Chapter 4

Balanced Scorecard Development for the Government Shareholder

by Christian C. Johnson and Irv Beiman

Governments have varying structures for managing the operations of their government-controlled, state-owned enterprises (SOEs). The landscape of structures can be tiered into three separate models: a decentralized model, a dual model, and a centralized model.

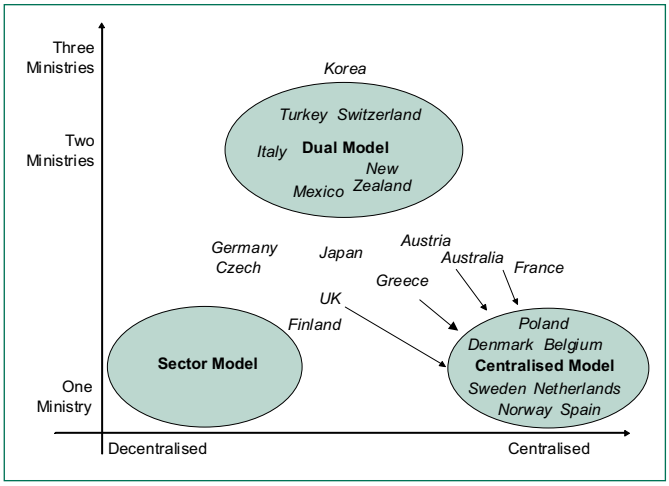
The most traditional structure is the decentralized model where SOEs are under the responsibility of relevant sector ministries. A dual model is, however, a more prevalent one, where responsibility is shared between a sector ministry and a "central" Ministry or entity, usually the Finance Ministry or the Treasury.

Finally, a centralized model, in which the ownership responsibility is centralized under one ministry, organization, or intergovernmental entity, has more recently been on the increase.

A 2005 Organisation for Economic Co-operation and Development (OECD) report[38] noted the significant evolution and reform since 1995 of the government ownership function. These reforms have tended to move countries away from the decentralized model and more toward the centralized model, although a few countries seem to have developed a fairly stable dual model of organization (see Figure 11).

[38] OECD Comparative Report on Corporate Governance of SOEs, March 2005. Figure 11 is also from the OECD Comparative Report.

Figure 11: Organization and evolution of Government ownership



Source: OECD Comparative Report on Corporate Governance of SOEs, 2005.

It is important for a government executive to understand the structure of the government control of their SOEs. The most straightforward model is the centralized model, whereby a single government organization is responsible for government ownership.

In the People's Republic of China (PRC), the State-owned Assets Supervision and Administration Commission (SASAC) was created in May 2003 to consolidate central ownership of the largest SOE groups in the PRC. SASAC was created with the responsibility to manage 189 of PRC's largest industrial SOE conglomerates. In effect, SASAC is the "institutional shareholder" for these enterprises on behalf of the Chinese Government. As such, SASAC has a fiduciary duty to both the Government and the citizens of the PRC to manage these SOEs effectively.

Singapore provides another example, where Tamasek (the government holding company) has a $90 billion portfolio, with shares in more than 20 SOEs, including SingTel, Singapore Airlines, and Raffles. The 12 government-linked companies listed on the Singapore Stock Exchange represent about 20% of the market capitalization.

In Indonesia, the Ministry of State Owned Enterprises controls 161 SOEs and has minority shareholdings in another two dozen. These SOEs employ more than 1.4 million people and

operate in more than 20 industries. And, 70% of the SOEs operate in competitive (non-monopoly or utility) sectors.

The PRC example is notable because the country moved from a decentralized model to a centralized model for important reasons. An overriding challenge facing many SOE directors was that the SOE often reported to different agencies within the Chinese Government, each with distinct agendas and claims. For example, until recently, Chinese SOE management and oversight at the central government level was handled by at least six different organizations. Creating SASAC solved this problem and provided SOE managers with a single organization responsible for government supervision and administration ownership functions.

DEVELOPING A GOVERNMENT STRATEGY FOR MANAGING SOEs

Government ministries or agencies responsible for a portfolio of SOEs normally manage the strategic direction of their SOEs in one of two ways—by setting an overarching strategy for their SOEs, or by allowing each SOE to set its own strategy and taking action only when an SOE's performance or actions deviate from recommended norms or required boundaries. When a government sets an overarching strategy, the government, in effect, sets up a strategic fence within which SOEs are encouraged or required to operate.

