



Improving Corporate Governance: A Balanced Scorecard Approach

For further information please contact:

Michael E Nagel, CMA
Principal, Corporate Governance Practice
Balanced Scorecard Collaborative, Inc.
781.402.1154
mnagel@bscol.com

Chris Rigatuso, MBA
Director of Business Development
Oracle Corporation
650.633.6915
Chris.Rigatuso@oracle.com

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Executive Summary

Corporate governance is a matter of enormous public attention and concern. More was published on this topic in the past 12 months than in the last five years combined. Much of the press provides governance practices and control recommendations that introduce more regulation into the governance process. While tough measures such as Sarbanes-Oxley Act and the SEC orders and regulations reforms are necessary, given recent events, they are not sufficient.

Corporate leaders need a modern set of tools that provide greater visibility into their organizations and strengthen corporate governance and corporate performance management. This paper proposes a three-part Balanced Scorecard-based system, i.e., the Board Balanced Scorecard, Corporate Balanced Scorecard and Executive Balanced Scorecard integrated into cohesive information technology foundation. The users of these scorecards are the board of directors, executive management, general managers, and executive staff respectively.

To meet the reporting deadlines imposed by new legislation, organizations must operate at maximum *efficiency*. Business applications can remove complexity and increase visibility enabling firms to confidently face new governance demands. A truly efficient business system operates on a single data model with data consolidated in one location. Integrated applications architecture and automated business flows quickly move business data among global front and back office operations. This allows integrated Balanced Scorecards to represent up-to-date performance metrics across the enterprise to appropriate user communities.

Context for Strengthening Corporate Governance

Several interrelated conditions have damaged public and investor trust in the performance of companies and their leaders. First, the massive business scandals of the recent past seem to confirm the investing public's growing perception: Corporate leadership is fraught with greed and excess. These scandals create a crisis of confidence and trust for providers of debt and equity capital.

Public disclosure practices have also drawn skeptical attention. Disclosure practices are applied unevenly and they frustrate users who want insight into the non-financial drivers of financial value. Federal Reserve Board Chairman Alan Greenspan testified that misleading disclosures diminished confidence in corporations and depressed the valuation of equity securities¹.

The weak economy heightens scrutiny of corporate leadership. Unemployment is at the highest level in nine years. The Dow Jones Industrial Average has been in the 7,000's several times, down about 30% since its last 12 month high. Retirement plans are depressed and investors are frustrated.

The modern corporate model is based on a system of trust and confidence. The core assumption is that shareholders entrust directors to provide oversight of the executives who professionally deploy investor assets for long-term return. This system of corporate stewardship only works if shareholders have a high level of confidence that its leaders (directors and senior

¹ Alan Greenspan, Federal Reserve Board's Semiannual Monetary Policy Report to the Congress, Testimony Before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, July 16, 2002

executives) are managing the company in their best interests. Because board directors and senior executives are jointly culpable for effective corporate performance management, it's important to understand their roles.

Roles of the Board of Directors

An active and engaged board is an essential part of shaping and executing a successful strategy. Boards contribute to organizational performance when they fulfill five major responsibilities. First, directors approve the strategic direction of an enterprise. While the board does not create strategy their approval sets the organization in motion. Therefore, directors need to know enough about the business (the central business issues and non-financial factors that drive the business) so they can identify a winning strategy from a risky or problematic one. However, directors complain that they lack visibility into the key issues and drivers of the business. For example, they have limited exposure to customers, operations or the workforce. A McKinsey survey notes that 44% of directors don't fully understand the key drivers of value for the organizations they govern². This is a *Visibility* issue that can be addressed by an automated Balanced Scorecard that provides timely, relevant, and accurate information.

Secondly, another concern of the board involves ensuring that resources are used most effectively and efficiently to achieve the strategy. As such, the board oversees the financial actions of an organization. They set fiscal policy and approve large capital expenditures. Many of these expenditures are highly strategic. However, the strategic relevance of these requests is not always clear because large funding requests do not demonstrate a tight linkage to strategy. Moreover, in the absence of a well-defined strategy, the advantage of a particular strategic expenditure over another is difficult to determine. Directors lack the information necessary to monitor strategic expenditures. For example, once a strategic expenditure is approved, directors often have little knowledge on whether the expenditure generated the desired benefits.

