectives.
5. Where appropriate, cascade your BSC to subsidiaries and other business units. Be willing to invest time and energy toward improving organizational alignment when you implement the cascading process.
6. Periodically review your enterprise strategy map and BSC to update objectives, measures, and action plans as needed, taking into account changes in your internal and external circumstances, including market, competition, and organization.

This chapter explores these steps in more detail and provides examples of how others have implemented the BSC Methodology in their organizations. Additionally, a prototype BSC is designed step-by-step and provides an illustrative example of the BSC process and methodology.

DETERMINE YOUR MISSION, VISION, AND STRATEGIC FOCUS[16]

Before describing the enterprise strategy with a strategy map, the SOE manager or executive should craft an enterprise mission, organizational vision, and strategic plan. Mission, vision, and the strategic plan (as well as strategic themes) provide conceptual clarity for both management and employees:

[16] Information in this chapter is drawn partially from Chapters 5 and 6 in Irv Beiman and Yong-Ling Sun (2003), *Balanced Scorecard: Applications in China.* See www.egate-china.com (thought leadership) books for summaries of the other chapters. The present chapter updates eGate's learning and experience during the 4 years since publication of the 2003 book.

- **Mission**
  What is the organization's purpose? (Why does the organization exist?)
- **Vision**
  Where is the organization going, and what should it look like in 5–10 years? (What is the organization's vision for success?)
- **Strategic Themes**
  To fulfill the organization's purpose and achieve its vision for success, what are the organization's most important areas for strategic focus? (What must the organization pay attention to in order to succeed?)

It should not be surprising that most managers and employees in SOEs (and most other enterprises) cannot answer these questions, or that different people in the same organization will provide quite different answers. Consistent answers to these questions help everyone in the enterprise to understand the boundaries within which the enterprise should operate, as well as key areas the company needs to focus on to be successful.

An organization's mission statement, which defines the purpose of the organization, is a brief verbal description of why the enterprise exists. Many famous global enterprises have quite short mission statements that simply and clearly communicate why the enterprise exists. Effective mission statements tend to share several characteristics.

- They inspire change.
- They apply over a long time period.
- They are easily understood and communicated.[17]

Individual perceptions of the enterprise will be quite varied if there is no mission statement. If each member of the senior management team were asked, "What is your enterprise's mission?" it is likely they would each give varied answers.

[17] Niven, Paul R. 2002. Balanced Scorecard Step-By-Step. New York: Wiley. p. 73.

Examples of mission statements from famous global enterprises include the following:

- Wal-Mart: To give ordinary folks the chance to buy the same things as rich people.
- Mary Kay Cosmetics: To give unlimited opportunity to women.
- Walt Disney: To make people happy.
- Merck: To preserve and improve human life.
- Hewlett-Packard: To make technical contributions for the advancement and welfare of humanity.[18]

Consider some SOE mission statements:

- China Mobile: To be an innovator in the telecommunication world and become the backbone of the IT community.
- Zambia Privatization Agency: To privatize identified state-owned enterprises in a transparent, efficient, and effective manner.
- Bank Pembangunan Malaysia: To be a progressive development financial institution, providing specialized financing and advisory services to priority and growth segments and supporting the national development agenda.

These simple mission statements say a lot in a few words. Some enterprises choose to create what are sometimes called "stakeholder" mission statements. These mission statements are often longer but define the enterprise's mission to different stakeholder groups. Two large Chinese organizations with stakeholder mission statements are illustrated:

[18] footnote 17.

- **Ping An Insurance (HK)**[19]
  - ⇨ For customers: best service and reliable guarantee
  - ⇨ For employees: career development, devoted to the family and the enterprise
  - ⇨ For stockholders: stable returns, increased value
  - ⇨ For the society: create value for the society, and contribute to the development of the country

- **Legend Holdings, Ltd.**[20]
  - ⇨ For customers: To enrich our customers' life and enable them to work more effectively and efficiently by providing them with the latest and best in IT products and services
  - ⇨ For shareholders: To maximize our shareholders' long-term returns and benefits
  - ⇨ For staff: To provide a stimulating and challenging work environment in which employees have opportunities for innovation, as well as personal and professional advancement
  - ⇨ For the community: To contribute responsibly to the development of the society.

The Ping An Insurance and Legend Holdings mission statement examples illustrate the difficulty of designing mission statements because of the need for many organizations to satisfy multiple stakeholders.

An enterprise mission statement identifies why the enterprise exists. The enterprise vision statement identifies where it is going and what it intends to become in the future

An enterprise *mission statement,* as can be seen above, defines why the enterprise exists. The enterprise *vision statement* defines where it is going and what it intends to become in the future over a 5–10 or even a 20-year period. This can be useful for both governments and SOEs.

Government Vision. The city of Shanghai illustrates the power of a tangible expression of vision. In the early 1990s, the Shanghai Government (with the approval of Beijing) developed a dramatic

19 www.cpaihk.com
20 www.legendholdings.com.cn

vision for the city. That vision eventually contributed to a huge architectural model of what the city would look like in the future. This tangible impressive model is displayed on the top floor of the city planning building adjacent to the People's Square in Shanghai.

When the model was first opened to the public, it gave all who viewed it a clear visual picture of the city's high aspirations for real estate development and transportation infrastructure. The real estate development was intended to provide modern commercial office and residential living space. By committing funds for both visible infrastructure (real estate and transportation) and other infrastructure development (such as subway, power generation, and telecommunications), the city was able to attract investors for co-development projects. This was crucial to the city's strategy to become a showplace attraction for foreign direct investment into the PRC.

