



# BALANCED SCORECARD FOR STATE-OWNED ENTERPRISES

Driving Performance and  
Corporate Governance

Edited by  
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With contributions from  
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Asian Development Bank

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A study on the benefits of adopting the Balanced Scorecard methodology  
to measure and improve performance

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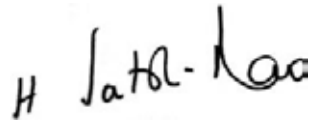
# Foreword

The Asian Development Bank (ADB) is pleased to present this book on performance management and corporate governance, the culmination of more than 3 years of research and analytical work. The book is important for a number of reasons:

- First, it focuses on putting in place a framework for governments to strategically manage the organizations that they own and control. It introduces a methodology by which governments can (i) set strategic goals for their state-owned enterprise (SOE) sectors; (ii) measure progress toward achieving those goals; and (iii) stimulate their SOEs to improve performance through improved performance management.
- Second, it represents an attempt to focus attention on the responsibilities of governments to maximize the financial and nonfinancial performance of enterprises entrusted to their control.
- Third, the book presents eight different case examples in which this methodology is applied. These cases range from a national government operating through an agency to state-owned holding companies to individual SOEs.

The book grew out of an ADB-financed technical assistance project, the purpose of which was to further develop a Chinese performance measurement system that had been in place since 1999. The performance measurement system described herein is part of a broader approach toward stimulating an improvement in performance management effectiveness throughout the SOE sector. The book is a valuable contribution to our knowledge of the measurement and management of performance in both market and transitional economies.

It should be useful to enterprise managers, government leaders, bankers, policymakers, and development partners. The book will hopefully trigger further work and fresh approaches toward maximizing the contributions of government-owned corporations in Asia and the Pacific and beyond.

A handwritten signature in black ink, reading "H Satish Rao". The signature is written in a cursive, slightly slanted style.

H. Satish Rao  
Director General  
East Asia Department  
Asian Development Bank

# Table of Contents

Foreword .....	iii
Introduction .....	vii
Acknowledgments.....	ix
Abbreviations .....	xi
Chapter 1 – Introduction to the Balanced Scorecard and Performance	
Measurement Systems .....	1
The Balanced Scorecard .....	2
Activity-Based Management (ABM) .....	6
Economic Value Added (EVA).....	8
Quality Management.....	10
Customer Value Analysis and CRM.....	11
Performance Prism .....	12
Chapter 2 – Balanced Scorecard in Developed and Transitional Economies.....	15
Use of the Balanced Scorecard in Developed Countries.....	17
The People’s Republic of China’s First Use of the Balanced Scorecard .....	20
Three SOE Balanced Scorecard Case Studies .....	21
Chapter 3 – Balanced Scorecard Development for Individual State-Owned	
Enterprises (SOEs) .....	29
Determine Your Mission, Vision, and Strategic Focus .....	30
Link Enterprise Strategy to the Balanced Scorecard via a Strategy Map .....	38
Select Appropriate Measures for each Balanced Scorecard Objective .....	44
Cause-and-Effect Analysis of Objectives and Measures.....	48
Cascade your Balanced Scorecard to Subsidiaries and Other Business Units .....	51
Periodically Review Your Balanced Scorecard and Enterprise	
Strategy and Update.....	53

Chapter 4 – Balanced Scorecard Development for the Government Shareholder.....	59
Developing a Government Strategy for Managing SOEs.....	61
The People’s Republic of China’s Experience with Setting an Overarching SOE Strategy .....	64
Creating a Scoring Methodology for the Balanced Scorecard .....	68
Chapter 5 – Corporate Governance as an Internal Process Objective.....	73
Corporate Governance Rating Systems.....	77
Country “SOE Corporate Governance Rating Indexes” .....	80
Germany’s Corporate Governance Scorecard for Listed Companies.....	81
People’s Republic of China’s SOE Corporate Governance Rating Index (CGRI) .....	82
Brief Explanation of each Category of the Chinese CGRI .....	85
Chapter 6 – Managing SOEs for Improved Performance.....	89
Strategy Management Survey.....	89
Strategy Management Process: Describe, Measure, Align, and Manage.....	91
Three PRC SOE Cases of Balanced Scorecard Deployment for Strategy Management.....	93
Award-Winning Case: China Resources Microelectronics—First PRC Winner of the BSC Hall of Fame.....	100
Chapter 7 – Summary and Conclusions.....	105
Appendix 1 – ABC Bank’s Modified Strategy Map and Balanced Scorecard .....	109
Appendix 2 – DVFA Scorecard for German Corporate Governance .....	111
Appendix 3 – Sample Listing of Chinese Corporate Governance Legal Framework .....	117
Appendix 4 – CGRI Index for Non-100% Chinese Government-owned Companies.....	119
References .....	133
About the Editors and the Contributor.....	135

# Introduction

This book is written to expand the benefits of the Balanced Scorecard (BSC) Methodology for strategic management from developed economies to transitional economies. Specifically, it provides a road map for governments and enterprise managers to adopt a performance management system (the BSC) in order to drive improvements in performance management and corporate governance among their state-owned enterprises (SOEs, also referred to by some as public-sector enterprises).

The BSC is the most widely adopted methodology in use today for the measurement and management of performance—both in the corporate world and in the nonprofit and government sectors. The BSC has also been ranked recently as one of the most important management concepts in the last 75 years by the Harvard Business Review. Moreover, it incorporates best practices from previous enterprise management systems developed over the last 40 years.

Governments and SOEs around the world are financially and resource constrained, yet governments and the SOEs they control are being called upon to provide better services to more people—often for cheaper prices. Considering that the BSC has helped countless organizations achieve strategic alignment, increase productivity, and become globally competitive, it follows that governments should learn about and adopt this important tool for the strategic management and improved corporate governance of enterprises.

Government officials, especially those in transitional economies, may not yet have learned much about enterprise performance measurement. Thus, Chapter 1 of this book provides an overview of the BSC and performance measurement systems. The use of BSC—the most widely used approach to performance measurement—is then more fully explained in Chapter 2. The BSC is a best practice tool, yet it can be used for much more than merely measuring performance at the enterprise level. It is widely used globally for managing enterprise performance in order to achieve improved strategic results. Chapter 2 includes several early case studies of successful deployments of the BSC among SOEs in the People's Republic of China (PRC) as a system for measuring, managing, and improving strategic performance.

Chapter 3 provides the framework for individual SOEs to adopt enterprise BSCs, either based on their government's overall SOE strategy or in isolation—should their government not be in a position to articulate an overall SOE strategy or scorecard. Chapter 3 describes, more specifically, the approach used in the PRC to measure, manage, and review performance in order to achieve improved strategic results.

Chapter 4 describes a process by which governments may adopt the BSC to measure, control, and strategically manage their SOE sectors. It is noteworthy that Chapter 4 deals with adopting a BSC to measure the performance of a portfolio of SOE enterprises, rather than an individual SOE. The chapter focuses governments on determining an overarching strategy for their SOE sectors, rather than setting the strategy of a single organization. This use of the BSC by countries and governments for their SOE sectors is a major, landmark evolution in the use of the BSC Methodology. This is the first book to describe and advocate use of the BSC approach for this purpose and, therefore, represents a milestone in the evolutionary development of the BSC approach to strategic management.

Because corporate governance is an area of increased focus for transitional economies, Chapter 5 suggests two steps that governments may take to improve the corporate governance of their SOEs. One step is to create a code of corporate governance for SOEs and the second step is to create a corporate governance rating index (CGRI). Chapter 5 provides two examples of CGRIs (one in Germany and another in the PRC) and describes how a CGRI can be adapted for use as an internal process measure in a BSC. The CGRI can also be used as a stand-alone tool for improving corporate governance.

Chapter 6 provides advice to governments and SOE managers who may be considering adopting the BSC as a measurement tool. The BSC Methodology enables much more than performance measurement. This chapter explains how to go beyond measurement to actually improving management of strategic performance at the level of holding companies and subsidiary enterprises. The content of Chapter 6 is based on lessons learned: (i) globally over the last 15 years by organizations specializing in deploying the BSC, and (ii) over the last 10 years in the PRC since the BSC was first introduced there in 1996. This chapter provides insights into what enterprises and governments need to do to measure, manage, and sustain improved SOE performance after adopting the BSC Methodology. Four case studies—including a more extensive case description about the PRC's first winner of the global Balanced Scorecard Hall of Fame for Executing Strategy™ (China Resources Microelectronics)—are presented.

Chapter 7 concludes the book by summarizing the information presented and offering some additional conclusions based on the research and experience of the authors.



# Acknowledgments

This book is based, in part, on the work performed to implement a Technical Assistance (TA) Project for the Asian Development Bank (ADB), TA No. 3933-PRC: Improving Corporate Governance and Financial Performance of SOEs. This project was implemented by BearingPoint ([www.bearingpoint.com](http://www.bearingpoint.com)) in collaboration with eGate Consulting ([www.egate-china.com](http://www.egate-china.com)) and Dayue Consulting Beijing ([www.dayue.com](http://www.dayue.com)).

The content of this book benefited tremendously from the work performed by the Project Team, which included the following members: Mr. Christian C. Johnson (Team Leader) of BearingPoint; Dr. Irv Beiman of eGate Consulting; Dr. John Thompson of the Organisation for Economic Co-operation and Development (OECD); Mr. Frank (Ligun) Zheng of Dayue Consulting; and Mr. Liao Jiasheng, Mr. Sun Qinghong, and Mr. Sun Jianwei of the People's Republic of China's (PRC) State-owned Asset Supervision and Administration Commission (SASAC), the representative owner of the PRC's most important state-owned enterprises (SOEs). Mr. Geoffrey Elkind was the BearingPoint Project Manager for the TA Project. Ms. Shen Ying and Ms. Xu He provided substantial valuable input and direction throughout the course of the TA Project. Focused training in the Balanced Scorecard (BSC) approach was provided to groups of SASAC managers in the PRC, Australia, and Germany by Dr. Yong-Ling Sun of eGate Consulting. These two overseas educational trips were organized and implemented by BearingPoint, with support from Dayue Consulting.

The seven case studies presented in Chapters 2 and 6 are drawn from the experience of Dr. Irv Beiman and his work as Chairman of eGate Consulting, including 10 years experience in applying the BSC in the PRC.

Chapter 5 was developed based on consultations with Dr. John Thompson, who was one of the original members of the ADB TA Project 3933-PRC team. Importantly, Appendix 4 (CGRI Index for Non-100% Chinese Government-Owned SOEs) is largely attributable to Dr. Thompson's more than 20 years of experience at OECD .



# Abbreviations

ABC	-	Activity-Based Costing
ABM	-	Activity-Based Management
ADB	-	Asian Development Bank
APEC	-	Asia-Pacific Economic Cooperation
BSC	-	balanced scorecard
BScol	-	Balanced Scorecard Collaborative
CCTEC	-	Continuous Casting Technology Engineering Company
CGRI	-	Corporate Governance Rating Index
CVA	-	Customer Value Analysis
CRM	-	Customer Relationship Management
DVFA	-	The Society of Investment Professionals in Germany
EFQM	-	European Foundation for Quality Management
EPES	-	Enterprise Performance Evaluation System
ERP	-	enterprise resource planning
EVA	-	economic value added
GM	-	General Manager
GMI	-	Governance Metrics International
ISS	-	Institutional Shareholder Service
IT	-	information technology
KPI	-	key performance indicator
MBO	-	management by objective
OECD	-	Organisation for Economic Co-operation and Development
OSM	-	Office of Strategy Management
PRC	-	People's Republic of China
ROE	-	return on equity
S&P	-	Standard & Poor's
SASAC	-	State-owned Assets Supervision and Administration Commission
SBU	-	strategic business units
SOEs	-	state-owned enterprises
TCL	-	The Corporate Library
TOR	-	Terms of Reference that contains the specific deliverables for the Project
TQM		Total Quality Management
WTO	-	World Trade Organization



## Chapter 1

# Introduction to the Balanced Scorecard and Performance Measurement Systems

by Christian C. Johnson

From the beginning, it is important to understand why measuring an organization's performance is both necessary and vital. An organization operating without a performance measurement system is like an airplane flying without a compass, a Formula One race car driver guiding his car blindfolded, or a CEO operating without a strategic plan. The purpose of measuring performance is not only to know how a business is performing but also to enable it to perform better. The ultimate aim of implementing a performance measurement system is to improve the performance of an organization so that it may better serve its customers, employees, owners, and stakeholders.

If one “gets” performance measurement right, the data generated will tell the user where the business is, how it is doing, and where it is going. In short, it is a report card for a business that provides users with information on what is working well and what is not. With this in mind, Chapter 1 provides an overview of the various performance measurement systems used today by enterprises to drive improvements in overall organizational performance.

A performance measurement system enables an enterprise to plan, measure, and control its performance according to a pre-

A performance measurement system enables an enterprise to plan, measure, and control its performance according to a pre-defined strategy

defined strategy. In short, it enables a business to achieve desired results and to create shareholder value.