Thirdly, the board plays an essential role in counseling and advising the CEO. Board members are elected because their industry knowledge, functional acumen or strategic relationships are deemed contributory to the enterprise. The board meeting is the most frequent opportunity directors have to share their knowledge, discuss strategic tradeoffs and lend decision support. However, many board meetings are primarily approval forums and lack opportunity for meaningful discussion on strategy and its execution. To benefit the CEO, directors need financial and non-financial information that shows current and anticipated performance. They also need a forum to use this information to ask key questions, discuss central business issues and offer performance advice.

Fourth, selecting and motivating executives is another essential board role. Directors are expected to approve the hiring of senior executives, assess their performance and reward them appropriately. For the organization to remain a going concern, directors are also charged with succession planning. However, directors have few tools that enable them to separate the performance expectations of an individual executive from the performance expectations of the enterprise.

Finally, a director is a watchdog for uncompensated risk and a guardian for compliance. A working definition of business risk is "the factors that can prevent an organization from achieving its objectives". Compliance includes legal, accounting and regulatory requirements but also adherence to ethical standards. Directors receive insufficient information to effectively address key compliance issues and business risks that can prevent the organization from achieving its strategic targets. The same 2002 McKinsey survey suggests 43% of directors cannot identify plans for key risks facing the company. However, risk management practices must move beyond identifying individual risks toward linking them to specific strategic objectives so directors can monitor the overall level of risk.

² Source: McKinsey April-May 2002 US Directors Survey

Roles of the CEO

The CEO's responsibility to manage the company is distinct but complementary to the board's oversight responsibility. The CEO is the senior most management team leader. As such, he or she is accountable to the board for corporate performance. Four major CEO responsibilities contribute to organizational performance described in the paragraphs below.

First, the CEO and the executive team must define and communicate the strategy. An enterprise or business unit strategy describes how value will be created for shareholders. A strategy should outline the financial targets and outcomes. It should also describe how the financial objectives will be achieved, i.e., the non-financial drivers of value. Since value is derived from customers, processes and intangible assets such as human and information capital, a multi-business company may have multiple strategies.

Once these strategies are defined, the CEO and executive team must effectively communicate them. The first audience is the board and the shareholders who ultimately approve and fund the strategy. Shareholders and directors need to understand the targeted financial outcomes and the non-financial drivers and assumptions that underpin the strategy. The workforce also requires high strategic awareness since their day-to-day activities influence the enterprise. A study found that only about 5% of the workforce understands the strategy and how their actions link to that strategy³.

The CEO must fund the strategy. The common tool to allocate funding is the annual budget and long-term capital plan. The budget is a powerful tool for expressing the priorities of the enterprise in quantitative terms. The problem is that 60% of organizations don't link budgets and capital expenditures to strategy in part due to a lack of modern tools and information to support this⁴.

Because the workforce is the dominant asset for creating value, talent alignment is ultimately a CEO responsibility. The workforce must align directly with CEO priorities. Through the performance management process, the CEO ensures executive talent is aligned to the strategy, accountable and rewarded for executing these priorities. The Human Resource organization ensures the overall workforce is focused on these priorities and motivated to execute them. However, only 50% of organizations link human capital to strategy and only 25% have a consistent way to measure human capital⁵.

³ David Norton, Managing the Development of Human Capital, Balanced Scorecard Report, 2001

⁴ David Norton, Managing the Development of Human Capital, Balanced Scorecard Report, 2001

⁵ Aligning HR with Organizational Strategy Survey, SHRM/Balanced Scorecard Collaborative, 2002