When APEC[21] was held in 2001, political and business leaders from around the world gathered in Shanghai. They were uniformly amazed at the city's progress. Television images of Shanghai were projected globally, for the entire world to see the tangible expression of the city's 10-year vision. The combination of such favorable publicity with PRC's entry to the WTO has contributed to a continuation of PRC's strong economic growth.

Enterprise Vision. Enterprise vision statements strive to have the same kind of enabling power, but they seldom succeed. One of the important reasons is often a "disconnect" (significant gap) between the enterprise's ambitious vision and the enterprise's strategy for accomplishing that vision.

The vision statement describes a word picture of what the enterprise intends to look like or accomplish at some point in the future

The vision statement describes a word picture of what the enterprise intends to look like or accomplish at some point in the future. It may define the scope of activities that are included in the enterprise vision, such as which industry sectors, product categories, and target markets the company intends to complete. It may also define the enterprise's market standing (#1 or #2), brand reputation, or how it wishes to be perceived by shareholders, customers, or employees.

21 Asia-Pacific Economic Cooperation (APEC) is a premier forum for facilitating economic growth, cooperation, trade, and investment in the Asia and Pacific region.

A vision statement can be a useful component in an organizational change process as it crystallizes where the enterprise is going. An enterprise vision statement can accomplish several objectives for organizational change and improvement:[22]

- Clarifies the direction of change for the enterprise
- Provides a context to guide decision making at lower levels of the organization
- Motivates management and employees to take action
- Provides a context for coordinating actions across different individuals or groups

There are also risks when developing an enterprise vision statement. For example, it is not unusual for employees in these enterprises to be somewhat cynical about the enterprise vision. If this is the case, such negative perceptions and feelings can arise because an individual's direct experience of the enterprise can be quite different from what is aspired to in the vision statement, for example:

- The vision may include a statement about "respecting employees," but some employees may feel they are not treated with respect by a supervisor or manager.
- The vision may include a statement about "Quality (or Customer Service) is our most important goal," but some employees may think that management decision making is not consistent with this statement.
- The vision may include a statement about significant revenue growth, but enterprise sales may be stable or even declining.
- The vision may include a statement about "integrity" or "treating suppliers as partners," but some suppliers may have a quite different experience of what happens on the due date when they are contractually supposed to be paid.

[22] Kotter, John P. 1996. Leading Change. Boston: Harvard Business School Press.

Taking a high-level vision that projects 5 or 10 years into the future—and then translating that into daily action—can seem to be an almost impossible challenge. The BSC Methodology provides a structure for systematically taking high-level aspirations and converting them into strategic objectives and, eventually, into practical action. A key aspect of this methodology is defining an organization's strategic themes or focuses.

The next task for SOE managers is to identify strategic focuses or themes for their organizations to build a bridge between the enterprise's mission/vision and a strategic plan that includes a description of the organization's strategic objectives.

Each focus or theme establishes the direction for several possible groups of objectives beneath it. These objectives can be linked in several ways:

- One group of objectives is at the enterprise level, with linkages across multiple perspectives (financial, customer, process, people, and learning).
- Another group of objectives flows from enterprise objectives down to lower levels of the organizational hierarchy, with the potential to reach individuals.

Strategic themes provide a way to organize these enterprise and lower-level objectives around a higher-level thematic focus. This focus identifies what the senior management team believes should be done to achieve their most important objectives.[23] The theme can be expressed very briefly. It can also be accompanied by a more detailed translation of the strategic focus into high-level objectives, such as the examples below:

- **Increase profit**
  (by developing and launching profitable new products much more quickly, while minimizing raw material and finished goods inventory through significantly improved sales forecasting)

[23] Kaplan, R. S. and David P. Norton. 2001. *The Strategy-Focused Organization*. Boston: Harvard Business School Press, p. 78.

- **Improve efficiency**
  (by significantly improving quality defects, cycle time, and the on-time delivery from key suppliers)
- **Increase revenue**
  (by expanding into the right new markets with the right products, while using reliable distributors who have the capability to be our partners)

The enterprise mission, vision, strategic themes, and value proposition can be used to more precisely clarify the enterprise's business strategy. We consider all this to be included within the BSC Methodology.

The BSC Methodology involves establishing a clear, visible, and logical linkage between an enterprise's business strategy and the enterprise's BSC.

The BSC Methodology involves establishing a clear, visible, and logical linkage between an enterprise's business strategy and the enterprise's balanced scorecard

As an oversimplified example of designing mission statements, consider how one would create an appropriate mission statement for a state-owned microfinance bank in Central Asia. Obviously, such an organization would have several stakeholders with varying agendas, desired outcomes, and needs. For example, customers want low-cost loans on the most favorable terms; employees desire competitive salaries, training, and promotion opportunities; while the government owner wants to limit risk, operate the bank profitably, and expand to provide more financial services to more citizens.

A possible mission statement for such an organization could be "to provide high-quality financial services to as many rural customers as possible in an efficient and cost-effective manner." We shall expand on this rural bank example in later steps and build a prototype BSC in an illustrative manner. [24]

[24] This example draws on Christian Johnson's experience as an advisor to Kyrgyzstan's largest microfinance organization in 2006 and 2007.

LINK ENTERPRISE STRATEGY TO THE BALANCED SCORECARD VIA A STRATEGY MAP

Strategy maps provide a visual representation of an enterprise's critical objectives and the crucial relationships among them that drive organizational performance

The BSC Methodology is a tool for senior management to define their strategy for success. It is also a method by which management may diagram the key elements of the enterprise's strategy. Kaplan and Norton call this diagram a *Strategy Map*. "Strategy maps provide a visual representation of an enterprise's critical objectives and the crucial relationships among them that drive organizational performance."[25]

Strategy map diagrams and charts can include objectives, target markets, value propositions, critical internal processes, key competencies, and more. These charts and diagrams map the hypothesized relationships among the critical variables that describe the enterprise's strategy and how to implement it. They illustrate the cause-and-effect linkages between financial and nonfinancial objectives. They can also illustrate the cause-and-effect linkages between outcome measures (lagging indicators) and the performance drivers (leading indicators) for those measures.