The major performance measurement systems in use today are profiled below (in order of global adoption) and include

- The Balanced Scorecard
- Activity-based Costing and Management
- Economic Value Added (EVA)
- Quality Management
- Customer Value Analysis/Customer Relationship Management
- Performance Prism

## THE BALANCED SCORECARD

The balanced scorecard (BSC) is the most widely applied performance management system today.<sup>1</sup> The BSC was originally developed as a performance measurement system in 1992 by Dr. Robert Kaplan and Dr. David Norton at the Harvard Business School. Unlike earlier performance measurement systems, the BSC measures performance across a number of different perspectives—a financial perspective, a customer perspective, an internal business process perspective, and an innovation and learning perspective.

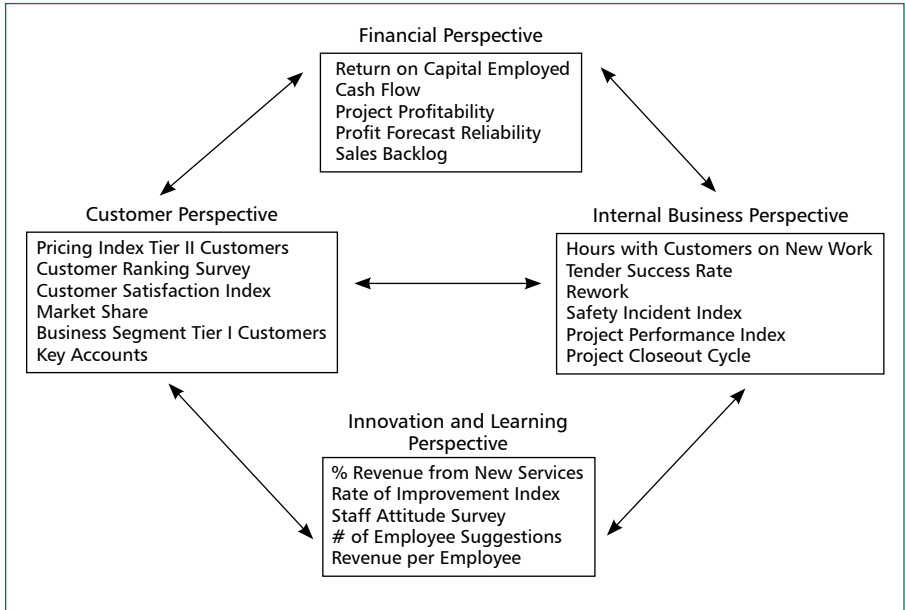
Through the use of the various perspectives, the BSC captures both leading and lagging performance measures, thereby providing a more “balanced” view of company performance. Leading indicators include measures, such as customer satisfaction, new product development, on-time delivery, employee competency development, etc. Traditional lagging indicators include financial measures, such as revenue growth and profitability. The BSC performance management systems have been widely adopted globally, in part, because this approach enables organizations to align all levels of staff around a single strategy so that it can be executed more successfully.

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<sup>1</sup> We will use the acronym BSC as a substitute for spelling out Balanced Scorecard. This saves space and is easier on the reader.

An example of a BSC is shown below:

Figure 1: Example of a Balanced Scorecard



Source: Kaplan and Norton. Putting the Balanced Scorecard to Work. Harvard Business Review. September-October 1993.

Organizations have adapted the BSC to their particular external and internal circumstances. Both commercial and not-for-profit organizations have successfully used the BSC framework. Since 1992, Drs. Kaplan and Norton have studied the success of various applications of the BSC in different types of organizations. Companies have used as few as four measures and as many as several hundred measures when designing a BSC performance measurement system. Based on this research, it has been found that a BSC framework using about 20–25 measures is the usual recommended best practice. Smaller organizations might use fewer measures, but it is generally not advisable to go beyond a total of 25 measures for any single organization, holding company, or conglomerate group of holding companies.

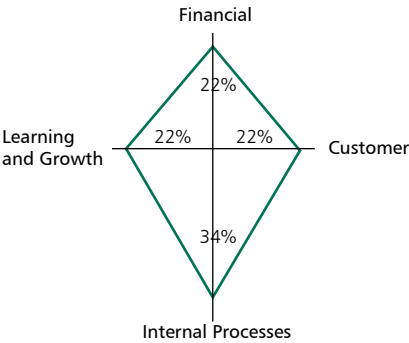


Figure 2:    Example an “Ideal” Balanced Scorecard

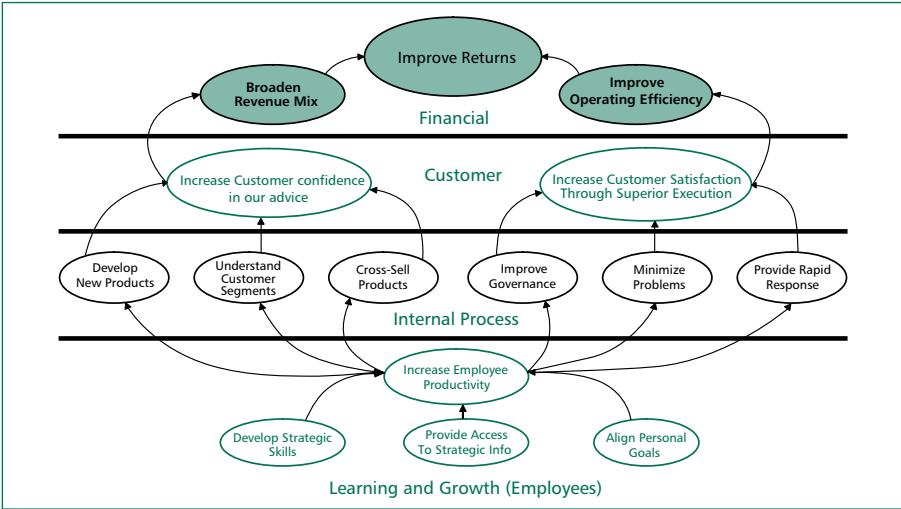
Perspective	#of Metrics	Weight
Financial	5	22%
Customer	5	22%
Learning and Innovation	5	22%
Internal Processes	9	34%
24 measures		100%

Source: Norton, David. 2000. Beware: The Unbalanced Scorecard.

Figure 2 is drawn from an article written by Dr. David Norton. The brief article explained the need for balancing the number of measures in all four perspectives, with greater emphasis on process measures, because the process perspective is the primary domain through which organizational strategy is implemented.

Eight years after introducing the BSC, Kaplan and Norton published an article entitled, Having Trouble with Strategy, Then Map It! The article introduced the concept of a “Strategy Map” to the BSC framework. A “Strategy Map” enables organizations to clarify their strategy and assist organizations with creating their BSC framework and measures. A generic corporate strategy map is provided below to illustrate the “Strategy Map” concept.

Figure 3:    Example of a “Generic” Strategy Map





As a result of continued research and innovations over the last 15 years, the BSC has gone through an evolutionary process of improvement, from performance measurement (1990–1996) to performance management (1996–2000), to becoming a globally recognized best practice for strategic management (2001–to present). In fact, the benefits a firm can obtain from properly implementing the BSC include

- Translating strategy into more easily understood operational metrics and goals;
- Aligning organizations around a single, coherent strategy;
- Making strategy everyone's everyday job, from CEO to the entry-level employee;
- Making strategic improvement a continual process; and
- Mobilizing change through strong, effective leadership.

Although thousands of companies have adopted and benefited from the BSC, it is the Balanced Scorecard Collaborative, Inc. (BSCol) that has taken a leadership role in the evolution of the BSC Methodology as it is adapted by more and more organizations globally. BSCol is a consulting, education, training, research, and development firm facilitating the worldwide awareness, use, enhancement, and integrity of the BSC as a value-added management process. BSCol is founded and led by the creators of the BSC concept, Dr. Robert Kaplan and Dr. David Norton. The company serves as a global center of BSC excellence and expertise. BSCol merged with two other firms in 2005 to form Palladium Group, Inc.—the largest global firm focused exclusively on strategy execution services.

The BSC Methodology has been in use for 15 years. Early adopters of the methodology were confined to developed markets of the United States/Europe and later Asia/Australia. Adoption of the BSC in transitional economies has been slow but growing as evidenced by the case studies contained in later chapters. More importantly, firms, including eGate Consulting and BearingPoint, are increasingly spreading best practices to both the governments and private sectors of emerging markets.

## ACTIVITY-BASED MANAGEMENT (ABM)

Traditional cost accounting permeates most organizations and is characterized by arbitrary allocations of overhead costs to items being produced. Typically, the company's total overhead is allocated to goods produced based on volume-based measures (labor hours, machine hours, etc.). The underlying assumption is that there is a relationship between overhead and the volume-based measure.

Activity-based costing (ABC) was developed to provide better insight into how overhead costs should be allocated to individual products or customers. Businesses that do not use ABC typically only make simple adjustments to allocate overhead costs that do not accurately fit elsewhere. Businesses that use ABC link expenses related to resources supplied to the company to the activities performed within the company. Through the use of ABC, expenses are allocated from resources to activities and then to products, services, and customers.

Activity-Based Management (ABM) is a discipline that focuses on the management of activities to maximize the profit from each activity and to improve the value received by the customer. This discipline includes cost-driver analysis, activity analysis, and performance measurement. ABM draws on ABC as its major source of information.

Using the ABC approach, companies get insights into profitable and profitless activities based on a customer or a product viewpoint. ABC then is a way of measuring which of the firm's activities generate revenues in excess of costs and, as a result, provide keen insight into what is really providing value for customers.<sup>2</sup> ABC is used by many organizations that implement the BSC because ABC enables businesses to more accurately define and measure their metrics (or, measures as referred to in later chapters).

Using the ABC  
approach,  
companies  
get insights  
into profitable  
and profitless  
activities based  
on a customer  
or a product  
viewpoint

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<sup>2</sup> Meyer, Marshall W. 2002. Finding performance: The new discipline of management. In *Business Performance Measurement: Theory and Practice*, edited by Andrew Neely. Cambridge University Press.

The figure below provides a window into the value of ABC vs. traditional accounting.

**Figure 4: Comparison of Traditional and ABC Accounting**

Traditional View		ABC View	
Salaries	\$375,000	Select Suppliers	\$82,000
Benefits	\$92,000	Procure Material	\$175,000
Supplies	\$47,000	Certify Vendors	\$92,000
Phone	\$8,500	Resolve Problems	\$103,500
Travel	\$13,000	Expedite Shortages	\$83,000
Total	\$535,500	Total	\$535,500

Firms that implement an ABC methodology are able to

- Identify the most and least profitable customers, products, and channels;
- Determine the true contributors to (and detractors from) financial performance;
- More accurately predict costs, profits, and resource requirements associated with changes in production volumes, organizational structure, and resource costs;
- More easily identify the root causes of poor financial performance;
- Better track costs of activities and work processes; and
- Provide front-line managers with cost intelligence to drive improvements.

While firms will likely benefit from ABC, the system is mainly an accounting and cost-based method of viewing and analyzing an organization and its activities. ABC also lacks the strategic and nonfinancial elements that are captured in the BSC. Thus, most successful firms use ABC to manage costs and gain insight into their internal competitive advantages. ABC is particularly valuable initially as a management accounting and reporting tool, but has also proved valuable as providing metrics for use in the BSC's internal process perspective. In other words, successful firms use ABC in combination with the BSC to drive the achievement of a firm's strategy and competitive advantage.

Successful firms use ABC in combination with the balanced scorecard to drive the achievement of a firm's strategy and competitive advantage

## ECONOMIC VALUE ADDED (EVA)

Stern Stewart Corporation developed in 1982 the Economic Value Added (or, more simply EVA) as an overall measure of organizational performance. EVA is both a specific performance measure and the basis for a larger performance measurement framework. According to Stern Stewart, EVA is a financial performance metric that is most directly linked to the creation of shareholder value over time.

The definition of EVA is net operating profit less an appropriate charge for the opportunity cost of all capital invested in an enterprise. Mathematically it is

$$\text{EVA} = \text{Net Operating Profit After Taxes} \\ - (\text{Capital} \times \text{Cost of Capital})$$

Since EVA is a single metric, it is complementary to the balanced scorecard and can be included in a balanced scorecard framework (for example, as a financial perspective measure)

EVA is designed to give managers better information and motivation to make decisions that will create the greatest shareholder wealth. Since EVA is a single metric (although it can cascade down and across an enterprise to evaluate the performance of specific investments) it is complementary to the BSC and can be included in a BSC framework (for example, as a financial perspective measure). Using EVA alone has been found to cause managers to invest in less risky, cost-reducing activities rather than in growth activities. Also, because it is a pure financial model, EVA does not serve as a vehicle for articulating a strategy. When coupled with the BSC, the trade-offs between short-term productivity improvements and long-term growth goals can be managed.<sup>3</sup>

Some criticize EVA as being a very complex framework that relies on complicated calculations. The “Cost of Capital” calculation is particularly difficult to calculate and prone to errors that lead to grossly misleading results. Also, EVA is not easily understood by the majority of employees because of its complex framework and calculations.

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<sup>3</sup> Kaplan, Robert. 2001. Integrating shareholder value and activity-based costing with the balanced scorecard. *Balanced Scorecard Report*. 15 January.