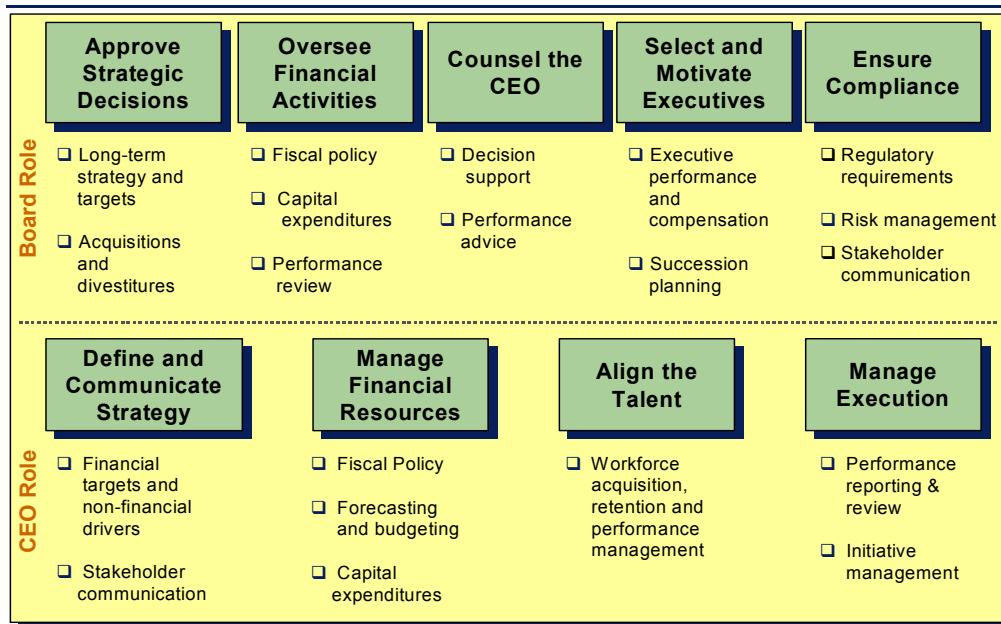


Figure 1. Directors and executives have complementary responsibilities in promoting strong corporate governance.

Once the strategy is described and funded and the workforce is aligned, the strategy must be managed. The most consequential thing a CEO can do to manage the execution of strategy is to regularly review and discuss strategic performance. This process should be the central feature of the governance calendar and all executives should participate. During these meetings, the executives should examine if the strategy is working and if strategic initiatives are performing to established targets. However, 85% of executive teams spend less than one hour per month discussing the achievement of strategy⁶.

Balanced Scorecard

The Balanced Scorecard (BSC), developed in 1992 by Drs. David Norton and Robert Kaplan, has gained global acceptance as a powerful framework to help leaders define and rapidly implement strategy. This is accomplished by translating the vision and strategy into a set of operational objectives that drive behavior and performance. The BSC concept is built upon the premise that measurement motivates and that measurement must start with a clearly described strategy. The four perspectives of the BSC framework (financial, customer, internal and people and knowledge) are used to describe the strategy.

⁶ David Norton, Managing the Development of Human Capital, Balanced Scorecard Report, 2001

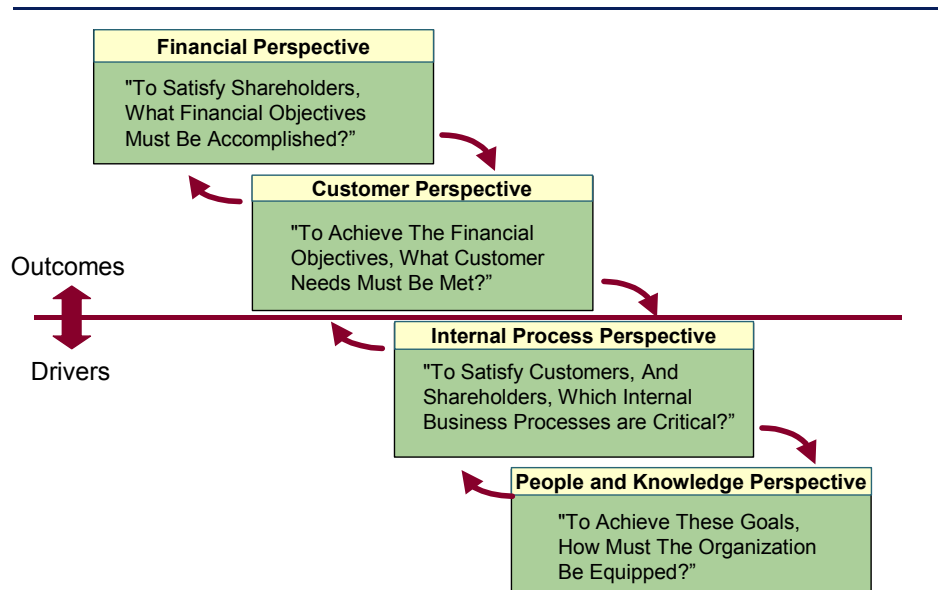


Figure 2. The Balanced Scorecard framework describes how value will be created across four business perspectives

A balanced set of performance measures across these four perspectives provides the essential feedback required to assess performance and adjust and refine the organization's strategy over time. The roles of board directors and the CEO are strengthened through a three-part BSC based system, i.e., the Board Balanced Scorecard, Corporate Balanced Scorecard and Executive Balanced Scorecard⁷.