A strategy map is a "logical and comprehensive architecture for describing strategy... [It visually illustrates] the critical elements and their linkages for an organization's strategy."[26]

A well-designed strategy map includes linkages among multiple elements of an enterprise's business strategy:

- Common strategic themes and objectives
    - ⇨ **Financial** – balancing revenue growth with increases in productivity, efficiency, and costs
    - ⇨ **Customer** – balancing the focus on different target markets that might have different value propositions
    - ⇨ **Process** – identifying which core business processes are critical for effective delivery of the enterprise's value proposition to target markets

[25] Kaplan, R. S., and David P. Norton. 2000. Having Trouble with Your Strategy? Then Map It. *Harvard Business Review* , Vol. 78:167.

[26] footnote 25, p. 88.

- ⇨ **Learning and Growth** – balancing the enterprise's focus on competency development, improving access to information, and improving the enterprise culture in the key areas that are important for successful strategy execution.

- Linking those themes and objectives with performance measures that include
  - ⇨ **Lagging indicators** – measures that reflect historical (outcome) performance on a key objective
  - ⇨ **Leading indicators** – measures that drive or significantly influence future performance on a key outcome measure (lagging indicator).

An enterprise business strategy can be described by a set of *hypotheses.* A strategy map illustrates the hypothesized cause-and-effect relationships that tell the story of the enterprise's business strategy.[27] An initial step in building a BSC is to translate your organization's mission statement, vision statement, and strategic plan into a balanced set of objectives. Often, it is best to first set objectives for the financial perspective and then move to setting objectives for supporting customer, internal process, and learning and growth perspectives. Some possible financial objectives may include

- Increase Revenue
- Decrease Indirect Costs
- Increase Assets
- Increase Profitability
- Increase Cash Flow
- Minimize Financial Risk by Reducing Debt

Consider the issue of strategic themes. A firm that is losing sales to its competitors may choose to focus on "grow revenue." Alternatively, a firm that is bloated and barely operating at breakeven or is suffering a loss may adopt a short-term strategy of

[27] Kaplan, R. S. and David P. Norton. 1996. *The Balanced Scorecard*. Boston: Harvard Business School Press.

"rapidly improve cost management" to rationalize its operations. In the case of the Central Asian microfinance institution mentioned previously, the firm is striving to achieve its mission of "providing high-quality financial services to as many agricultural and rural customers as possible in an efficient and cost-effective manner."

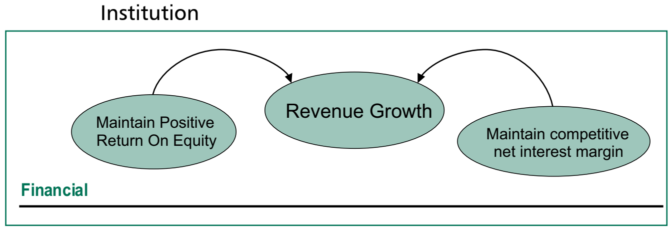
Because microfinance is a new industry in many countries and rural populations are often underserved in terms of loans, deposit facilities, and other basic financial services, it follows that such an institution may include the following strategic themes:

- maintain profitability (but not to unreasonably increase profits),
- raise revenues (by serving more people and offering more loans), and
- provide a net interest margin[28] in line with competitors (so as not to unreasonably profit from a large margin or squeeze competition away from rural areas by offering below-market-rate loans).

Additionally, many microfinance institutions operate according to a "double bottom line." The institution strives to remain profitable and solvent (financial "bottom line"), but also works to achieve nonfinancial social objectives (social "bottom line").

With these considerations in mind, a high-level strategy map can be designed based on the following microfinance strategy and financial objectives:

Figure 7: Example of Financial Objectives for a Microfinance Institution



[28] Net interest margin (or, a funding rate spread) is the difference between the institution's cost of funds and use of funds. This is the difference in the average interest rate a loan customer pays the institution and the interest rate the institution pays investors for the money it lends.

Figure 7 illustrates a powerful message: the firm is striving to balance the social and financial returns of the organization. The central focus of the organization is to provide financial services to as many rural citizens as possible (as defined by its mission statement). Thus, the central financial goal of the organization is revenue growth, not profitability. The financial goal of "maintain positive return on equity" implies that the firm desires to maintain its present breakeven (but positive) profitability and invest any excess profits into expanding its business and providing greater numbers of loans to clients. In other words, it is not seeking to *increase* return on equity, rather it is seeking to *maintain* its present positive return on equity.

Moreover, the microfinance institution is working to "maintain a competitive net interest margin." In other words, it is seeking to offer interest rates in line with those of its competitors while at the same time growing its funding base at interest rates in line with its competitors. Importantly, it is not striving to be a price leader (by offering concessionary or below-market interest rates) but rather follows market forces and market pricing.[29] Such a strategy will allow growth of the microfinance industry in the country rather than stifle competition and discourage private-sector growth in the microfinance financial services industry.

Taking this example one step further, we can explore possible customer objectives. Possible customer objectives for the microfinance institution may include

- Increase the total number of rural customers, because this is a measure of the organization's social impact and a goal stated in its mission statement.
- Increase rural penetration as measured by the number of areas or towns served. (It is possible to increase the total number of rural customers serving only a limited portion of the country. This objective helps to drive greater geographic coverage.)