Consider a simplified calculation of EVA for an organization called “Firm A.” Suppose Firm A generated net profit after taxes of yuan (CNY)100 in 2006, and suppose that Firm A had capital (plant, equipment, cash, etc.) of CNY100,000, if one determines the prevailing cost of capital (both debt and equity) average 10% during 2006 in the areas where Firm A raises capital, we can calculate its “cost of capital” as being equal to 10% x CNY100,000 = CNY10,000.

The firm’s EVA would then equal –CNY9,900.

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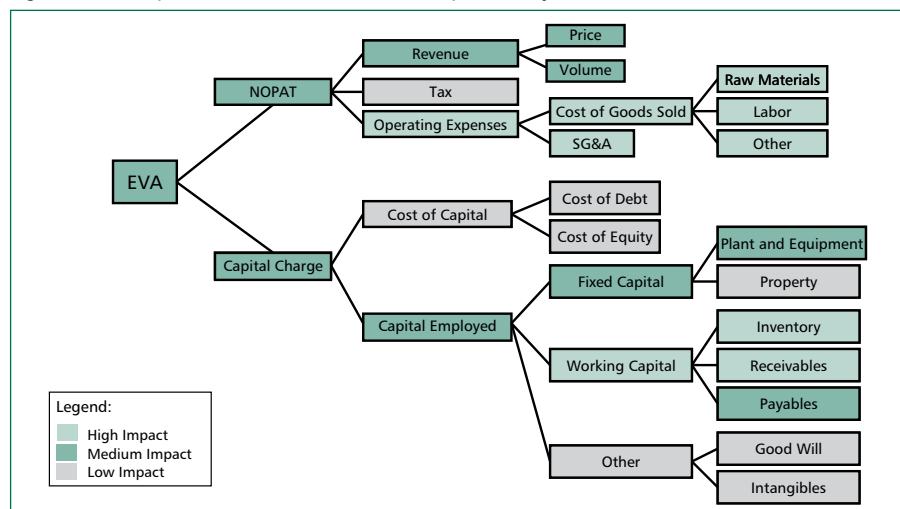

$$\begin{aligned}
 \text{EVA} &= (\text{Net Operating Profit After Taxes}) - (\text{Capital} \times \text{Cost of Capital}) \\
 &= \text{CNY}100 - (\text{CNY}100,000 \times 10\%) \\
 &= \text{CNY}100 - \text{CNY}10,000 \\
 &= -\text{CNY}9,900
 \end{aligned}$$


---

In other words, the firm *lost value* for its shareholders because the firm’s capital was not effectively invested and used.

A more detailed view of the EVA framework and impact analysis is provided below. The figure below (for a manufacturing organization) shows the areas that have the highest impact on EVA—those being operating expenses and working capital.

Figure 5: Example of a Framework for EVA Impact Analysis



Source: Demystifying EVA and EVA Implementation. Finegan and Company, LLC. Presentation at Icelandic Management Association. EVA Conference, November 16, 1999.

A major difficulty faced by firms implementing EVA is the calculation of the “cost of equity” and the “cost of debt.” As mentioned previously, small errors in this calculation can lead to grossly misleading results. For example, the cost of equity is easiest to measure for extremely liquid, publicly traded firms. Calculating the “cost of equity” for private firms or those with limited liquidity is difficult and inexact. Thus, firms that are not publicly traded tend to avoid EVA as a performance measurement system.

## QUALITY MANAGEMENT

Over the past few decades, many firms have adopted various quality programs, such as Total Quality Management (TQM), Six Sigma, European Foundation Quality Management (EFQM), and The Baldrige National Quality Program. Such Quality Programs aim to assist organizations to improve the quality of the manufacturing and service offerings. A central tenet for all of these programs is business performance measurement. For example, The Baldrige National Quality Program measures businesses in seven categories and the EFQM in nine.<sup>4</sup>

Although Quality Programs focus a firm on continuous improvement, they are not well suited to measuring relative

Table 1: Framework Comparison of Baldrige and EFQM Criteria

Baldrige Categories	EFQM Criteria
Leadership	Leadership
Human Resource Focus	People
Strategic Planning	Policy and Strategy
Process Management	Processes
Customer and Market Focus	Customer Results
Information and Analytics	Key Performance Indicators
Business Results	People Results, Society Results
	Partnerships and Resources

Source: Baldrige, *EFQM Publications*.

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<sup>4</sup> Kaplan, Robert S. and G. Lamotte. 2001. The balanced scorecard and Quality Programs. *Balanced Scorecard Report*. 15 March.

performance among differing enterprises in different industries. A 2001 *Balanced Scorecard Report* noted the differences and synergies between the Quality Frameworks and the BSC:

- The BSC emphasizes explicit causal links through strategy maps and cascaded objectives more than the quality programs do.
- The BSC programs rely on benchmarking approaches.
- The BSC sets strategic priorities for process enhancements.
- The BSC integrates budgeting, resource allocation, target-setting, reporting, and feedback on performance into ongoing management processes.
- These elements enable the BSC to be a central management tool for an upgraded and more effective performance measurement system and *strategy management process*.

## CUSTOMER VALUE ANALYSIS AND CRM

Customer Value Analysis (CVA) and Customer Relationship Management (CRM) techniques are enabling businesses to improve performance, to measure that improvement, and to focus a firm on the value of its customers. Moreover, CVA and CRM technologies are providing firms with better data integration and, hence, better measurement regarding customers.

Given the obvious strategic importance of customers, it is natural for businesses to begin exploring more robust ways of measuring customer and business activities directly related to customers. For example, the Baldrige National Quality Award includes a customer focus and satisfaction criteria, which contribute to about 30% of the overall score for the award.

Several CVA/CRM frameworks have evolved over the years. One illustrative framework decomposes the customer problem down to three top-level areas (with further decomposition beneath each of the three):<sup>5</sup>

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<sup>5</sup> Rust, Roland T., V.A. Zeithaml, and Katherine E. Lemon. 2000. *Driving Customer Equity*. The Free Press.

1. Value equity refers to the customers' perceptions of value
2. Brand equity refers to the customers' subjective appraisal of the brand
3. Retention equity refers to the firm building relationships with customers and encouraging repeat-purchasing

These three areas correspond to three distinct disciplines in the CVA/CRM and marketing literature (brand management, customer value analysis, and customer loyalty analysis)—each with its own detailed measurement approaches. The implications for organizational performance measurement systems are clear: measuring business activities and outcomes regarding customers is becoming increasingly complex and increasingly important to the successful execution of a firm's strategy.

Proponents of the BSC note that the BSC framework includes the customer as one of four perspectives, while CVA and CRM techniques fail to account for important noncustomer aspects of a business. That being said, CVA and CRM are often used by BSC practitioners to drive improvements in the customer perspective of the BSC. In other words, the benefits of CVA and CRM technologies are increasingly used in a BSC framework evaluation.

## PERFORMANCE PRISM

The  
"Performance  
Prism" is an  
example of a  
"customized"  
balanced  
scorecard  
framework

Many alternative and "customized" frameworks continue to be developed based on the breakthrough BSC framework developed by Kaplan and Norton in 1992. The "Performance Prism" is an example of one such "customized" BSC framework.

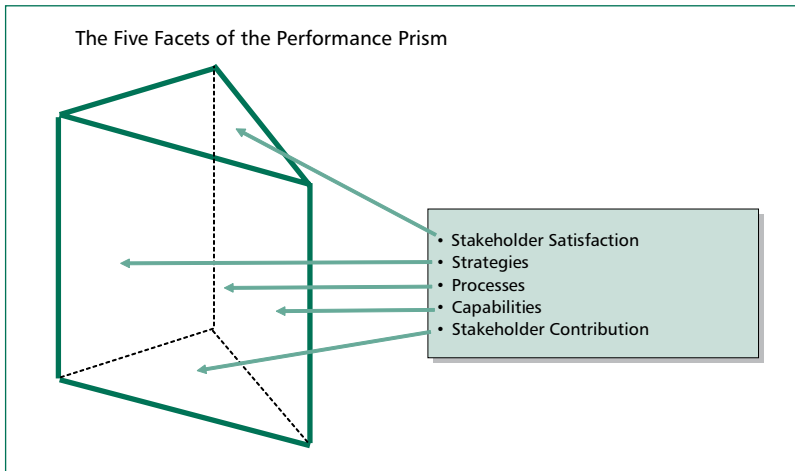
In the "Performance Prism," companies view their organizations from five perspectives, rather than the four traditional perspectives of the BSC. These five perspectives are

- Stakeholder Satisfaction – *Who are the key stakeholders and What do they want and need?*
- Strategies – *What strategies do we have to put in place to satisfy the wants and needs of these key stakeholders?*



- Processes – *What critical processes do we require if we are to execute these strategies?*
- Capabilities – *What capabilities do we need to operate and enhance these processes?*
- Stakeholder Contribution – *What contributions do we require from our stakeholders if we are to maintain and develop these capabilities?*

Figure 6: Illustration of the Five Facets of the “Performance Prism”



Source: Perspectives on Performance: The Performance Prism. Professor Any Neely, Cranfield School of Management, Undated Paper.  
<http://www.som.cranfield.ac.uk/som/research/centres/cbp/downloads/prismarticle.pdf>

The “Performance Prism” is relatively new, having been developed by a major consulting firm and the Cranfield School of Management in 2000. Its first significant implementation was in 2001, and it illustrates the flexibility of the BSC framework to be adapted and applied to the various needs of businesses.



## Chapter 2

# Balanced Scorecard in Developed and Transitional Economies

by Irv Beiman and Christian C. Johnson

The Balanced Scorecard (BSC) was created by Harvard Business School Professor, Dr. Robert Kaplan, and his partner, Dr. David Norton. It continues to evolve through the work of Drs. Kaplan and Norton and the consultants of Palladium and the Balanced Scorecard Collaborative, as well as other consulting firms and the companies that use the BSC to create improvement in enterprise business performance.<sup>6</sup> Palladium is now the largest global firm focused exclusively on strategy execution.<sup>7</sup>

More than 100 books have been written about the BSC, but this book is the first to be focused on the use of the BSC framework for state-owned enterprises (SOEs) in transitional countries. The Balanced Scorecard Collaborative ([www.bscol.com](http://www.bscol.com)) online bookstore lists 48 books on various aspects of the BSC.

The proven benefits of using the BSC Methodology is consistent with numerous government objectives for their SOEs, including

- improving enterprise profitability;
- providing guidance to enterprise managers using modern management concepts, methods, and tools;

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<sup>6</sup> eGate Consulting ([www.egate-china.com](http://www.egate-china.com)) is a member of the Balanced Scorecard Collaborative and partnered with BearingPoint ([www.bearingpoint.com](http://www.bearingpoint.com)) on ADB TA-3933.

<sup>7</sup> See [www.palladiumES.com](http://www.palladiumES.com).

- stimulating identification, analysis, and resolution of problems interfering with improvement of enterprise performance; and
- building consensus and improving communication among management, employees, and stakeholders.

The BSC has a dynamic history over the last 15+ years. The BSC approach has gone through several stages of evolutionary development:

- From 1990 to 1996, the focus was more on how to use the BSC to *measure* performance;
- From 1996 to 2000, the focus shifted toward improving the *management of performance* at the organizational level;
- From 2000 up to the present time, the BSC Methodology has evolved into a clear, ongoing, and replicable process for *strategic management*.

The BSC and its associated management tools are now being used not only in developed economies, but in transitional economies as well. Having been successfully used to drive alignment and strategic results in the private sector, governments are increasingly using the BSC in government organizations and SOEs as part of an integrated strategy management process. (Later chapters review recent case studies that illustrate how various types of SOEs use BSC tools to describe, measure, align, and manage their strategies.)

The four key aspects of strategy management are



- **Describe the strategy** in a strategy map that illustrates key objectives in four perspectives;

- **Measure the strategy** via a BSC that includes objectives, measures, targets, and strategic initiatives;



- **Align the organization(s) with the strategy** by cascading the strategy map vertically downward throughout the organization and building cross- functional/cross-organizational alignment through shared strategic themes and objectives; and



- **Manage the strategy** in an ongoing process that includes periodic strategy review sessions, plus establishing linkages of the strategy with budgeting, human resources policies and practices, and information technology.