Board Balanced Scorecard

The Board BSC is built to describe and manage the strategic responsibilities of the board. It uses the four perspectives of the framework and starts with a strategy map. Major strategic themes on the strategy map frame the contributions of the board. These strategic themes may include: performance oversight, executive enhancement, compliance and communication, and corporate citizenship. These themes provide the architecture for defining the specific objectives of the board. In for-profit organizations, the board does not directly produce financial results yet the enterprise financial objectives are still part of the Board BSC because they provide context for the board's objectives.

⁷ Certified Management Accountants of Canada, Management Accounting Guideline: *Measuring and Improving the Performance of Corporate Boards* applies the principles of the Balanced Scorecard to the performance of boards, CEO's and corporations. Preface by David P. Norton, CEO Balanced Scorecard Collaborative, 2002.

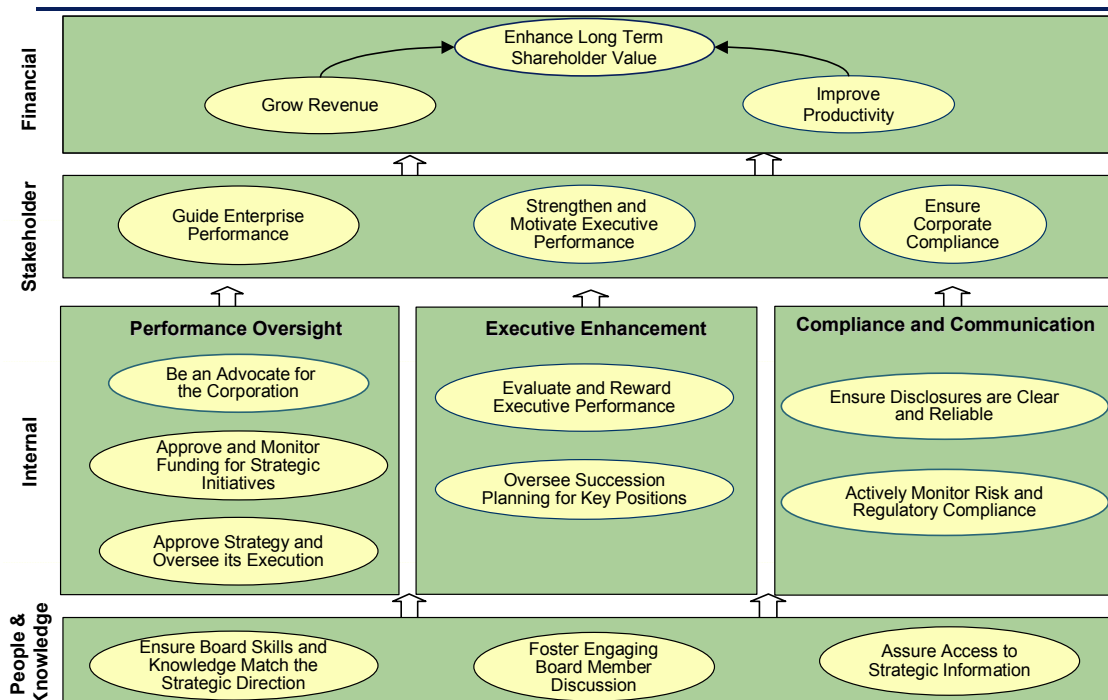


Figure 3. The Board BSC clarifies the role of the board and its information requirements

The Board BSC clarifies the strategic information required by the board. It also becomes a modern tool to manage and evaluate the performance of the board and its committees.

Corporate Balanced Scorecard

The Corporate scorecard has a dual role. It is clearly a tool for the CEO. However, it also has a central role in fulfilling the board's performance oversight responsibilities. As a CEO tool, the corporate scorecard is used to define, communicate and manage the strategy. The corporate scorecard uses a strategy map to describe how the enterprise will create value. Each objective on the strategy map has a corresponding measure and target. Performance against the strategy is evaluated by using the scorecard measures and targets.