[29] Microfinance banks and organizations sometimes often benefit from concessionary funding from international donor organizations. Thus, it is possible the bank could pass these concessions (below market-rate) to its customers. In this case, however, the bank is unable to fund a significant backlog of loan applications and thus raising loan rates would be an economically viable – but not perhaps a politically tenable - alternative.

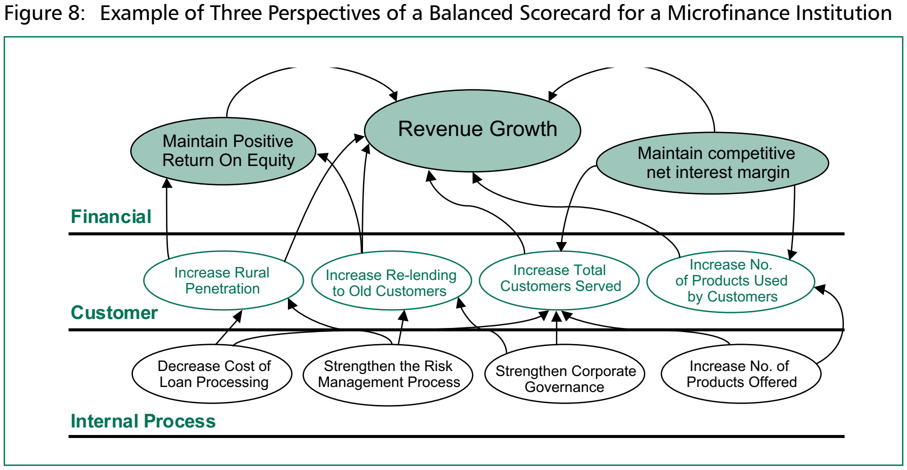
- Maintain/increase the "re-lending" rate (the number of customers that renew or expand their lending after repaying their initial loans). This is also an indirect measure of customer satisfaction and whether the organization is meeting the needs of its customers.
- Increase the "cross sell" or number of financial products used by customers. In other words, the bank should work to encourage rural depositors to also become loan clients and to perhaps use the money transfer services of the institution.

Strengthening corporate governance is of particular importance for most state-owned institutions. Thus, strengthening corporate governance is included as an internal process objective in the microfinance strategy map

Likewise, the microfinance institution needs to determine appropriate internal process objectives. Some important areas of focus for microfinance institutions include decreasing the cost of offering/processing a loan (the organization's primary product), strengthening the risk management process, and increasing the number of financial products offered to customers. Strengthening corporate governance is of particular importance for most state-owned institutions (as explained later in Chapter 5). Thus, strengthening corporate governance is included as an internal process objective in the microfinance strategy map.

With the above information, we can now expand our microfinance institutional strategy map to also include customer and internal process objectives:

Figure 8: Example of Three Perspectives of a Balanced Scorecard for a Microfinance Institution

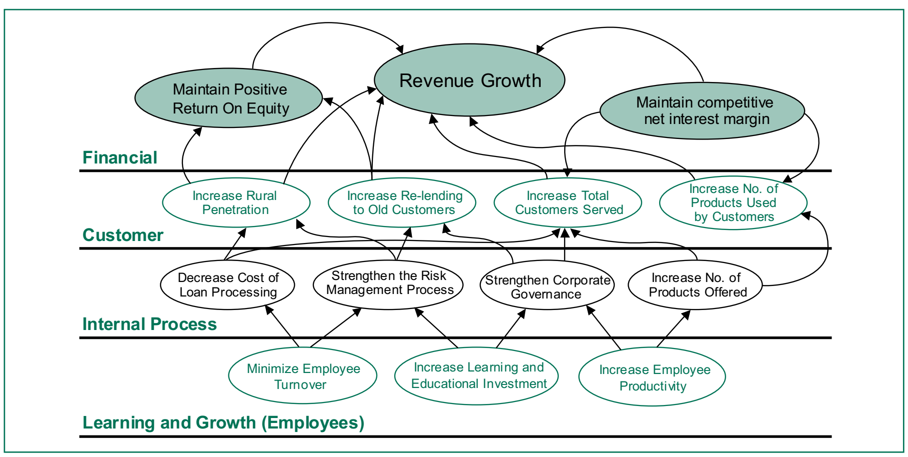


The fourth and final perspective is the learning and growth perspective. This was referred to as the "employee perspective" in the early stages of the evolution of the BSC Methodology because it focused at that time on actions needed to encourage a motivated, efficient, and productive staff. More recent developments in the BSC Methodology have included not only human resource objectives, but also objectives related to information systems and organizational issues, such as leadership, teamwork, alignment, and culture.

Some measures that may be appropriate in this microfinance example include increasing staff educational and learning investment (to increase efficiency and improve risk management), minimizing employee turnover (a recurring problem for SOEs because staff leaves for better-paying, private-sector jobs with greater potential for promotion), and increasing employee productivity.

With the above information, we can now expand our microfinance institution strategy map to also include all four perspectives and all objectives:

Figure 9: Prototype Microfinance Institution Strategy Map



Source: Author (Johnson)

A major reason for developing a simplified strategy map for this Central Asian microfinance organization is to illustrate how a BSC can be created. The exact objectives and measures used by the organization will likely need to be debated internally by staff and management so that the final objectives selected are solidly linked to a single, overall enterprise strategy. This example illustrates how the four perspectives build on one another to create a comprehensive, cohesive, and balanced description of the microfinance organization and its strategy.

It is relevant, however, to share the following information related to this microfinance case: this Central Asian microfinance organization was actually first introduced to the BSC approach during a microfinance branch manager training program in the Kyrgyz Republic in 2006. From the training program, the branch managers acquired knowledge of financial and nonfinance measures (metrics) which could be used to track the performance of their individual branches.