When a government does not set an overarching strategy, the government operates similar to a sheep herder with regard to its SOEs, frequently chasing the sheep (individual SOEs) that are wandering too far when implementing their own strategies. In each case, a responsible government will take steps to review, influence, and redirect the SOE strategies.

Setting strategic boundaries empowers government executives to assess the appropriateness of individual SOE strategies against overall government objectives and strategies

The "strategic fence" approach works best for control and for driving SOEs toward common goals and objectives. Setting strategic boundaries empowers government executives to assess the appropriateness of individual SOE strategies against overall government objectives and strategies.

Thus, **an appropriate starting point for developing a balanced scorecard (BSC) for a portfolio of SOEs under a**

government agency is to determine an appropriate strategy statement and/or overarching strategy for SOEs under their purview. A simple strategy statement, such as "Maximize citizen benefits with government resources" will allow government ministries, representatives, and SOE managers to structure their organizations to a government's overarching strategy.

Because of the complexity and often conflicting objectives within a government, a clear strategy is often difficult to craft for an individual SOE, and even more difficult for a portfolio of SOEs that may operate in different industries and geographies. For example, the Ministry of Health may desire for SOEs to expand their health clinics while the Ministry of Education may wish for the SOE to invest in preschool education in their child care facilities. At the same time, the SOE will likely be pressured to increase revenues and decrease costs in its core business.

A country's legal framework may also impact the nature of government SOE strategies. In countries with a centralized ownership function, SOEs executives and Boards of Directors are responsible to single government ministry. Thus, implementing a central government strategy for SOEs is more straightforward. When the governance of SOEs is split between two or more Ministries, implementing a single government strategy for SOEs becomes more complex.

This difficulty of balancing conflicting and complex objectives is precisely the reason why it is important for government leadership to clearly define an overarching strategy for their SOE portfolio. Table 3 provides some sample strategy statements for various types of government agencies and ministries.

A simple strategy statement, such as "Maximize citizen benefits with available government resources" will allow government ministries, representatives, and SOE managers to structure their organizations to a government's overarching strategy. Such a simple strategy statement would be appropriate for SOEs in which the government seeks to retain long-term ownership.

Under this scenario, SOEs should be empowered to pursue strategies appropriate for their core competencies. For example, government hospitals would be encouraged to expand and improve

Table 3: Sample Strategy Statements for Government Organizations

Strategy Statement Example	Rationale for Strategy Statement
Privatization Agency "Maximize shareholder value and increase private sector competitiveness"	Agency intends to groom SOEs for privatization and to maximize share price at privatization
Telecom Holding Company "Increase the competitiveness of the telecommunications sector"	Holding Company is asked to provide users with competitive communications (in terms of costs, availability, etc.)
Ministry of Defense "Maximize national defense capabilities with available allocated resources"	Ministry must define an appropriate national defense infrastructure and maximize its defense capabilities within a defined budget
Central Government Organization for SOEs "Maximize citizen benefits within allocated budgeted resources"	Public organizations are owned by and serve a country's citizens, who desire services at reasonable costs that are not excessive

their delivery of healthcare, schools would be encouraged to expand and improve the education they provide, and industrial manufacturers would focus on manufacturing quality products at a globally competitive cost. It follows that the practice of having large SOEs operate schools and hospitals in addition to their manufacturing facilities would be discouraged.

Likewise, if the government agency is a privatization agency that is restructuring and/or grooming SOEs for privatization, then the strategy statement could be "Maximize shareholder value and increase private-sector competitiveness."

In the absence of a clear strategy for SOEs by government leadership, the strategy for individual SOEs is effectively delegated to the leadership of each individual SOE. Historical evidence suggests that unmonitored management may result in wasted resources, excessive costs, and uncompetitive SOEs. (See Chapter 4 for information on developing a balanced scorecard for individual SOEs.)

Importantly, we focus in this Chapter on enabling governments to set appropriate strategies for their portfolios of SOEs so that government ministries may drive strategic performance improvement. It is relevant to quote a frequently expressed principle: "If you can't measure it, you can't manage it."