## USE OF THE BALANCED SCORECARD IN DEVELOPED COUNTRIES

As indicated previously, the BSC is the most widely used organizational system in the world for measurement and management of enterprise business performance. The BSC is used by more than 70% of the Fortune 500 companies. Additionally, numerous studies and BSC implementations have proven the effectiveness of the BSC. For example,

The balanced scorecard is used by more than 70% of the Fortune 500 companies

- Mobil Oil (North America) increased cash flow by \$1.2 billion and return on investment from 6% to 16% between years 2 and 5 after implementing the BSC. Within 2 years of implementing the BSC, Mobil moved from last place in industry profitability to first place. Mobil North America held that first place position for 5 straight years, before it was acquired by Exxon.
- UPS (United Parcel Service) increased revenues by 9% and net income by 33% within two years after BSC implementation.
- Three years after implementing the BSC, Wells Fargo Bank increased its customer base by 450% and was rated the Best Online Bank. Also, as a result of the BSC implementation, the company added 750,000 online customers over a 2-year period and decreased its costs per customer by 22%.
- Chemical Bank increased its group company profits 20-fold over a 4-year period after implementing the BSC. The Chemical Bank Vice-Chairman, Michael Hegarty, (of what is now Chase Manhattan Bank) stated: *"The balanced scorecard has become an integral part of our change management process, enabling us to look beyond financial measures and concentrate on factors that create economic value: quality, organizational learning, and focusing on customers. The scorecard has delivered on our major goals in communication, teamwork, learning, and commitment."*

- The world famous advertising firm Saatchi and Saatchi achieved a five-fold increase in market capitalization to \$2.5 billion within 3 years of implementing the BSC. The company—which won major awards at the Cannes International Advertising Festival, the leading industry benchmark—was ranked as the #1 creative agency 2 years in a row after implementing the BSC. William H. Cochrane, Chief Financial Officer, stated: *“The balanced scorecard has not only helped us manage our human capital, it has transformed our agencies into being action-oriented and client-focused. And it has put everyone in the same ballpark with a consistent definition of what we call ‘permanently infatuated clients’ and consistency in measures.”*
- Texaco Refining and Marketing increased profitability by \$29 million in 1 year—a 1,500% return on investment from their BSC initiative. Al Derden, Director of Quality and Productivity, stated: *“If we truly believed that the only difference between our competition and ourselves was our people, then we had to find a way to tap into what Federal Express CEO Frederick W. Smith described as ‘discretionary effort.’* Texaco used the BSC Methodology’s five principles for creating a Strategy Focused Organization to mobilize and focus this “discretionary effort.”
- Siemens IC Mobile increased sales 76% to euro (€)9 billion within 1 year of BSC implementation. Rudi Lamprecht, member of the managing board at Siemens AG and President of Siemens IC Mobile, stated: *“We’ve always had strategies, but through the balanced scorecard we bring them to life.”*

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focus

Increasingly, the BSC is being used by non-profit, government, and state-owned companies to improve performance and achieve strategic alignment and focus. For example, Dubai in 1997 began designing an automated BSC system to monitor the performance of Dubai government departments. The PRC, Thailand, Malaysia, and Fiji are also among the transitional governments using the BSC to monitor and improve performance. The BSC is also a popular management tool for public sector enterprises in the United States, Australia, the United Kingdom (U.K.) and Scandinavia. For example,

- The US Postal Service (USPS) first implemented the BSC in 1996. Since then, USPS has been able to increase on-time delivery of mail by 20%, increase productivity by almost 3% per year while decreasing overall employment by full-time equivalent (FTE) of 60,000, increase employee and customer satisfaction, and deliver mail at rates a about half those of Germany or Japan.
- The Defense Accounting and Finance Service (DFAS) of the US Department of Defense first implemented the BSC in 2001. Since then, DFAS has been able to increase customer satisfaction by an average of 2% per year; increase employee satisfaction by 14%; reduce overall employment by 30%; cut its federal budget allocation by half and, most importantly, align and clarify its mission to its customers, employees, and managers.
- The UK Ministry of Defense implemented the BSC in April 2000. The Ministry is one of the largest government departments in the United Kingdom, with a budget of £25 billion or 2.5% of GDP; it employs more than 300,000 military and civilian personnel and has fixed assets of £87 billion.

As a part of the UK Government's wider modernizing agenda, in April 2000, the Ministry released its first BSC that established clear strategic goals, targets, measures, and initiatives. The results have been clear and visible: simplified strategic objectives, better communication of strategic intent, improved resource allocation, greater accountability, better decision making, and enhanced military capability and readiness.

The BSC has also been used successfully in some transitional economies, particularly the People's Republic of China (PRC). The most important success factor for these BSC projects in the PRC has been the top executive's commitment and support for implementation of the BSC Methodology. This requirement and other important success factors were summarized in a recently published management book in both Chinese and English language

versions by Dr. Irv Beiman and Dr. Yong-Ling Sun: *Balanced Scorecard and Strategy Execution: Applications in China* (Beijing: China Machine Press, 2003).<sup>8</sup>

The book introduces readers to the BSC as it can be applied to the varied challenges and unique aspects facing organizations in the PRC. The book includes chapters on measuring performance objectives; creating horizontal and vertical alignment; and integrating the BSC with business process improvement, human resource systems, leadership and change management. The final chapter offers predictions about how the BSC is likely to evolve in the PRC based on scientific application of the methodology.

To provide some insights into the application of the BSC in emerging markets, four case studies of BSC implementations in the PRC are provided below.

## PRC'S FIRST USE OF THE BALANCED SCORECARD<sup>9</sup>

The BSC has been in use in the PRC since 1996. In 1996, the largest food company in the world sought consulting support for an organizational transformation project in its PRC operations. The project included multiple elements: localization of the General Manager, BSC deployment, business process improvement, management development, team building, and culture change.

The BSC was the central organizing framework and system for creating focus and alignment within an organization that was challenged by numerous growth opportunities and conflicting stakeholder needs. The project was successful, as the General Manager position was localized on schedule, the BSC was deployed successfully, and profitability was established.

The BSC assisted the senior management team to identify key customer needs and the critical process improvements necessary for meeting those needs. Additionally, the management team identified

The balanced scorecard was the central organizing framework and system for creating focus and alignment within an organization that was challenged by numerous growth opportunities and conflicting stakeholder needs

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<sup>8</sup> This book may be ordered online. The web link to the online bookseller can be found at [www.egate-china.com](http://www.egate-china.com) > thought leadership > books.

<sup>9</sup> This case is summarized in *Balanced Scorecard and Strategy Execution: Applications in China*, by Dr. Irv Beiman and Dr. Yong-Ling Sun.



the learning and growth objectives critical to achieving the desired process improvements. This linkage of learning, process, customer, and financial objectives was central to implementation of the BSC Methodology.

As a result of the implementation, the management team improved the organization's overall performance and profitability by focusing on objectives in the four perspectives of the BSC. These improvements were a critical success factor that enabled the organization to be sold to an even larger global consumer products company.

### THREE SOE BALANCED SCORECARD CASE STUDIES

Three SOE case studies of BSC implementations are summarized below to provide an overview of the challenges and opportunities SOEs can expect when seeking to adopt this management tool as a means to improve performance. Please note that these are “early” case studies in the PRC. After a short period of time, more sophisticated approaches for SOEs have been developed in the PRC and are described in Chapter 6 of this book. It is noteworthy that SOEs in the PRC have learned and adapted so quickly to this best practice management tool.

#### SOE Balanced Scorecard Case Study 1: Improving Performance Management at Jinshan Telecom<sup>10</sup>

Jinshan Telecom is a branch unit of China Telecom (an SOE). Jinshan Telecom has four sections, 17 substations, and more than 20 retail service offices. In 2001, Jinshan's performance measurement and appraisal system did not reflect the company's strategic priorities. Jinshan Telecom's Key Performance Indicators (KPIs—another term used to describe the “measures” were not linked to the company's strategy. Each employee at Jinshan had 30–50 KPIs for which the

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<sup>10</sup> Reported by Mr. Xia Pei Yun, General Manager of Jinshan Telecom, in a presentation entitled, “Using the BSC to Implement Performance Management”, at the *First BSC Forum in China*, Shanghai Jin Mao Conference Center, 19 December 2003.

employee was responsible. The numerous KPIs deterred employees from focusing on what was most strategically important. Moreover, it was difficult for the company to analyze, consolidate, or discuss the KPIs in management's efforts to execute their strategy more effectively.

Further investigations found that Jinshan Telecom's cross-departmental teamwork and cooperation was weak. The existing performance appraisal system lacked focus and did not align the organization horizontally across sections. The eGate consulting team assisting Jinshan was told by several managers that many of the KPIs were difficult (or impossible) to accurately measure, and that the performance appraisal system had become a formality that provided no real value. This can be a common situation in the PRC.

As a result of using the BSC Methodology, Jinshan Telecom's top management developed a clearer understanding of the Group Company's business strategy and how it should be cascaded down throughout the organization. As a starting point in the project, the top management team agreed on Jinshan's strategic objectives and incorporated these objectives into a company-level BSC.

The resulting BSC for Jinshan Telecom was cascaded down to all departments and individuals. As a result, company employees had clearer objectives, measures, and performance "targets". Also, a variable pay incentive system was established while deploying the BSC Methodology. This led to an increase in employee motivation for improving business results. The company achieved significant improvements in vertical and horizontal alignment, as well as significant improvements in cross-departmental teamwork and cooperation as a result of its BSC implementation.<sup>11</sup>

Measurable improvements in quantitative performance, as reported by Mr. Xia Pei Yun, General Manager of Jinshan Telecom, included the following:

- Jinshan Telecom's 2003 growth rate was more than three times the Group Company's growth rate. Jinshan grew by 14%,

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<sup>11</sup> For an extensive discussion of organizational alignment issues and solutions in the PRC, see Chapter 7: Designing Organizational Alignment with BSC in *Balanced Scorecard and Strategy Execution: Applications in China*, by Dr. Irv Beiman and Dr. Yong-Ling Sun.

As a result of using the BSC Methodology, Jinshan Telecom's top management developed a clearer understanding of the Group Company's business strategy and how it should be cascaded down throughout the organization

compared to the Group Company's 4% growth rate (Jinshan was the first branch unit in the group company to deploy the BSC).

- Jinshan's superior growth rate was enabled by reaching or exceeding strategic performance targets in the Customer, Process, and Learning areas.
- Jinshan's results on five performance measures met or exceeded targets: Key Account Satisfaction, Commercial Account Satisfaction, Repair Cycle Time, Connection to Internet Success, and Implementation of Planned Trainings.

### SOE Balanced Scorecard Case Study 2: CCTEC – Continuous Casting Technology Engineering Co., Ltd.

CCTEC is a scientific and technology holding company formed by the China Metallurgy Construction Group. CCTEC is the largest continuous casting professional engineering company in the PRC. The company's core business activities include continuous casting, continuous casting and rolling, steel surface engineering, industrial auto control systems, etc. The company's mission is to create value for customers, shareholders, and employees through creative activities and to develop the company's business by developing its people.

In 2002 CCTEC had a large market share and positive customer recognition, but it was facing important challenges.

- Weak protection of intellectual property and low barriers to market entry had created significant low-price competition.
- Multinational companies were reducing their prices to the point they were approaching that of the low-price competitors.
- Management had recently developed a new strategy focusing on high-technology products and development of international markets. Implementation and execution of this strategy was proving to be difficult.
- CCTEC had hired many qualified technical professionals, from varied locations and cultural backgrounds. This led to different understandings and interpretations of the company's new strategy. There were also different interpretations of the

strategy at branch locations, such as Beijing and Anhui, which contributed to further difficulties and misunderstanding.

- As a result of these factors, the company leaders wanted a systematic management tool that would enable the company to clearly and consistently communicate its strategy and objectives to its various organizational units.

Late in 2002, CCTEC decided to implement the BSC Methodology with guidance from external consultants. The top management team clarified their strategy and formulated the company objectives for their BSC. For example, part of their strategy emphasized developing overseas markets, as well as enhancing their company culture.

CCTEC cascaded the company scorecard to different branch locations and to different functional departments. These units developed their own BSCs in a manner that was in alignment with and supported achievement of the company-level objectives. This cascading process emphasized improvement of cross-departmental communication and cooperation. CCTEC also implemented a variable pay system to support the company BSC project.

CCTEC's revenue in 2002 was yuan (CNY)150 million. Their revenue target for 2003 was CNY270 million—a targeted increase of 80%. With the help of the BSC, CCTEC's actual 2003 results exceeded their revenue target by more than 10%. After implementing the BSC, CCTEC achieved an annual revenue increase of more than 100% (to more than CNY300 million).

The CEO of CCTEC stated: *"The balanced scorecard is an excellent communication tool. We are a newly built company with employees from many different locations. Different cultural backgrounds make communication difficult. It is very important for our business to have smooth cross-departmental communication. The balanced scorecard helped us solve this problem and brought significant value to our company."*

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### SOE Balanced Scorecard Case Study 3: Strategic Change at First Level ABC Bank<sup>12</sup>

ABC Bank (the actual name of the bank is not provided to ensure confidentiality) was a successful first-level subsidiary of a Chinese state-owned bank. It had been ranked as the #1 performer among its parent bank's first-level subsidiaries for 4 consecutive years. It had also been ranked #1 in revenue growth and profitability among all competitors in the city where it was located.

ABC Bank had been successfully implementing its strategy of innovation and product leadership. It was the first bank in its home city to establish three special centers: for housing mortgages, for car loans, and for currency trading. These special centers had attracted many new customers.

ABC Bank had also created many new financial products for the private sector, including telephone banking, Internet banking, government bonds, foreign exchange products, stock investment banking cards, etc. The bank had established a reputation for product leadership. However, other state-owned banks in the local area had begun following ABC Bank's business model and competition was intensifying.

Despite its success, ABC Bank's business model did not promote a customer-focused approach. For example, a high net worth individual had to travel to one special center for a housing mortgage, and a different center for a car loan. Also, ABC Bank did not provide customers with total solutions, and the bank's culture was not focused on the customer. Another shortcoming was that ABC Bank did not maintain a customer database, as was the case with most Chinese banks. Moreover, departments and branches focused on their own specialty functions and responsibilities, without consideration of cross-departmental processes. While ABC Bank was focused on its financial goals, the bank had not yet identified goals in other areas, such as customer, process, and learning and growth.