One manager commented after the training, "Using the balanced scorecard at my branch will enable us to focus on the business, customers, and double bottom line results—rather than simply our financial statements!" More impressive results are possible should the organization implement the balanced scorecard methodology among all branches in a consistent manner.

Shifting to a more general issue for all SOEs, it is important to note that each enterprise will have its own set of business drivers, business dynamics, competition, and pressures. It follows that each organization's business strategy (and each organization's BSC) will need to be carefully designed in light of its current circumstances.

Finally, while enterprise strategy, objectives, and measures may be determined internally by an organization's management, engaging the services of an established external consulting firm experienced in BSC implementations can substantially increase the quality, sustainability, value, and usefulness of an organization's BSC.

SELECT APPROPRIATE MEASURES FOR EACH BALANCED SCORECARD OBJECTIVE

Measurement is fundamental and essential to the BSC Methodology. A key issue is the *selection* or *design* of the most appropriate and helpful measures. Some enterprises have a large number of measures, many of them in the financial, sales, and process areas of performance. These measures have historically (prior to the BSC) been identified as KPIs (key performance indicators). KPIs used in a BSC are referred to as measures.

Most enterprises have experience tracking and reporting results using KPIs, although oftentimes, these KPIs may not be closely connected to the enterprise strategy. More often, the measures have been accumulating for several years and have grown into a sizable number. Some enterprise managers and executives may believe they have designed a BSC when they organize their existing KPIs into the typical perspectives of a BSC. None of this actually fits the BSC Methodology.

The BSC Methodology requires a systematic linkage of the strategy to the value proposition, to specific objectives, and to measures for those objectives. The enterprise's BSC measures should be a result of the senior management team's collective discussion about key aspects of their strategy, value proposition, and enterprise objectives. That discussion should precede the selection of measures. The measures flow *from* the strategy and objectives. The strategy and objectives should *not* be *built up* from measures that already exist by moving from the detail (measures) to the big picture (strategy). Just because a measure exists, and possibly has been extensively used in an enterprise, does *not* necessarily mean that it should be included in an enterprise's scorecard. Rather, such a measure may or may not be appropriate for the scorecard. The selection of measures depends on the enterprise's strategy and the objectives that are an important element in the strategy.

The balanced scorecard methodology requires a systematic linkage of the strategy to the value proposition, to specific objectives, and to measures for those objectives

Michael Porter of Harvard University makes the point that strategy includes not only what is important to do; it also includes what *not* to do and what *not* to focus on.[30] This idea is particularly applicable to the usual KPIs that many enterprises have already identified. Kaplan and Norton agree with Porter, and caution managers to avoid automatically including their traditional KPIs in their scorecard.[31]

30 Porter, M. 1996. What is Strategy? *Harvard Business Review*, Vol. 74. November–December.

31 Kaplan, R. S., and David P. Norton. 2001. Transforming the Balanced Scorecard from Performance Measurement to Strategic Management: Part I. *Accounting Horizons* Vol. 15:87–104.

The purpose of an enterprise balanced scorecard is to create clarity and focus on what is most important for successful execution of the enterprise's strategy

SOEs, in particular, are subject to tracking a large number of KPIs. This likely arises because of government ownership or regulation. It may also occur as a result of evolution in the enterprise's compensation system. Whatever the reason, it is important to understand that all of the KPI measures do not belong in an enterprise scorecard. Some KPIs may be useful, but all of them cannot be expected to fit the enterprise's strategy and specific value proposition to its target markets.

The purpose of an enterprise BSC is to create clarity and focus on what is most important for successful execution of the enterprise's strategy. The result of the senior management team's discussion should be a small number of key objectives, and measures of those objectives, for each perspective.

Also, it should be noted that some measures (and KPIs) are sometimes referred to as outcome measures and other measures as performance drivers or performance measures.

Lagging indicators are measures of historical performance, such as profit, revenue, customer satisfaction, and market share. These are outcome measures, which are the measurable results created by actions taken earlier, sometimes much earlier. These tend to be represented as generic or core measures in most enterprise scorecards. They do not usually differentiate an enterprise's specific business strategy.

Leading indicators are called performance drivers.[32] Leading indicators, or performance drivers, tend to be more closely related to an enterprise's value proposition. For each traditional or core outcome measure (lagging indicator), a key question is: What "drives" performance on that outcome measure?[33]

This question is important to the BSC Methodology. It helps the senior management team translate strategy, value proposition, and important financial objectives into more focused measures of what fundamentally drives performance in the enterprise.

It can be useful to select or design measures within a context of evaluating management's hypotheses about how to succeed. In

32 footnote 27, p. 149.
33 footnote 17, p. 116.

fact, the BSC Methodology can be viewed as a set of tools that enables management to formulate and test their hypotheses about how to achieve business success. As such, the BSC Methodology provides a systematic structure that enables management to

- define the mission and vision for their enterprise's success;
- define their strategy for achieving that success (which can be treated as a set of hypotheses);
- define which key objectives and associated outcome measures are the most appropriate and useful measures (lagging indicators) of success;
- identify their hypotheses about what will drive successful performance on those core outcome measures; and
- choose the enabling objectives and measures that will support achievement of the critical desired outcomes.

With this background, we can determine some representative measures for the Central Asian microfinance organization. The easiest measure is the one associated with the objective to "increase revenue." The appropriate outcome measure for that objective would be "percent increase in annual revenue."

For the "maintain positive return on equity" objective, an appropriate measure would be "percent increase or decrease in return on equity." For this objective, management should strive to minimize deviations from its current return on equity (ROE) with a view toward maintaining breakeven profitability and the resulting positive ROE.