Government agencies need to measure the degree to which their portfolio SOEs are achieving defined strategies—and then take appropriate actions to improve performance in specific areas. The focus is shifted from "budgeting" to performance. The performance is focused on executing strategies to achieve the most important high-level strategic objectives. A key element in strategy execution is the identification of strategic objectives and measurement of performance in achieving those objectives.

What follows is a case study of how the PRC has instituted a performance measurement system for their largest SOEs. This performance measurement system is stimulating improvement in corporate governance and strategic management. This is discussed further in Chapter 5 for corporate governance and in Chapter 6 for strategic management. This case study is presented so that other governments may learn from PRC's experience and consider similar approaches for their own SOE sectors.

THE PRC'S EXPERIENCE WITH SETTING AN OVERARCHING SOE STRATEGY

SASAC is empowered by the State Council to be the institutional investor for PRC's largest industrial SOEs. The Asian Development Bank (ADB) commissioned a project to assist SASAC with improving their performance measurement system for SOEs.

BearingPoint was retained to implement a state-of-the-art, international best-practice performance measurement system for the largest SOEs of the PRC Government. Because the BSC is the leading performance measurement system in existence today, BearingPoint developed a project team from multiple sources.[39] The project team worked closely with SASAC and the Chinese Government to design a system that measured more than just financial performance, but included the three other perspectives of the BSC—customer, internal process, and learning and growth.

[39] The project team was composed of expert staff from BearingPoint, eGate Consulting, and Dayue Consulting. The project team members are identified in greater detail in the Introduction to this book and in author descriptions at the end of this book.

An important starting point was to conduct numerous interviews and discussions (both written and oral) with SASAC and other Chinese stakeholders. SASAC's long-term vision was for its SOEs to become globally competitive enterprises. As the country's domestic market continues to open, the PRC's SOEs need to develop their own core competencies to compete successfully on a global scale. This competition will occur in the PRC's domestic market, as well as in its export markets.

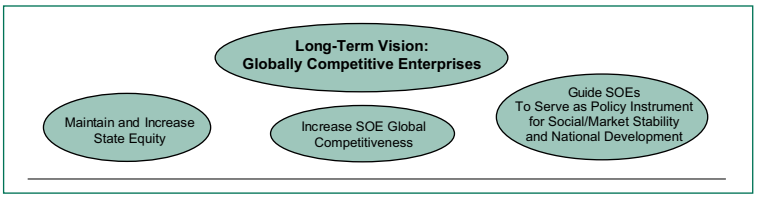
Based on this long-term vision, SASAC developed three high-level strategic themes:

- Increase SOE Global Competitiveness
- Maintain and Increase State Equity
- Guide SOEs to serve as a policy instrument for Social Market Stability and National Development

These themes are separate and not mutually reinforcing. For example, some equity may need to be sacrificed in order to invest in future competitiveness. Also, equity may need to be sacrificed to pursue policy goals of improving employment and social programs. Despite these natural conflicts, increasing SOE global competitiveness was determined as the primary goal.

Based on these findings, the project team placed these important strategic themes at the top of SASAC's Strategy Map. These themes provided guidance for designing the goals comprising SASAC's Enhanced EPES[40] and Strategy Map.

Figure 12: SASAC's Major Strategic Themes for its SOEs



EPES = Enterprise Performance Evaluation System, SOE = state-owned enterprise.
Source: Asian Development Bank TA 3933-PRC Project Team based on interviews with Government officials

[40] EPES = Enterprise Performance Evaluation System.

The project team was mindful that the BSC is typically used for a single enterprise or for a corporate holding company that includes multiple subsidiary enterprises and strategic business units. In these more typical applications of the BSC, the corporate or enterprise strategy is translated into strategic objectives and performance measures.

SASAC, with assistance from the project team, designed an overarching strategy for the wide variety of SOE conglomerates, holding companies, and operating subsidiaries for which SASAC is responsible. In effect, SASAC was striving to achieve strategic alignment of its SOEs. SASAC also embarked on a whole new application of the BSC—moving away from the one-*company*, one-strategy model to a one-*country*, one-strategy model.

In short, the project team designed an entirely new application of the BSC—a performance measurement system and strategic management tool for an entire country's SOE sector.