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<sup>12</sup> This case was summarized by Dr. Yong-Ling Sun of eGate Consulting, and reported by Dr. Robert Kaplan in his 2 June 2003 Shanghai Seminar entitled, *Strategy Maps: The Continuing Journey of the Balanced Scorecard*.

The CEO of ABC Bank had led the bank from a new start up in 1999. He was an innovative leader, and frequently implemented new management ideas. He recognized that private banking provided significant growth potential and had learned that ABC needed to be more customer-focused so it could provide more complete solutions to its customers.

The CEO also realized ABC needed to focus on process improvement and employee competency development. The CEO read about the BSC Methodology, and he believed the methodology could help ABC implement an improved business strategy and create the necessary cultural change to implement the new strategy successfully.

Subsequent analysis suggested that three major external factors were important for the bank to consider for its new strategy:

1. The Post World Trade Organization (WTO) external business environment was becoming more competitive and market-oriented
2. Local competitors were attempting to rapidly change and improve
3. Customers expectations were changing and intensifying in three critical areas:
  - a. Customized financial solutions and total financial solutions
  - b. New products and services
  - c. Advisory financial services

This strategy map was used to identify the Bank's strategic themes and objectives, and to communicate the strategy to all managers and employees. (see Appendix 1)

ABC Bank sought consulting support for using the BSC to clarify and implement its new strategy. A strategy map was developed to describe the new strategy on a single page. Both ABC Bank's Strategy Map and BSC are provided in Appendix 1. This strategy map was used to identify the Bank's strategic themes and objectives, and to communicate the strategy to all managers and employees. The strategy map was also used to translate the new company strategy into company-level objectives within a BSC.

ABC Bank's BSC (also shown in Appendix 1) contained objectives, measures, and performance targets in four performance

categories (financial, customer, process, and learning/growth). Strategic initiatives and accountabilities for those initiatives were identified to enable achievement of the company's important objectives. The company-level BSC was then cascaded to all departments and branches, as well as to all individuals. This was accomplished in a manner that created vertical and horizontal alignment—an important goal of the CEO.

ABC Bank also used initiatives in the BSC project to drive business process improvement and competency development, resulting in an improved customer-focused culture. The BSC enabled the bank to create human resources systems that tracked performance management, competency development, and variable pay. The management team also successfully adopted the BSC Methodology as a strategy-execution system.

The CEO described his experience with the BSC as follows:

*"During balanced scorecard implementation, we could feel the changes the BSC brought to us. The bank's strategy has been clarified and effectively communicated. The balanced scorecard helped us realize that we need to develop in a balanced way by evaluating our performance from multiple perspectives, rather than just a single financial perspective. The BSC data enabled us to do a better job in decision making and analysis. All of our people are moving forward in the same direction with objectives that are aligned. We developed many initiatives at the beginning of the year, which have been tracked and implemented by specific people who were accountable for results. In summary, the implementation of BSC has established a solid basis for our strategic performance management system and improving our strategy execution."*<sup>13</sup>

The performance results are summarized below:

- Breakthrough progress in private banking business.  
Ranked #1 in the group company.

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<sup>13</sup> See Chapter 6 of the Beiman and Sun book for additional cases in which Strategy Maps and Balanced Scorecards are being used in an ongoing strategy management process to create organizational alignment and dramatic improvements in performance.

- Ranked in top 3 for 5 years in a row across more than 30 provincial banks within the group.
- The only organization recognized as “outstanding performer” for 5 years in a row.
- By deploying the BSC Methodology, the bank established a strategy management process consistent with the five principles of a strategy-focused organization.<sup>14</sup>
- The bank now reviews and evaluates BSC performance quarterly to fine-tune strategy execution and the management of initiatives.

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<sup>14</sup> See Robert Kaplan and David Norton (2000) *The Strategy-Focused Organization*. Boston: Harvard Business School Press.



## Chapter 3

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

by Irv Beiman and Christian C. Johnson

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.

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.<sup>15</sup> 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."

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

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<sup>15</sup> 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<sup>16</sup>

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:

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<sup>16</sup> 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](http://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.<sup>17</sup>

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.

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<sup>17</sup> 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.<sup>18</sup>

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:

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<sup>18</sup> footnote 17.

- **Ping An Insurance (HK)**<sup>19</sup>

- ⇒ 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.**<sup>20</sup>

- ⇒ 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*, 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

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

<sup>19</sup> [www.cpaihk.com](http://www.cpaihk.com)

<sup>20</sup> [www.legendholdings.com.cn](http://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<sup>21</sup> 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. 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.

The vision  
statement  
describes a word  
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accomplish at  
some point in  
the future

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<sup>21</sup> 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:<sup>22</sup>

- 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.

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<sup>22</sup> 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.<sup>23</sup> 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)

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<sup>23</sup> 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.

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.<sup>24</sup>

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

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<sup>24</sup> 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."<sup>25</sup>

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."<sup>26</sup>

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

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

<sup>26</sup> 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.<sup>27</sup> 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

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<sup>27</sup> 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.”

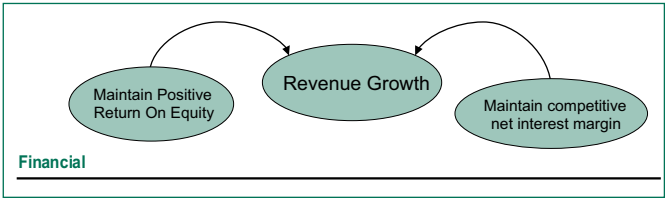
Because microfinance is a new industry in many countries and rural populations are often underserved in terms of loans, deposit facilities, and other basic financial services, it follows that such an institution may include the following strategic themes:

- maintain profitability (but not to unreasonably increase profits),
- raise revenues (by serving more people and offering more loans), and
- provide a net interest margin<sup>28</sup> 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**



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<sup>28</sup> 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.<sup>29</sup> 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.)

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<sup>29</sup> 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.

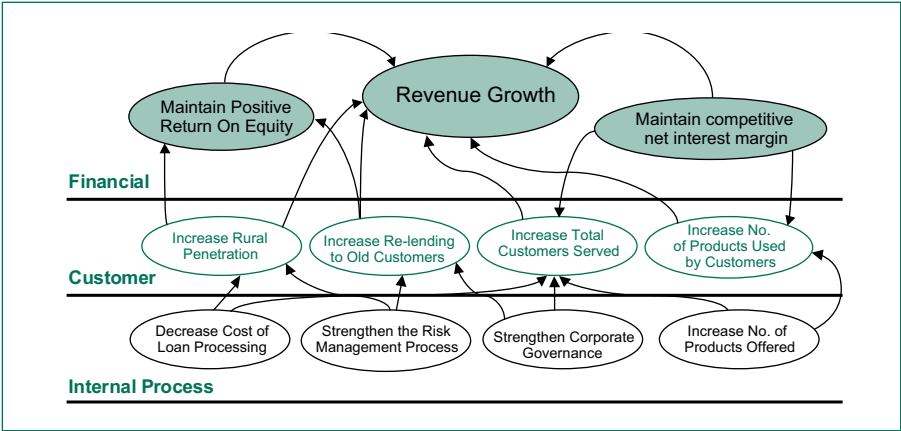
- Maintain/increase the “re-lending” rate (the number of customers that renew or expand their lending after repaying their initial loans). This is also an indirect measure of customer satisfaction and whether the organization is meeting the needs of its customers.
- Increase the “cross sell” or number 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

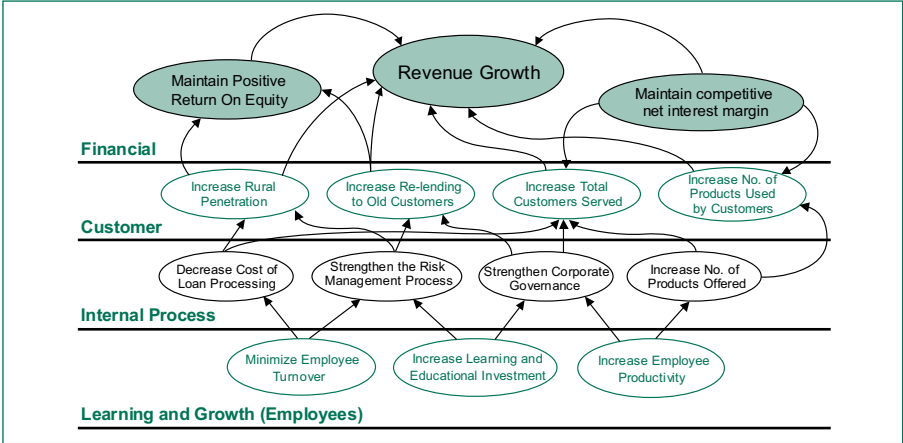


The fourth and final perspective is the learning and growth perspective. This was referred to as the “employee perspective” in the early stages of the evolution of the BSC Methodology because it focused at that time on actions needed to encourage a motivated, efficient, and productive staff. More recent 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.

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.<sup>30</sup> 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.<sup>31</sup>

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

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

<sup>31</sup> 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.<sup>32</sup> 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?<sup>33</sup>

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

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<sup>32</sup> footnote 27, p. 149.

<sup>33</sup> 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."<sup>34</sup> The net interest rate margin of competitors and the banking industry as a whole can be obtained from annual reports and advertised interest rates.

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<sup>34</sup> 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
<b>Customer Perspective</b>	
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
<b>Internal Process Perspective</b>	
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
<b>Learning and Growth</b>	
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.

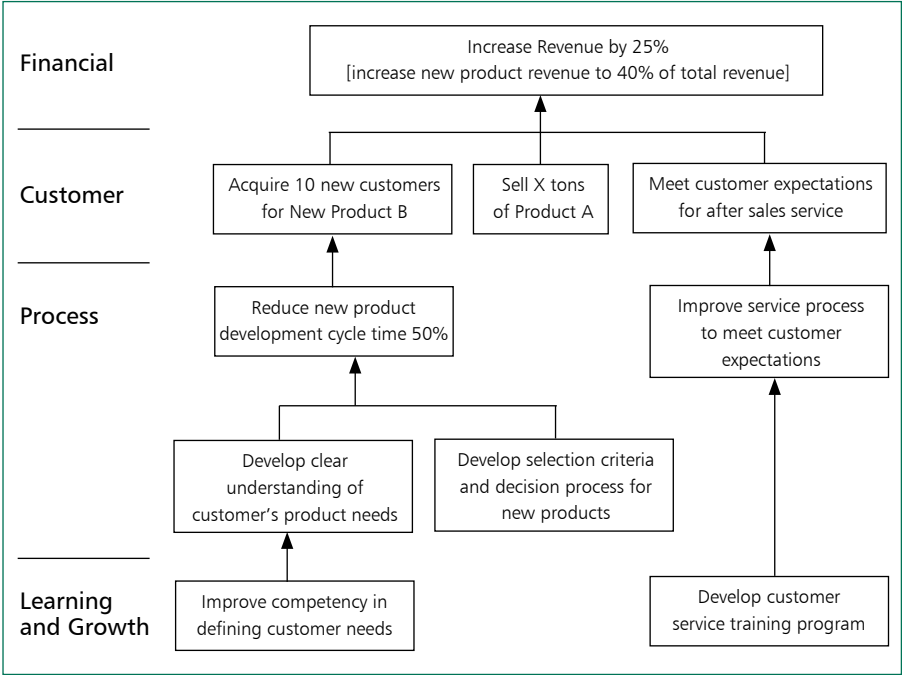
These cause-and-effect relationships are related to other cause-and-effect relationships. For example,

- 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.

## 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.

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

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<sup>35</sup> 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.

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<sup>35</sup> 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 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

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

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.<sup>36</sup>

*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.<sup>37</sup> 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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<sup>36</sup> 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.

<sup>37</sup> 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.

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

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

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.

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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?



## 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.

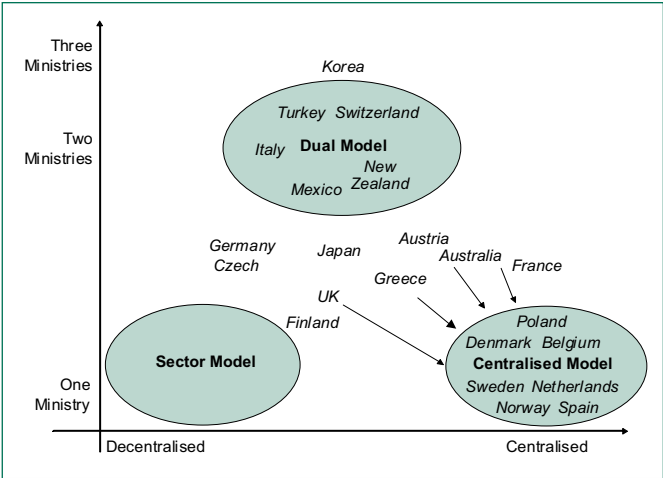
Finally, a centralized model, in which the ownership responsibility is centralized under one ministry, organization, or intergovernmental entity, has more recently been on the increase.

A 2005 Organisation for Economic Co-operation and Development (OECD) report<sup>38</sup> 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).

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<sup>38</sup> 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 Temasek (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.