For the "maintain competitive net interest margin" objective, the obvious measure is the institution's "net interest margin."[34] The net interest rate margin of competitors and the banking industry as a whole can be obtained from annual reports and advertised interest rates.

[34] Net interest rate margin in this context is defined as the difference between the cost of funds the institution pays for its capital and the average interest rate it earns from its loans to customers.

Note that **SOEs need not strive for perfection in selecting their BSC measures. These measures are often altered, replaced, or dropped based on feedback and a cause-and-effect analysis review**.

Examples of measures for the remaining objectives in the Central Asia microfinance organization are provided below for illustrative purposes.

Table 2: Sample Balanced Scorecard measures for a microfinance organization

Balanced Scorecard Objective	BalancedScorecard Measure
Customer Perspective	
Increase Rural Penetration	% Rural Communities serviced
Increase re-lending to old customers	% of expiring (paid off) loans that are renewed
Increase total customers served	% increase in new customer accounts
Increase number of products used by customers	Average number of products used per customer
Internal Process Perspective	
Decrease cost of loan processing	Operating Expense Ratio = total operating expenses / gross loan portfolio
Strengthen risk management process	Portfolio at Risk (loans more than 30 days overdue)
Strengthen corporate governance	Corporate Governance Rating Score (explained in Chapter 5)
Increase number of products offered	Number of different and distinct financial products offered to customers
Learning and Growth	
Minimize employee turnover	Total number of employees departing voluntarily over past 12 months / total employees
Increase Learning and Education Investment	Total training and education expense / total employees
Increase employee productivity	Two measures: a. Gross loan portfolio/total staff b. Number of active borrowers/total staff

Source: Author (Johnson)

CAUSE-AND-EFFECT ANALYSIS OF OBJECTIVES AND MEASURES

A key purpose of an enterprise BSC is to explicitly describe the enterprise strategy in terms of the senior management team's hypotheses about how to achieve their important objectives. These hypotheses identify the important objectives and the linkages among them across different perspectives. The hypotheses can be stated in the form of multiple "if, then" statements about the causal relationships among the critically important variables. Consider the example below for a state-owned manufacturing firm.

Objective: Increase revenue by 25%

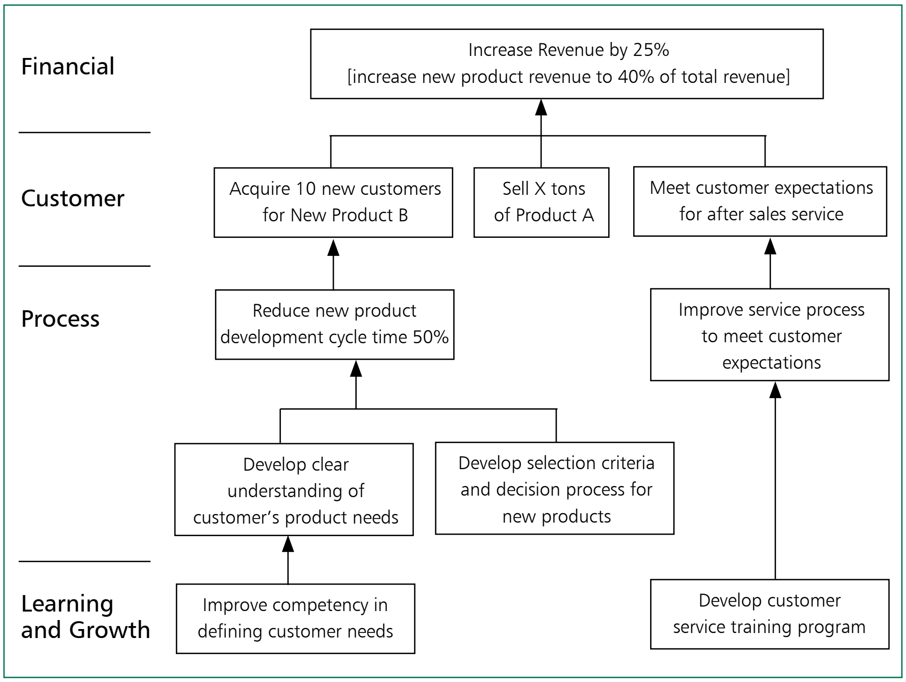
If we want to increase revenue by 25%, **then** we must increase new product revenue to 40% of total revenue. Developing new products that quickly gain market share is critically important to our financial goal of increasing total revenue. **If** we reduce our average new product development cycle time by 50%, **then** we should be able to meet our total revenue objective. This is assuming that we execute well on our other objectives. These objectives include selling X tons of Product A and acquiring 10 customers for Product B. We must also meet our customers' expectations for after sales service, in order to retain current customers for future business that can be more quickly sold. **If** we fail to meet customer expectations for after sales service, **then** we will not be able to meet our revenue increase target.

These cause-and-effect relationships are related to other cause-and-effect relationships. For example,

- **If** we intend to reduce average cycle time for new product development by 50%, **then** we must develop a better understanding of our customers' needs and more carefully select the optimum new products for development.
- **If** we must meet customers' expectations for after sales service, **then** we need to
    - ⇨ more precisely understand each customers' expectations,
    - ⇨ train service personnel to perform to customers' specified requirements,
    - ⇨ track customer satisfaction in a timely manner, and
    - ⇨ respond quickly and effectively to customer complaints.

These hypotheses illustrate the thinking involved in doing a cause-and-effect analysis. Notice that we began with a simple measurable financial objective—to increase revenue by 25%. When we considered *how* to accomplish that objective, and what causative factors would enable us to succeed, we began the cause-and-effect analysis. We illustrate this example in Figure 10: Abbreviated Strategy Map Example.