Corporate Scorecard Framework Adapted for the Board							
Strategic Theme: Acquire and Build Relationships		Objective	Measure	Target	Initiative	Funding	Milestone & Risks
Financial		<ul style="list-style-type: none"> Increase Revenue Growth 	<ul style="list-style-type: none"> Fee Income as a share of revenues 	<ul style="list-style-type: none"> 2003 20% 	<ul style="list-style-type: none"> Brokerage and Banking Integration 	\$650,000	<ul style="list-style-type: none"> 11/25 Joint offerings defined Field Retention
Customer		<ul style="list-style-type: none"> Know Me and Give Tailored Advice 	<ul style="list-style-type: none"> Share of customers with financial plans 	<ul style="list-style-type: none"> 2003 5% 	<ul style="list-style-type: none"> Brand Image Campaign 	\$3.2 MM	<ul style="list-style-type: none"> Launch 11/15 Low brand recall scores
Internal		<ul style="list-style-type: none"> Retain and Expand Valuable Relationships 	<ul style="list-style-type: none"> Share of customers with two or more products. 	<ul style="list-style-type: none"> 2003 40% 	<ul style="list-style-type: none"> Employee Sales Training Program 	\$525,000	<ul style="list-style-type: none"> All staff by 9/30 Peers offering free checking
People and Knowledge		<ul style="list-style-type: none"> Build and Maintain a Customer Centric Culture 	<ul style="list-style-type: none"> Improvement on Employee and Customer Poll 	<ul style="list-style-type: none"> 2003 20% 	<ul style="list-style-type: none"> Customer Information System 	\$750,000	<ul style="list-style-type: none"> Test runs complete by 11/25 Data integrity

Figure 4. The Corporate and or business unit BSC is used by the CEO and the board

This framework is used to align major strategic initiatives and screen significant funding requests. It also provides the basis for aligning the workforce to the strategy and is the starting point for managing enterprise risk.

Executive Balanced Scorecard

The Executive scorecard equips the board to select and motivate executives. By defining the strategic contributions of key executives, the tool helps the board separate and evaluate the performance expectations of an individual executive from the performance expectations of the enterprise. CEO's use the tool to align the executive team, hold them accountable and reward them based upon strategic performance. The compensation committee uses the tool to assess individual executive performance and facilitate compensation decisions. The governance committee uses the tool as a strategic job description. As such, it is quite useful in identifying succession candidates. In fact, a more advanced use of the executive scorecard is to include a development component so that rising stars in the organization are developed and groomed for succession.

Executive Scorecard Framework: <i>President Retail Banking</i>			
Strategic Objectives (from corporate strategy map)	Individual Objective	Measure (from corporate)	Target
Financial 	Enable key sources of revenue growth 1) investment offerings for the affluent and small business segments 2) deposit and credit offerings for the mass market.	• Fee Income as a share of revenue	• 2003 20%
Stakeholder 	Deliver financial plans for targeted affluent and small business customers	• Share of customers with financial plans	• 2003 5%
Internal 	Identify targeted affluent and small business relationships. Ensure a current account profile is in place for each	• Share of affluent and SB customers with two or more products.	• 2003 60%
Learning & Growth 	Retain the High Performing Talent (levels 10 – 12)	• Retention rate	• 2003 95%

Figure 5. The executive BSC defines expectations and measures contribution

Balanced Scorecard Business Systems

Immediate access to high-quality business information is imperative for enterprise *visibility*. At most large enterprises, the best information executives have about the state of their business comes from the close of the preceding quarter. However, without access to the current state of their business, executives risk making decisions that solve yesterday's problems, not today's. To exercise good governance and meet regulation demands, executives need access to timely, relevant, and accurate information across the organization. Only a business system with a complete set of integrated business intelligence and analytics can provide managers with continuous, current, customized information.

Enterprise *control* is necessary to provide information based on standardized processes and procedures. With effective control, executives can avoid careless accounting practices, enable compliance through documented business practices and procedures, implement their vision and business strategies, and find and fix discrepancies proactively. To control the enterprises more effectively, executives need to centralize and secure policies, processes, and procedures across the organization. Business systems can help streamline the transparency of policies and procedures, enforce them, reduce the risk of malfeasance and errors, and improve confidence in business data.