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

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

**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
<b>Privatization Agency</b> “Maximize shareholder value and increase private sector competitiveness”	Agency intends to groom SOEs for privatization and to maximize share price at privatization
<b>Telecom Holding Company</b> “Increase the competitiveness of the telecommunications sector”	Holding Company is asked to provide users with competitive communications (in terms of costs, availability, etc.)
<b>Ministry of Defense</b> “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
<b>Central Government Organization for SOEs</b> “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.<sup>39</sup> 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.

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<sup>39</sup> 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.

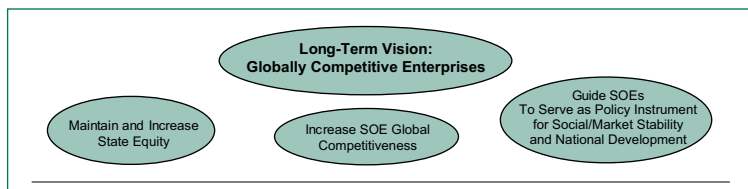
Based on this long-term vision, SASAC developed three high-level strategic themes:

- 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<sup>40</sup> 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

<sup>40</sup> EPES = Enterprise Performance Evaluation System.

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

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.

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.

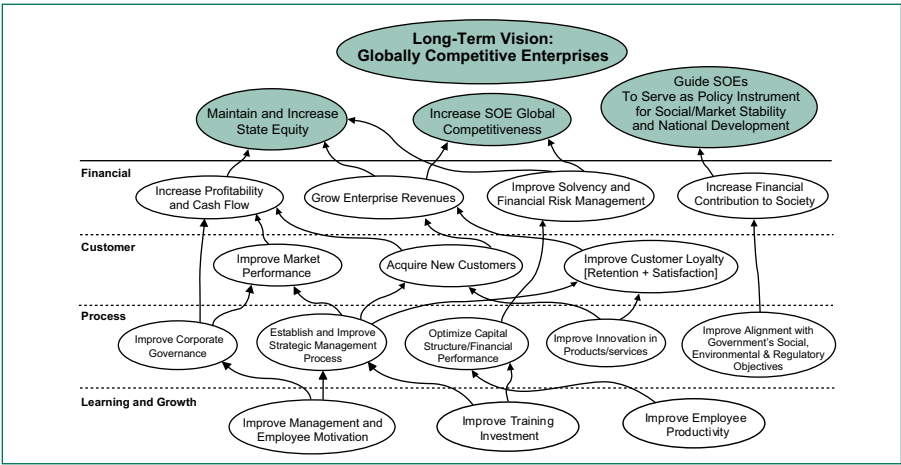
*Customer Perspective.* Three objectives include improving market performance and customer loyalty while acquiring new customers.

*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. 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.

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



## Chapter 5

# Corporate Governance as an Internal Process Objective

by Christian C. Johnson and John K. Thompson

BearingPoint has implemented state-owned enterprise (SOE) restructuring and privatization projects, which often involve corporate governance assessments and improvements, in more than 60 countries.<sup>41</sup> We have consistently found those SOEs that are monitored, controlled, and governed in accordance with international best practices are more successful in terms of profitability and growth. Conversely, we found those enterprises lacking in proper corporate governance practices are more susceptible to poor performance, leakage, and insolvency. In fact, improving corporate governance of SOEs has been a priority in both the Organisation for Economic Co-operation and Development (OECD) and developing countries alike.

Because improving corporate governance has recently become a major policy objective (for both SOEs and non-SOEs) in countries around the world, many countries have adopted Codes of Corporate Governance that specify common standards for corporate behavior that should be followed by all organizations. Early Codes of Corporate Governance were created mainly for companies listed on a country's stock exchange. More recent Codes

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<sup>41</sup> BearingPoint (NYSE: BE) is a global management and technology consultancy with 17,000 employees. Its Emerging Markets practice provides management, economic, and technology consulting services to developed and developing economies worldwide. Also, BearingPoint is a trusted advisor to donor institutions and to central, regional, and local governments around the world.

of Corporate Governance were often modeled after the OECD Principles of Corporate Governance, first issued in 1999, and later updated in 2004.

In September 2005, OECD published the OECD Guidelines on Corporate Governance of State Owned Enterprises.<sup>42</sup> These guidelines were developed based on a growing need among OECD economies for guidance on how to best govern their state-owned organizations, but they have also been embraced by transitional economies as well. Countries are now using the OECD Principles and OECD Guidelines as a baseline for creating country-specific guidance on SOE corporate governance.

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The OECD Guidelines represent the first international benchmark to assist governments in improving the corporate governance of SOEs. These Guidelines can be used to help governments evaluate and improve the way they carry out their ownership function. The OECD Guidelines address the State as an owner, and represent what OECD governments agree are the core elements of good corporate governance practice for SOEs. In short, they provide standards and good practices for corporate governance, as well as guidance on implementation. The OECD Guidelines can also be used by individual countries to design country-specific Codes of Corporate Governance for SOEs with adaptation to the specific circumstances of an individual country or region.

Some examples of countries that are specifying Guidelines or Principles of their SOEs: India proposed the Principles of Corporate Governance for Public Enterprises in 2001, and South Africa released an updated Protocol on Corporate Governance in the Public Sector in 2002. In Indonesia, the Ministry of State Owned Enterprises has a core mission to reform SOEs based on Good Corporate Governance Principles. Egypt in June 2006 published a Code of Corporate Governance for the Public Enterprise Sector (after publishing a Code of Corporate Governance for corporations in 2005).

Development of such Codes and Guidelines are useful in focusing governments on the importance of corporate governance

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<sup>42</sup> Available online in English, French, and Polish at [www.oecd.org](http://www.oecd.org).

for SOEs. Such focus is especially important given the following challenges that are unique to state-owned institutions:

- Ensuring SOEs operate on a level-playing field with the private sector
- Reinforcing the ownership function within the state administration
- Improving transparency of SOEs' objectives and performance
- Strengthening and empowering SOE boards
- Providing equitable treatment of minority shareholders in SOEs with multiple shareholders

However, many of the principles and guidelines in these documents are, for the most part, voluntary. (We note some provisions in the country-specific principles and codes are based on a country's company law and are, thus, required.) In other words, unless an SOE Code of Corporate Governance is specifically enshrined within a law or regulation, an SOE will not be required to meet the entirety of the standard, code, or guideline.

Also, while guidelines, standards, and codes of corporate governance are now in place in many countries, what has not been adequately addressed is how to hold enterprises (and especially SOEs) accountable for meeting the corporate governance provisions of these guidelines, codes, or standards. We have found that developing a straightforward, simple, country-specific corporate governance rating system is particularly useful in educating government leaders and SOE executives about the extent to which an individual SOE has adopted corporate governance best practices.

For this reason, we suggest governments consider the following steps to improve the corporate governance of their SOE sector:

- (1) If SOEs comprise a large segment of a country's economy, create a working group to review the country's SOE Governance policy and to consider drafting a Country Code of Corporate Governance for SOEs.

While guidelines, standards, and codes of corporate governance are now in place in many countries, what has not been adequately addressed is how to hold enterprises (and especially SOEs) accountable for meeting the corporate governance provisions of these guidelines, codes, and standards

Once a country's SOE Governance Policy is drafted (either via an SOE Code of Corporate Governance or similar SOE Governance Policy Statement), the same working group can work to create a country-specific corporate governance rating index (CGRI) for their SOEs

- (2) Once a country's SOE Governance Policy is drafted (either via an SOE Code of Corporate Governance or similar SOE Governance Policy Statement), the same working group can work to create a country-specific corporate governance rating index (CGRI) for their SOEs. A CGRI is a simple index that helps enterprise managers and stakeholders understand how fully an SOE has adopted modern corporate governance principles and country-specific corporate governance requirements.

Governments should be aware that international funding organizations may be able to provide technical assistance when taking these two steps. (It is possible for a government to create an SOE CGRI prior to issuing a formal Country SOE Code of Corporate Governance. However, creating an SOE CGRI is a much easier and more straightforward task if the SOE Code of Corporate Governance Standard is used as the baseline requirement.)

Not all countries will necessarily benefit from the creation of an SOE Code of Corporate Governance or even an SOE CGRI. For instance, a country that has few SOEs will see fewer benefits from such a SOE Code of Corporate Governance or SOE Policy Statement. Conversely, a country with large numbers of SOEs that drive segments of the economy will likely see greater benefits. However, since many transition and emerging economies tend to have large SOE sectors, these countries are the ones that stand to benefit most from implementing the above steps.

Before we explore the concept of an SOE CGRI for a particular country, it is useful to review corporate governance rating systems in use today. The following corporate governance rating systems are generally used to rate corporate governance globally—rather than in one particular country. In other words, the systems use a very high (stringent) benchmark of corporate governance that is expected from western institutional investors. These systems measure a company on how it rates according to this stringent international standard. Later, we will examine how a country-specific SOE CGRI can be developed to rate SOEs on how well they meet local standards of corporate governance.



## CORPORATE GOVERNANCE RATING SYSTEMS

During the 1990s, major institutional investors from the largest markets increasingly sought to diversify their portfolios by investing in foreign companies. As the demands and needs of investors grew, a more detailed and focused analysis was needed. Thus, analysts began rating individual companies on their corporate governance practices, rather than the corporate governance systems of entire countries. Consequently, today there are more than a dozen different rating systems used throughout the world. The largest and most widely used corporate governance rating systems are summarized below.

Table 6: Global Corporate Governance Rating Systems (Summary)

Corporate Governance Rating System	Coverage (number of companies)	First Report Issued In	Categories	Variables
The Corporate Library (TCL)	1,750 (US)	2000	7	>1,100
Intl Shareholder Services CGQ	7,500 (US & Intl)	2001	8	61
Governance Metrics International	1,625 (Intl)	2002	7	600
S&P	Europe & US	1998	4	~100
Deutsche Bank	DJ EuroStoxx 50	2002	5	Undisclosed
Deminor Ratings	300+ (Europe)	1998	4	300

Source: Author (Johnson)

Table 7: Global Corporate Governance Rating Systems (Overview)

Corporate Governance Rating System	Rating Score (Good to Poor)	Cost
The Corporate Library (TCL)	A to F	Up to \$1,200/year subscription
Intl Shareholder Services CGQ	100 to 0	Up to \$17,000/rating
Governance Metrics International	10 to 1	Up to \$50,000/year subscription
S&P	10 to 1	Up to \$200,000/rating
Deutsche Bank	50 to 1	Free (Annual Ranking of 50 companies)
Deminor Ratings	10 to 1	Not Disclosed

Source: Author (Johnson)

Some of the above rating systems are based solely on quantitative scoring analysis while others provide qualitative judgments. Some corporate governance scoring systems are used and paid for by the company being reviewed while others are used and paid for by outside interested parties, especially investors.

Some systems require the active cooperation of the company being rated, but others do not. Some scoring systems publicly disclose a company's corporate governance score, while others are available only to those who purchase the scores.

The contents of the various scoring systems vary, partially due to the needs of the particular rating system's target audience.

*The Standard & Poor's (S&P) Corporate Governance rating system* was one of the first corporate governance rating systems to be created. The S&P System rates corporate governance according to four broad categories and assigns a score between 0 and 100.

S&P has developed three products in corporate governance assessment. The Corporate Governance Score, as the name implies, assesses companies' corporate governance performance for investors. The Corporate Governance Evaluation Service confidentially diagnoses corporate governance for companies. The Corporate Governance Customized Research tailors research for investors, companies, regulators, or other organizations.

The Corporate Governance Evaluation Service enables the company being rated to use the S&P score as a means to assess its own corporate governance practices and to identify areas for improvement and reform. (Often, this product is purchased prior to the purchase of a Corporate Governance Score.) Also, S&P rates companies at a single point in time rather than on an ongoing basis.

To determine a company's Corporate Governance Score, S&P analysts visit the executives and members of the Board of Directors of each rated company. S&P also forms a "rating team" to assess a company's corporate governance. Due to its high labor and analysis content, a single S&P corporate governance report can cost a corporation as much as \$200,000.

*The Institutional Shareholder Service (ISS)* rates a company's corporate governance practices by issuing a Corporate Governance Quotient (CGQ), a score between 0 and 100. The CGQ is established by analyzing eight broad categories related to corporate governance. Initially, ISS only rated companies in the United States. However, ISS now rates companies outside the United States. Thus, the ISS universe of rated companies now includes 2,000 international companies, as well as more than 5,500 US companies.

*Governance Metrics International (GMI)* rates enterprises using seven categories.<sup>43</sup> The GMI rating includes a combination of quantitative factors and qualitative assessments by GMI staff. GMI thus is able to provide subscribers with a narrative explanation of its rating in addition to the quantitative scores. Unlike S&P, which receives its fees from the company being rated, GMI receives fees from subscribers to its services. Most subscribers are investors seeking corporate governance-related information to guide their portfolio selection process. The cost of a subscription to GMI's corporate governance ratings ranges from \$18,000 to \$50,000 per year.