Figure 10: Abbreviated Strategy Map Example



Source: eGate

Returning to the Central Asian microfinance example presented earlier, assume that management decides on a 20% revenue growth target for the coming year. However, the top team realizes that 5% of this revenue growth must come from new loan products.

Objective: Increase revenue by 20% for our microfinance organization.

If we want to increase revenue by 20%, **then** new loan products must account for 5% of that revenue increase. Developing a new loan product that our competitors do not offer will attract customers from our competitors. If we meet or exceed the needs of these new customers, they may move their entire banking relationship to our organization, further increasing revenue. **If** we introduce three new loan products next year, **then** new loan products should increase our total revenue by 5%. This is assuming that we execute well on our other objectives. These objectives include maintaining our existing return on equity (not profiting excessively from our customers) and maintaining a competitive net interest margin. We must also train our staff on these new loan products so they can explain the benefits and terms of the new loan products to new and existing customers. **If** we fail to train our staff appropriately, **then** we will not be able to meet our revenue increase target.

This cause-and-effect analysis is fundamental to the BSC Methodology. The process of designing a strategy map should stimulate senior management to enter into such a cause-and-effect analysis. This enables senior management to explicitly clarify their hypotheses about the critical causal relationships in their strategy. These hypotheses are testable by using appropriate lagging (outcome) measures in conjunction with the leading measures that drive performance on the outcome measures. One or more measures should be specified for each objective in each perspective.

The process of designing a strategy map should stimulate senior management to enter into such a cause-and-effect analysis. This enables senior management to explicitly clarify their hypotheses about the critical causal relationships in their strategy

CASCADE YOUR BALANCED SCORECARD TO SUBSIDIARIES AND OTHER BUSINESS UNITS

After an enterprise strategy map and BSC have been agreed upon by the top team of senior executives or managers, the strategy map should be cascaded to multiple levels of the organization or holding company subsidiaries.

One of the key risks to avoid in accomplishing this is to ensure that the Strategy Map cascade goes beyond the borders of functional silos. One of the most important benefits of using strategy maps and BSCs is the value they provide in dissolving the previously impermeable boundaries of functional silos.

Silo thinking and behavior is a critical problem in SOEs in the Asian region and beyond. Hierarchical cultures, combined with functional performance appraisal, have created silos with boundaries as strong as steel. No amount of talk or training will overcome this.

Involving management teams at multiple layers of the organization in designing their own strategy map and BSC has proven to be very successful in overcoming silo thinking. The discussion, analysis, and airing of different points of view during this process creates a shared understanding (and shared ownership) of business issues and lowering of organizational barriers to improving performance.

It is the management teams' shared understanding and agreement on the strategy map that begins the process of dissolving the silos and leading to new solutions for long-standing problems. It is important to pay attention to horizontal alignment during the cascading process. eGate has developed a horizontal alignment needs survey that has been useful in fine-tuning strategy maps to establish more effective alignment across commercial and functional organizations. The vertical cascade, combined with horizontal alignment adjustment, is an enormously powerful lever for creating organizational change and transformation in SOEs.

If this process is done MBO style[35] within functional silos it can have truly harmful consequences for any organization, particularly SOEs. The BSC Methodology can create laser-like focus within an organization. The focus should be on the critical outcomes and enabling objectives that will support enterprise success. If the objectives are cascaded within an MBO functional silo, the laser focus will *reinforce* silo thinking and behavior. This will harm the organization.

To be clear, the BSC Methodology must be developed, implemented, and used properly, or like any powerful tool, it will do harm.

Again, revisiting the microfinance organization example, cascading may be done by headquarters to each of its branch offices. In this way, headquarters management, working hand in hand with branch managers, can track achievement of the BSC objectives at the branch level. This type of deployment of the BSC can even stimulate competition and sharing of best practices among the branches, as well as improving performance and strategic alignment.

[35] MBO = management by objectives within a particular function or department.

PERIODICALLY REVIEW YOUR BALANCED SCORECARD AND ENTERPRISE STRATEGY AND UPDATE

The manufacturing of products and delivery of services involve work. That work must be managed in order for customers to be satisfied and retained.

Strategic management is similar in the sense that managerial work is required. For strategy to be described, measured, and managed, executives and managers must engage in behavior specifically intended to accomplish the requirements for each component of the strategy management process.

After strategy maps and balanced scorecards have been established for multiple levels of the organizational hierarchy, a strategy management process must be put in place to assure that performance is reviewed and analyzed on a periodic basis

After strategy maps and BSCs have been established for multiple levels of the organizational hierarchy, a strategy management process must be put in place to assure that performance is reviewed and analyzed on a periodic basis. The minimum requirement for strategic management is quarterly review, analysis, decision making, and planning. It can sometimes be useful for executive and management teams to conduct this review, analysis, and planning process monthly. Rapid market change, urgent need for improvement in organizational performance, post-merger integration, changes in leadership, changes in strategy, etc. are just some of the situations in which more frequent reviews of BSC performance may be warranted.

In the case of our microfinance organization, a twice annual review or a quarterly review would likely be sufficient. However, more frequent updates to strategy may be required if there is a new entrant to the market and/or there are major changes to the country's economy.

The management of strategy includes linkage of the strategy to budgeting, human resources, and information technology (IT). It can sometimes include the selective use of benchmarks. Consider each of these areas in turn.