In short, the project team designed an entirely new application of the balanced scorecard – a performance measurement system and strategic management tool for an entire country's SOE sector

To achieve this result, the project team accomplished the following:

- translated SASAC's long-term objectives into a reduced set of independent **Financial** objectives and measures that were consistent with the Government's long-term objectives;
- identified objectives and measures in the **Customer** arena that will enable and support achievement of the critical financial objectives;
- identified objectives and measures in the **Internal Process** arena that will enable and support achievement of the desired customer and financial objectives;
- identified objectives and measures in the **Learning and Growth** arena that will enable and support achievement of the desired process, customer, and financial objectives;
- integrated all of these objectives into a single graphic diagram, called a **Strategy Map**, that can be communicated to all those who have an "ownership

interest" in, or are otherwise involved with or affected by the SASAC BSC; and

- clarified the **rationale and scoring method** for each measure of each objective in the recommended Enhanced EPES.

The project team, in discussion with SASAC representatives, analyzed the cause-and-effect linkages that are most likely to occur across all types of SOEs in all types of industries. This analysis provided a basis for selecting the objectives and measures within each of the four BSC perspectives.

The SASAC Strategy Map (see Figure 13) provides a high-level view of the goals and strategic drivers of SASAC's strategy for its SOEs. This Strategy Map, while useful in communicating and updating strategy, was also used as the basis for designing an improved BSC performance measurement tool.

Before explaining the new approach toward performance measurement, it will be useful to briefly examine the strategic objectives in each of the BSC perspectives.

Financial Perspective. Four objectives include increasing profitability, cash flow, and enterprise revenues, while improving solvency, financial management, and financial contribution to society.

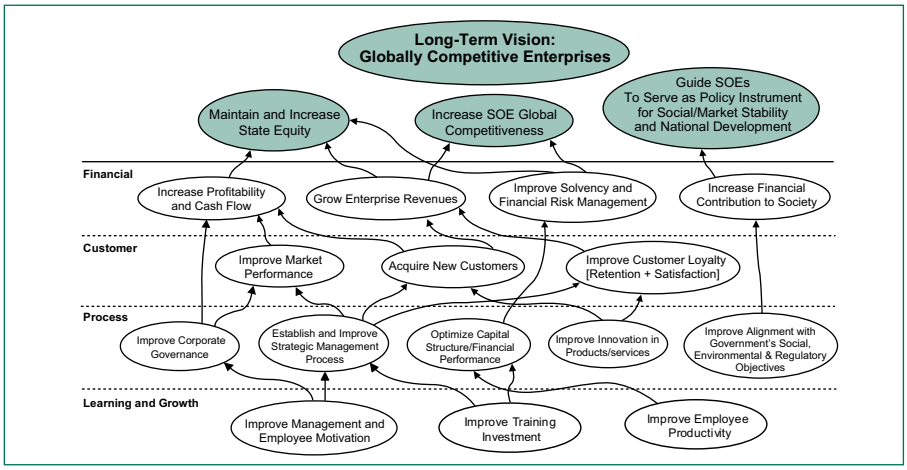
Customer Perspective. Three objectives include improving market performance and customer loyalty while acquiring new customers.

Process Perspective. Five objectives include improving corporate governance, innovation, and alignment with the Government's social, environmental, and regulatory objectives, plus establishing and improving a strategic management process and optimizing capital structure/financial performance.

Learning and Growth Perspective: Three objectives include improving training investment, employee productivity, and motivation of management and employees.

It is worthwhile to bring the reader's attention to two key objectives in the Process Perspective—focusing on Corporate Governance and Strategic Management. These two objectives at

Figure 13: SASAC Strategy Map



Source: Asian Development Bank TA 3933-PRC Project Team based on interviews with Government officials

the national level are intended to have strategic impact throughout the SOE sector. Chapter 5 of this book focuses specifically on the topic of Corporate Governance—what it is and how to measure it. Chapter 6 focuses on how to use the BSC Methodology for strategic management of enterprise performance.

Based on the above objectives, measures that drive each of the 15 objectives were developed in close collaboration with senior SASAC executives.

CREATING A SCORING METHODOLOGY FOR THE BALANCED SCORECARD

An important final step was the development and design of a scoring method that would enable SASAC to score and rank each SOE conglomerate or holding company based on its BSC performance. This step was possible because the Chinese Government has obtained performance data from all its SOEs—and collects this data in a standardized and systematic fashion.

The Government's continuing interest in data collection enabled another new application of the BSC—the development of a new **scoring system**.