*Deminor Rating* is the largest European-based corporate governance rating service. Deminor clients are institutional investors seeking an opinion on a company's corporate governance practices, as well as individual companies that desire to improve their corporate governance. Deminor uses a model that includes more than 300 governance indicators, where each criterion is based on internationally accepted corporate governance guidelines.<sup>44</sup>

Deminor offers two products: (i) Corporate Governance Review and (ii) Corporate Governance Rating. Typically, a company first engages Deminor to perform a Corporate Governance Review, which is an internal assessment of a company's corporate governance practices and includes recommendations for improvement. Companies often then engage Deminor to provide a Corporate Governance Rating, which includes an investor-friendly report summarizing the corporate governance structures and practices of the rated company. With the rated company's permission, a Corporate Governance Rating and Investor Report is issued to the public.

*The Corporate Library (TCL)* determines a Board Effectiveness Rating (and provides a grade of A to F) to more than 1,750 US companies. TCL rates Board's on their effectiveness and uses this rating as a reflection of a company's strength or weakness in the area

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<sup>43</sup> See Governance Metrics International's website, [www.gmiratings.com](http://www.gmiratings.com), for more information.

<sup>44</sup> See Deminor Rating's website, [www.deminorrating.com](http://www.deminorrating.com), for more information.

of corporate governance. The rating is based on TCL analyst reviews of publicly available information (SEC filings, proxy statements, corporate governance policies, and CEO contracts). TCL notes that particular emphasis is placed on CEO pay and CEO influence in the boardroom.<sup>45</sup>

## COUNTRY “SOE CORPORATE GOVERNANCE RATING INDEXES”

In order to manage and improve SOE corporate governance, it is necessary to measure it. A logical method for measuring SOE corporate governance—at the country level—is to develop a corporate governance rating index (CGRI). (Recall: “If you can’t measure it, you can’t manage it!”) Such CGRIs are themselves valuable tools for SOE managers, regulators, and government shareholders as they provide a standard measure of how well an individual organization has adopted set standards for corporate governance and how the enterprise measures up with respect to accepted norms of corporate governance.

Also, in the context of the balanced scorecard (BSC), the index score is an extremely useful measure that can be included in the Internal Process Perspective of an organization’s BSC. Finally, used appropriately, the CGRI can be an educational and diagnostic tool for management. In this context, the CGRI can be used to educate management about the different aspects of corporate governance, the legal framework for corporate governance, and reveal areas of corporate governance improvement within each SOE.

In summary, the CGRI has three purposes and uses. First, it is a stand-alone tool to measure how well an SOE performs with respect to local corporate governance provisions. Secondly, the CGRI may be used as an objective and measure in the Internal Process Perspective of an organization’s BSC. And, thirdly, the CGRI is an educational and diagnostic tool for SOE management.

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<sup>45</sup> See The Corporate Library’s website, [www.thecorporatelibrary.com](http://www.thecorporatelibrary.com), for more information.

As an internal process measure, an SOE would use the CGRI to determine its corporate governance “score.” The CGRI score can be viewed as a proxy for how well the SOE has reformed its corporate governance practices to be aligned with a country’s SOE code of corporate governance and/or international best practice. It is important to note that initial CGRI scores will generally be low, but can rise dramatically as SOE managers implement necessary improvements to their corporate governance. For example, if the system requires the formation of an audit committee, the enterprise raises its score by forming such a committee. The net result is improved CGRI scores and improved SOE governance.

## GERMANY’S CORPORATE GOVERNANCE SCORECARD FOR LISTED COMPANIES

While not specific to SOEs, Germany in 2003 developed a useful “DVFA Scorecard for German Corporate Governance” that enables publicly traded corporations in Germany to determine how well they comply with Germany’s Code of Corporate Governance and the OECD Principles of Corporate Governance.<sup>46</sup> Notably, the German Code contains both “Shall Recommendations” and “Should Recommendations.” And, the German Code follows the “comply or explain principle,” which means that listed companies in Germany have to either comply with the “Shall Recommendations” of the Code or explain in their annual report why they do not comply.

If a German company fulfills all the “Shall Recommendations,” the company will receive a minimum score of 75%. The remaining 25% of a company’s score can be obtained by fulfilling the “Should Recommendations.” The total score cannot exceed 100%. The Scorecard is included as Appendix 2 in this book. It serves as an example of a straightforward tool to enable companies and stakeholders to determine a company’s compliance with German Corporate Governance standards.

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<sup>46</sup> An electronic spreadsheet of the German version of this scorecard is available at [www.dvfa.com](http://www.dvfa.com).

Again, while this German Corporate Governance Scorecard is applicable only to listed companies, the scorecard is a valuable illustration of how a CGRI may be developed to measure compliance with a set of Corporate Governance norms for SOEs.

## PRC'S SOE CORPORATE GOVERNANCE RATING INDEX (CGRI)

In 2004, as part of an Asian Development Bank (ADB) Project, BearingPoint designed a CGRI for SOEs in the PRC. The SOE CGRI is designed to be used as (i) a measure for the SASAC BSC, (ii) as a stand-alone index measuring compliance with Chinese and international corporate governance standards, and (iii) an educational and diagnostic tool for educating SOE management about corporate governance.

In seeking to apply international standards in the Chinese context, the CGRI accepted the OECD Principles of Corporate Governance as its starting point. The OECD Principles are the recognized global benchmark for corporate governance. However, the OECD Principles are stated at a broad level so as to be applicable in countries with different historic traditions, legal systems, and institutional structures. The implementation of OECD Principles of Corporate Governance requires elaboration at the national and regional levels by legislators, regulators, stock exchanges, self-regulatory organizations, professional bodies, and individual firms.

BearingPoint designed a CGRI that is a stand-alone index measuring the degree to which SOEs comply with established standards – both International and Chinese. Such standards include (1) the OECD Principles of Corporate Governance (2) other international corporate governance standards and research, and (3) Chinese governance standards, including the PRC Company Law, the “Code of Corporate Governance for Listed Companies”<sup>47</sup>, and

BearingPoint designed a CGRI that is a stand-alone index measuring the degree to which SOEs comply with established standards—both International and Chinese

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<sup>47</sup> Issued by the China Securities and Regulatory Commission on 7 January 2001. Many SOEs are listed on PRC's stock exchanges.

the “PRC Code of Corporate Governance for SOEs.”<sup>48</sup> The design of the CGRI is, therefore, based on international best practices in the area of corporate governance ratings.

A partial listing of PRC’s laws and regulations affecting corporate governance that were considered by the drafting team is included in Appendix 3. The CGRI is based upon measurable objective criteria, rather than subjective scoring and is expandable and scalable. For example, BearingPoint and SASAC examined implementation of the CGRI on a web-based HyperText Markup Language (HTML) platform. The software design, pilot testing, and implementation of the CGRI was deemed to be a practical and cost-effective mechanism for educating SOE managers about corporate governance and for obtaining periodic CGRI measurements from SOEs.

*The Two Scoring Mechanisms of the CGRI in the PRC.* Another factor that challenged the project team was that SOEs in the PRC use many different forms of organizational structures. A survey of 2,473 SOEs by the Chinese State Statistics Bureau in 2000 revealed that 2,106 (81.5%) restructured according to the 1993 company law, 713 (35.4%) were restructured into limited liability companies, 700 (34.7%) restructured into Wholly-State Owned Companies, and 603 (29.9%) were transformed into joint stock companies. Some of these companies were organized with operational boards of directors and others were organized with a Director at the apex who did not report to a board of directors. In other words, some of the essential institutional features of an acceptable governance regime were lacking in some SOE structures.

Thus, two separate CGRI-scoring mechanisms were created: one mechanism scores companies that are 100% owned by the Government and the people of the PRC; and a separate mechanism scores SOEs that have multiple shareholders. The main difference between the two systems is that the second index includes a section on the equitable treatment of shareholders.

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<sup>48</sup> The last sentence of paragraph 7 of the TA for this Project made reference to the existence of a PRC Code of Conduct for SOEs. The actual title of this (provisional) regulation is Fundamental Code on the Modern Corporate System Establishment and Management Enhancement of State-owned Large and Medium-sized Enterprises (Provisional) issued on 27 October 2000 by the State Economic and Trade Commission.

*Structure of the Chinese CGRI.* BearingPoint designed a scoring system to determine the degree to which companies in the PRC are observing corporate governance practices and keeping with internationally accepted standards. In order to do this, five key categories were selected and assigned weights. (The five categories were chosen as they align the CGRI to the OECD Principles of Corporate Governance and other international corporate governance rating systems described above.)

For SOEs that are 100% owned by SASAC, the four categories are (1) Role of the Board of Directors, (2) Transparency and Disclosure, (3) Audit, and (4) Stakeholders and Corporate Citizenship. A fifth category, Equitable Treatment of Shareholders, is included for companies that have multiple shareholders.

Measurements (in the form of questions) were designed for each category. The scores for each measure (question) in each category are added together to provide a component category score. Category scores are then added together to provide an overall score (between 0 and 100) for the company.

**Table 8: Structure of Corporate Governance Rating Index**

Category	100% Government-Owned Companies (%)	Non-100% Government-Owned Companies (%)
I. Role of the Board of Directors	30	25
II. Transparency and Disclosure	30	25
III. Audit	30	20
IV. Stakeholders and Corporate Citizenship	10	10
V. Equitable Treatment of Shareholders	0	20

Source: Asian Development Bank TA 3933-PRC Project Team

The selected categories and measurement questions are deemed to be the most significant measures of corporate governance in the Chinese context as explained below. The system design is such that companies will receive higher scores if they comply with the most stringent corporate governance requirements in the PRC—those requirements for Joint Stock Companies listed in the Company Law of the PRC and the Code of Conduct on Corporate Governance for Listed Companies in the PRC.



The selection of the specific measurement questions and their weights within each category was, therefore, based upon four considerations: (1) the relevance of each variable to effective governance based on international best practices in corporate governance; (2) actual legal requirements pertaining to corporate governance that now exist in the PRC; (3) relevance to the Chinese situation and SASAC's mission; and (4) the ease with which data can be obtained and compliance can be evaluated.

As shown in the table below, the Chinese SOE CGRI is structured to include 72 discrete measures for 100% SASAC-owned companies and 84 discrete measures of non-100% SASAC-owned companies. (By way of comparison, the corporate governance rating system of ISS uses 61 measures and S&P uses about 100 measures or variables.) A brief summary of each CGRI category is provided below.

**Table 9: Measurements in the Chinese SOE CGRI**

Category	100% Government-Owned Companies	Non-100% Government-Owned Companies
I. Role of the Board of Directors	22	22
II. Transparency and Disclosure	18	19
III. Audit	24	20
IV. Stakeholders and Corporate Citizenship	8	8
V. Equitable Treatment of All Shareholders	0	15
Total number of measurements (questions)	72	84

CGRI = Corporate Governance Rating Index, SOE = state-owned enterprise.  
Source: Asian Development Bank TA 3933-PRC Project Team

## BRIEF EXPLANATION OF EACH CATEGORY OF THE CHINESE CGRI<sup>49</sup>

*Board of Directors.* Measures involving the Board of Directors are critical components of the CGRI. The pivotal role of the board, particularly its role as an independent check on the management, is recognized in the OECD Principles and in virtually all corporate governance codes and standards. It is especially critical in the

<sup>49</sup> This section is taken from the ADB TA-3933-PRC Project Report. The section was largely drafted by Dr. John Thompson in 2004 while designing the CGRI.

Chinese context because many other institutional safeguards, such as the capital market and the legal system, are not well developed. Thus, the Board of Directors is relied upon to act as the main institutional counterweight to management.

*Transparency and Disclosure.* Transparency and Disclosure constitutes an important component of the CGRI. The concept underlying this section is that the company should provide its owners, credit rating agencies, and other interested parties with complete and accurate information so they may form an opinion of the true financial state of the company. The specific items that should be disclosed include information that will enable the “owners” (and outside investors in the case of listed companies) to make reasoned decisions about investment in a given company.

Moreover, the measures included in this section are identified in the OECD Principles and have been reaffirmed in a number of national codes. They are also cited by groupings of institutional investors as representing the kind of information investors need to make informed decisions. The measures are combined into three subcategories: (1) Annual Report, (2) Audited Financial Statements, and (3) Corporate Communications.

*Audit.* Audit is a critical area of importance in all countries, given the importance of the integrity of the disclosure process. The provision of inaccurate information to the market has been an important element in several prominent corporate scandals, such as Enron and Parmalat. As a result, corporate governance analysis conducted since the recent wave of corporate scandals has emphasized the audit process. For example, in a recently released study of best practices in corporate governance sponsored by a group of leading research institutes, corporations, and consultants, the audit process was given expanded coverage in a separate section.<sup>50</sup> The Sarbanes-Oxley Law in the United States was intended, in part, to respond directly to the shortcomings in corporate governance that surfaced with the Enron and WorldCom cases. This law also gave increased emphasis to the audit process.

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<sup>50</sup> Brancato, C., and Christian. A. Plath. 2003. *Corporate Governance Best Practices: A Blueprint for the post-Enron Era*. The Conference Board. New York.

The CGRI Audit category is structured so that measures fall into four subcategories: (1) Audit Committee Procedures, (2) Audit Committee Structure, (3) Internal Audit, and (4) External Audit.