Budgeting. Linkage of the strategy to budgeting is important because budgets are developed in many organizations based on sales forecast and operational requirements to meet the sales forecast. To put it simply, budgets for strategy execution are quite rare, if they exist at all. Enterprises that have achieved the Balanced Scorecard Hall of Fame for Executing Strategy™ are more likely to establish budgets that include consideration of how to fund strategic initiatives critical for enterprise success.[36]

Human Resources. Linkage of the strategy to HR is a requirement for enterprise success. The reason is that HR recruits, hires, trains, evaluates, and compensates employees. If HR processes are disconnected from the enterprise strategy, senior managers will be headed in one direction while the rest of the organization's people are headed somewhere different. It is beyond the scope of this chapter to address the complexity of these issues.[37] We can only highlight the issue and encourage readers to gather additional information.

Information System. Any organization embarking on a deployment of the BSC Methodology will eventually need an information system to record, track, and report on performance data, as well as to manage the execution of strategy. Many organizations begin with spreadsheets and migrate toward more dedicated software applications as their needs for a user-friendly information system grow. The information system should enable more than the mere reporting of performance measures. Additional requirements include a system that enables the reporting of analysis and plans for how to take corrective action to improve performance. The simplest requirement, however, is a system that enables red, yellow, and green lights or indicators for whether performance is at or above the target, near the target, or significantly below the target.

Benchmarks. The desire for benchmarking SOE performance flows from the same kind of thinking that focuses on enterprise performance measurement and evaluation. Benchmarking was popular more than a decade ago in developed economies as manufacturing organizations sought to improve quality and

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[36] The Hall of Fame award is given regionally around the world, on a competitive basis. Criteria for the award include achieving breakthrough results while using the BSC framework and the five principles of strategy focused organizations. Innovations and evolutionary changes in the BSC methodology are based on case research with Hall of Fame companies.

[37] Focused treatment of HR issues is provided in three chapters of the Beiman and Sun BSC text: Chapters 6, 7, and 8 of *Balanced Scorecard & Strategy Execution: Applications in China.*

decrease costs with the primary objective of improving financial performance. The benchmarking pendulum, however, swung so far to an extreme position as to develop a life and purpose of its own. Benchmarking became the primary objective for some organizations, and the original purpose of benchmarking was lost.

The ultimate purpose of measurement, performance evaluation, and benchmarking should be the strategic success of the enterprise (or the SOE holding company that includes multiple subsidiary enterprises). That success is defined by the enterprise (or holding company) strategy map. The financial objectives and measures in the enterprise BSC enable the top team of the enterprise to continue the design process into lower-level perspectives (Customer, Process, Learning and Growth). The target-setting process should flow from the enterprise game plan, or strategy for success. This should not be driven by benchmarking what international or domestic competition has accomplished, should that data even be available, and often it is not. If it is available, it may not be directly relevant for the enterprise strategy. It simply may not be meaningful to compare one enterprise to another as each is likely pursuing different strategies for success.

The ultimate purpose of measurement, performance evaluation, and benchmarking should be the strategic success of the enterprise

What is more important is the enterprise leadership team's vision of how best to succeed in their industry with their critical target markets. The definition of the leadership team's vision is communicated in the enterprise strategy map. The targets should be determined *by the strategy,* not by the competition or other industry players—although competition should be considered when formulating enterprise strategy.

Benchmarks can, if desired, serve as general reference points, but they should not, in our opinion, serve as ends unto themselves. The strategy is what is important, not the KPI comparison to the competition. The strategy should *differentiate* the enterprise from its competition on the key areas of performance that will enable the enterprise to succeed. Success for SOEs is defined by the enterprise top executives and/or by some higher-level government authority. Comparisons to the competition on KPI benchmarks are of secondary importance. If those KPIs are important for customer buying decisions, the benchmark comparison informs management where they might beneficially improve to win more customer business.

It is important to remember that the customer is the one that brings revenues to the enterprise. The customer will be making the relevant comparisons to the competition. The customer's decision to buy from the enterprise should be sufficient evidence that the enterprise is succeeding in its game plan.

If the value proposition desired by the customer (or market) is operational excellence and low cost, then benchmarking the competition on variables, such as pricing, product quality, and cycle time, might be useful in some cases. The value in such cases might arise from knowing how direct competitors are winning business with customers who require low cost, acceptable quality, and delivery within certain time constraints.

Consider, however, a situation where the competition might be offering a low-cost value proposition, and the enterprise under consideration might be attempting to provide more customized design and service in a target market that does not value low cost per se, but instead considers customized design to be of greater value and importance.

This is not uncommon in the specialty chemicals industry, where customer relationship, knowledge of customer products and industry, customized design of specialty formulations, and other factors can play a critical role in winning and retaining key accounts. To simply offer low cost in the specialty chemicals industry is a losing value proposition. Benchmarking competition on cost might not reveal useful information. In fact, attempting to match low-cost competitors for some specialty chemicals could be undesirable, destroy potential profit, and hurt the long-term success of the enterprise.

We conclude that the value and benefit of benchmarking should be carefully evaluated, if considered at all, and only engaged in if the data provide strategic value. One view of the strategic value of benchmarking data is the extent to which the information enables an enterprise to improve performance in a market, including how to fine-tune and deliver a winning value proposition for that market.

We conclude that the value and benefit of benchmarking should be carefully evaluated, if considered at all, and only engaged in if the data provide strategic value

The critical elements in this equation are

- the understanding of the market;
- the formulation of the value proposition for the market;
- the identification of strategic objectives related to delivering that value proposition; and
- the enterprise success in winning, satisfying, and retaining the desired customers within that market.

These elements must be executed successfully in order for the enterprise to create significant improvements in performance. This is essentially a summary description of strategy and how to execute it. Strategy maps and BSCs are fundamental tools for accomplishing this.

The key strategic issue for benchmarking is this: Will the information enable more effective description, evaluation, and management of the enterprise strategy for success?