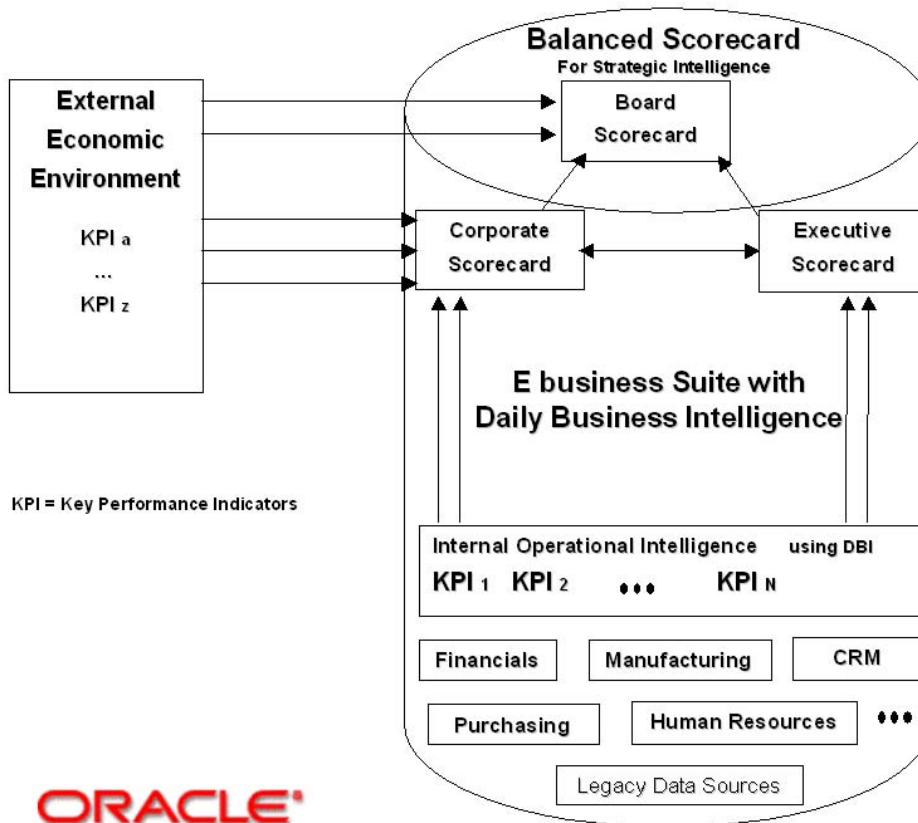
This Balanced Scorecard-based approach to corporate governance is highly dependent upon reliable and timely information. Directors and executives need timely access to the right strategic information if they are to fulfill their



responsibilities. Therefore, the linkage of strategy, measurement, targets, funding and risks across common dimensions of comparison for management reporting is critical. A common calendar for specific period-to-date summaries and the use of common reporting dimensions like 'line of business', customer and trading partner are required for alignment, accuracy, and visibility; all are necessary for improving corporate governance.

The Oracle E-Business Suite, with its unified data model, and its Daily Business Intelligence (DBI) reporting layer deliver pre-built reporting for various functional roles within corporations. Additionally, using the Oracle Balanced Scorecard, with access to pre-defined DBI performance indicators, means that companies can begin using Balanced Scorecard metrics for Oracle application sources, *without* performing an ETL (Extraction Transformation and Load) process to get started. This gives a strategic time and cost advantage to corporations deploying corporate governance solutions. Furthermore, using Oracle's integrated workflow, you reduce the risk of malfeasance and accidental errors by streamlining inter-user approvals and participation in review processes.

Oracle provides a strategic foundation for broad-scale corporate governance, through its integrated set of Business Intelligence tools using 9iAS Application Server, 9i Database, and the E-Business Suite of applications and Oracle Balanced Scorecard.



Best Practices in Corporate Performance Management and Corporate Governance

Figure 6. Oracle Architecture for Applications and Daily Business Intelligence including Balanced Scorecard

Conclusion

Directors and executives have separate but complementary roles in promoting well governed high performing organizations. When supported by cohesive information architecture as described above, the three-part Balanced Scorecard based system outlined in this paper offers a modern set of tools that enable leaders to better fulfill their distinct roles. As such, directors and executives achieve greater visibility and control of their organizations. They also have the information they need to make better decisions and they have the information safeguards to offer more reliable disclosures with confidence. This tools-based approach provides corporate leaders with insight, alignment and confidence to effectively govern and grow shareholder value.