After a significant amount of research and testing, the project team recommended a scoring methodology that met SASAC's requirements to adopt a simple, straightforward, and easy-to-understand scoring system. This scoring system is a "percentile ranking" of enterprises within their appropriate reference group. (A reference group is a select group of enterprises against which an enterprise competes. For example, a steel manufacturing firm in the PRC would be scored against other local steel manufacturers.)

Percentile rank scores provide SOEs with immediate feedback about their performance as compared with their reference group

Percentile rank scores provide SOEs with immediate feedback about their performance as compared with their reference group. For example, suppose a steel manufacturing enterprise has an ROE of 3.45%. The enterprise would first be ranked within its reference group (of other SOE steel manufacturing firms) and its score would equal its percentile ranking within that reference group.

Table 4: Example of Scoring using Percentile Rank

Rank Within Reference Group	Return On Equity (%)	Percentile Rank and EPES Score
1	19.30	1.00
2	17.40	0.93
3	12.45	0.86
4	9.65	0.79
5	6.32	0.71
6	4.54	0.64
7	3.45	0.57
8	2.21	0.50
9	1.45	0.43
10	-3.40	0.36
11	-4.60	0.29
12	-8.30	0.21
13	-14.50	0.14
14	-15.20	0.07
Average	2.20	

EPES = Enterprise Performance Evaluation System.

Ranking using percentile scores has several advantages:

- *Enterprises can easily interpret their scores.* In the above example, the enterprise with an ROE of 3.45% would

obtain a score of 0.57, which means that the enterprise is in the 57th percentile (top 43%) of its reference group.

- *Enterprises can more easily understand and interpret their scores from one year to the next.* A company scoring 0.40 in 1 year understands its ROE is in the bottom 40% of its reference group. If in the following year the enterprise scores 0.75, the enterprise can understand this performance improvement places it in the top 25% of its reference group—bypassing 35% of its peers in a single year!
- The scoring method is not influenced by the shape of the distribution for a measure. Percentile scores have a consistent meaning, regardless of the shape of the distribution.

Also, using this new scoring system enables enterprises to more easily understand their component scores and overall scores. The scoring system provides SOE managers with guidance about where they might best focus their attention to improve their performance relative to their peer group.

As an example, suppose a company obtains the following financial category scores when its performance measures are compared to a reference group of peer companies:

Table 5: Scoring Example using Percentile Ranking for the Financial Category

Objective	Measure	Score
Increase Profitability and Positive Cash Flow		
	Return on Equity (ROE)	0.63
	Cash Flow from Operations/Revenue	0.75
Grow Enterprise Revenues		
	Percentage Sales Growth	0.12
Improve Solvency and Risk Management		
	Debt Ratio	0.22
	Quick Ratio	0.33
Increase Financial Contribution to Society		
	Financial Contribution to Society	0.48

Both SASAC and the company can easily interpret the performance of this enterprise in the financial category. The enterprise scored in the top half of its reference group in terms of profitability and cash flow. It scored lowest in terms of sales growth and, thus, needs to focus more on generating more revenue. (The enterprise can also look at its performance relative to customer retention and customer acquisition for guidance in this area.)

The enterprise can be viewed as having higher-than-average levels of debt—both long-term debt and short-term debt. Finally, the enterprise is about average in its financial contributions to society.

Moreover, the enterprise can track its performance improvement or the lack of it in subsequent periods. This is a strong benefit and motivator for SOE management to improve its performance and to see the results of targeted efforts for performance improvement relative to its peer group.

The above methodology allows a government agency or ministry to measure the progress of its SOEs toward using its chosen strategy to improve its performance. That performance can be examined in either absolute terms alone or in a combination of absolute and relative terms. Absolute terms would involve the actual quantitative amount of improvement or deterioration in performance. A combination of absolute and relative terms would examine actual quantitative performance improvement in combination with how the enterprise performance compares with a reference group. The percentile scoring system above enables evaluation of performance improvement relative to a peer group.

The new scoring system enables a systematic and logical approach for evaluation of SOE performance. It is not without its drawbacks, however, because of the issue of establishing relevant and consistent reference groups. To the extent a government can use a logical unbiased system for establishing relevant reference groups and can collect comparable data for a reference group of SOEs, the percentile approach for relative comparison has considerable merit.