*Stakeholders and Corporate Citizenship.* Stakeholders and corporate citizenship are critical elements of corporate governance in all countries. Stakeholders in this context includes individuals, groups, or entities that are likely not owners of the firm, but who either have a significant relationship with the firm or are entities for whom the activities and performance of the firm have important consequences. Some stakeholders may have significant commitments to the company and the company may, in turn, have significant commitments to them. In recognition of the importance of stakeholders and the related concept of “corporate citizenship,” the Stakeholder and Corporate Citizenship category is assigned a moderate weight (10% of the total CGRI) in the scoring system. The design of the CGRI “Stakeholder and Corporate Citizenship” section includes measures in two subcategories: (1) Financial Obligations, and (2) Workplace Safety.

*Equitable Treatment of Shareholders.* Equitable Treatment of Shareholders applies only to companies that are not completely (100%) owned by SASAC. One of the OECD Principles regarding the rights of investors is that non-controlling shareholders are entitled to equal consideration with other shareholders and that the board and management should not favor one category of shareholders over the others.

Like other categories of the CGRI, the Equitable Treatment of Shareholders category is separated into three subcategories: (1) Annual Meetings, (2) Shareholder Issues, and (3) Shareholder Relations.

Appendix 4 contains the entire Chinese SOE CGRI developed by BearingPoint as applied to non-100% SOEs.<sup>51</sup> Included in the appendix are the questions, scoring, and justification for the measures, along with reference to the various applicable laws, regulations, and international standard.

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<sup>51</sup> Dr. John Thompson was the primary contributor of Appendix 4, which was delivered to both the Government of the PRC and ADB as part of the ADB TA 3933-PRC Project.

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The Chinese SOE CGRI should only be used as an example of how a CGRI can be developed and applied to the conditions present in a particular country. In short, the Chinese CGRI was developed based on the concept of applying internationally accepted corporate governance standards within a Chinese context and based on the Chinese legal framework for corporate governance. Thus, it would not be appropriate to take the Chinese CGRI and reformulate it for use in another country. Rather, it is necessary to develop a new, different, and unique CGRI based on the corporate governance laws, regulations, and practices for each particular country.

## Chapter 6

# Managing SOEs for Improved Performance

by Irv Beiman

### STRATEGY MANAGEMENT SURVEY

In 2006, eGate Consulting conducted a survey of organizations in the People's Republic of China (PRC). Survey respondents were queried on the most important business challenge facing companies in the PRC. Chinese managers cited “strategic management” as the most significant business challenge. Strategic management includes all phases of strategic planning, execution, and evaluation. Based on the survey results, eGate identified three important lessons:

- Strategy management is the biggest challenge for all types of organizations in the PRC, both state-owned enterprises (SOEs) and private companies;
- Establishing a clear, repeated, and ongoing strategy management process more than doubles the chances of becoming a winner in the PRC; and
- Implementing a balanced scorecard (BSC) helps companies establish clear strategies that, when used effectively, serve as a foundation for an effective strategy management process.

During August of 2006, all types of companies in the PRC were surveyed on 10 different areas of business challenges. Of the 105 usable responses received, slightly less than half of the organizations were state-owned or private enterprises; the other half of respondents were joint ventures or wholly foreign-owned. Of the 10 different challenges evaluated on a 5-point rating scale, only one (strategy management) was rated above 4.5 in importance. Strategy

management was rated as the most important challenge (4.57 on a 5-point scale) facing all types of organizations, including SOEs. This was an important first conclusion from the survey.

The survey revealed that more than half of organizational respondents reported not having any process in place for managing strategy. One half of this group indicated they had no strategy execution or formulation process in place, while the other half reported they were using a process for *formulating* strategy, but did not have a process for execution.

The second conclusion arising from the survey was based on the following results. Only 17% of respondents indicated they had an effective, clear, repeated, and ongoing strategy management process. For this group of companies, more than 80% of them reported being “winners”— they were performing either better than competitors or had achieved breakthrough results. Of the remaining 83% of respondents who indicated they did not have a clear, repeated, and ongoing strategy management process in place, only 42% reported they were “winners”. Thus, putting in a clear, repeated, and ongoing strategy management process doubles a company’s chances for becoming a winner in the PRC. This is true whether the company is an SOE, privately-owned, or a wholly owned joint venture enterprise.

A comprehensive implementation of the BSC Methodology enables three important pieces of strategy management: description of the strategy, execution of the strategy (or strategic plan) and evaluation of strategic results.

The third conclusion from the survey was based on the following results. Slightly less than one third (31%) of companies reported they had implemented any sort of BSC. One third of those that had implemented a BSC reported having a clear and ongoing strategy management process in place. Another third reported they had formulation and execution in place, plus some sort of evaluation, but were not evaluating strategic results regularly. The final third lacked either execution or evaluation, or both. eGate interpreted this to mean the following: BSC can help improve results but it must be deployed in a manner that establishes a clear, repeatable, and ongoing strategy management process.

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and evaluation of  
strategic results

It is noteworthy that one of the key Process Objectives in the SASAC Strategy Map reported in Chapter 4 of this book is Establishing a Strategy Management Process. This objective is consistent with the survey on how to become a “winner” in the PRC.

The strategy management survey reports, in combination with the SASAC strategy map, highlight a key issue for SOE awareness and action: “business as usual” is not sufficient. An important first step toward establishing a strategic management process is to adopt the BSC framework and approach to management. Once the BSC is adopted, the strategic management process can be expanded into a repeatable, clear, and ongoing process that includes updating the BSC periodically to adjust to changing business and competitive conditions.

## STRATEGY MANAGEMENT PROCESS: DESCRIBE, MEASURE, ALIGN, AND MANAGE

What can SOEs do to improve their performance and better achieve their strategic objectives? Research has been conducted over the last 15 years to identify the principles, tools, and best practices for executing strategy. These have been derived from more than 80 organizations that have been awarded the Balanced Scorecard *Hall of Fame for Executing Strategy*<sup>TM,52</sup>. This award recognizes organizations that have achieved breakthrough results using the BSC Methodology. The best practices by Hall of Fame companies have been adapted for the PRC and are being applied now by such Chinese organizations as Bao Steel (and Bao HQ), China Union Pay, China Resources, Qingdao Beer, and CATIC (China Aero-Technology Import & Export Corporation).

This methodology has evolved continuously, such that it is now the accepted global and PRC standard for best practices in strategy execution. Five Principles and 27 global best practices have been adapted for accomplishing four primary strategic management

<sup>52</sup> See [www.bscoll.com](http://www.bscoll.com) for information about the Balanced Scorecard Hall of Fame for Executing Strategy<sup>TM</sup>. See [www.egate-china.com](http://www.egate-china.com) for information about the PRC’s Hall of Fame for Strategy Focused Organizations.

objectives in the PRC: describe, measure, align, and manage the strategy.

The better-designed balanced scorecards illustrate a good balance between financial and nonfinancial metrics, between short- and long-term objectives, and between leading and lagging indicators of strategic success

1. **Describe the Strategy** is accomplished via an innovative tool developed by Dr. Robert Kaplan and Dr. David Norton of Palladium and the Balanced Scorecard Collaborative—a *Strategy Map*. A typical Strategy Map is a one-page, graphic illustration of strategic objectives in four primary perspectives: financial, customer, process, and learning and growth. Strategy Maps are powerful tools for clearly communicating throughout an organization, as well as serving as a catalyst and reference point for a well-managed change process. Some strategy maps show cause-and-effect relationships between different objectives. This describes the business logic of the strategy for success.
2. **Measure the Strategy** is accomplished via a BSC with objectives, measures, targets, and initiatives (action plans) for achieving the desired results. Many managers may think they are using best practice just because they have performance objectives and measures or key performance indicators (KPIs) organized into the four typical perspectives identified above. KPI systems typically reinforce “silo focus” rather than the more holistic “enterprise strategy”. A well-designed BSC must be properly developed. The better-designed BSCs illustrate a good balance between financial and nonfinancial metrics, between short- and long-term objectives, and between leading and lagging indicators of strategic success. Consider the issue of safety. Safety is a common objective area in the process perspective for companies engaged in hazardous activities (mining industry) or dealing with hazardous materials (chemical industry). This might appear as a single objective, or as a broader theme to include meeting regulatory requirements for hazardous materials. The number of safety incidents is a common measure for this objective. Some companies measure not only the number, but also the severity of such incidents.
3. **Establish and Sustain Vertical and Horizontal Alignment** by cascading strategic objectives vertically throughout the organizational structure. During the vertical cascade process



for a holding company, conglomerate, or single enterprise, consideration of horizontal alignment issues is critical. Cross-functional needs of commercial and support organizations can be identified in a horizontal alignment needs survey.<sup>53</sup> The BSC Methodology can be used to track and resolve critical alignment issues for strategy execution success.<sup>54</sup> Improving organizational alignment is a highly important strategic management issue for organizations anywhere in the world. This is even more important in Asian cultures that are hierarchically oriented, as well as in national economies that are in transition from central planning to greater market sensitivity. Each of the four cases described later in this chapter paid specific attention to establishing vertical and horizontal alignment.

4. **Manage the Strategy** by linking it to critical systems and processes, such as budgeting, human resources, and IT. Management should conduct strategic review meetings that build the competency for strategy execution. Well-run strategic review meetings create *real-time learning and development*, by combining the best of different opinions into a shared, consolidated view of important challenges and how to cope with them.

Improving organizational alignment is a highly important strategic management issue for organizations anywhere in the world

### THREE PRC SOE CASES OF BALANCED SCORECARD DEPLOYMENT FOR STRATEGY MANAGEMENT

This section presents descriptions of three case projects delivered by eGate that describe how SOEs in the PRC are using BSC tools to put a strategy management process in place. Each of these cases is in a different industry. Each organization was facing different internal and external business conditions at the time that SOE executives chose to investigate and deploy the BSC as a tool for

<sup>53</sup> eGate has developed a horizontal needs survey appropriate for SOEs. Some form of this survey was used in each of the SOE cases described in this chapter.

<sup>54</sup> Kaplan, R., and David Norton. 2006. *Alignment: Using the Balanced Scorecard to Create Corporate Synergies*. Boston: Harvard Business School Press. Go to [www.egate-china.com](http://www.egate-china.com) to learn where to purchase the Chinese language translation of this excellent book.

strategy management. These cases illustrate how the fundamental principles, practices, and tools of the BSC Methodology can be deployed in all types of SOEs.

### **PRC Balanced Scorecard Deployment Case 1: An Internationally Recognized Beverage Company**

The PRC is the largest beverage market in the world, with an average predicted annual increase of ~6% over the next few years. There is significant potential for market growth. Many international brands have sought to gain a piece of this market, with a number of them failing and pulling out of PRC operations. The beverage market in the PRC is intensely competitive.

ChinaBev is a well-recognized Chinese SOE beverage company in many locations around the world. GlobalBev, a major international player in the beverage industry, had taken a minority share in the Chinese organization. ChinaBev had a base of more than 20,000 employees, with revenue in excess of \$1 billion.

ChinaBev was facing challenges from both external competition and the need to improve internal management and utilization of productive capacity. Key executives recognized the company needed to improve clarity and focus on executing a winning competitive strategy. The CEO of ChinaBev decided to implement an initial BSC project involving corporate headquarters, one strategic business unit (SBU), plus several plants, sales organizations, and functional departments. The company spent about a half year designing and implementing the BSC Methodology in these units with consulting support and training.

An initial demand analysis identified key business needs and horizontal alignment issues. This information and analysis was incorporated into subsequent workshops that developed corporate and unit Strategy Maps and BSCs. A simple BSC tracking and reporting system was used to report on strategic performance at different organizational levels.

The BSC core team members were developed into serving as internal consultants for BSC implementation. They expanded the implementation process to include significantly more sales

organizations and production plants. The corporate and SBU Strategy Maps and BSCs were cascaded down to functional departments in multiple business units. The core team estimated that in the year following the BSC implementation, profit improved by approximately 20% on a revenue increase of approximately 2%.

Consider the words of ChinaBev's CEO:

*"Beginning our balanced scorecard project took a big stone away from my heart because when we formulated our strategy clearly, we learned how to turn it into action. We learned how to have everyone in our company understand our strategy and to execute our strategy. Importantly, we learned what actions needed to be taken to accomplish our strategy and how to probably use and implement our strategic measures and objectives. As a result, our organizational structure and process optimization are based on our newly clarified corporate strategy. And, we are not done. Every working day our employees are busy implementing our company strategy and employee moral and satisfaction has improved because workers feel more involved, valuable, and important.*

*Using the balanced scorecard methodology for communication enables us to make strategic thinking more real, visual, and practical. We had some strategic thinkers before, but now our employees understand how to execute strategy. Now our top management team knows how to manage the strategy, and how to execute company strategy through our management system."*

*"Using the balanced scorecard methodology for communication enables us to make strategic thinking more real, visual, and practical"*

### **PRC Balanced Scorecard Deployment Case 2: An Internationally Competitive Industrial Company**

IndustryCo was a public company with more than 15,000 employees at the time of its BSC project. It was a member of the Global Fortune 500 and ranked as the third most competitive company globally in its industry. IndustryCo exports its products to more than 30 countries around the world.

During the past several years, IndustryCo had successfully implemented a series of manufacturing and quality projects,

including enterprise resource planning (ERP), process reengineering, and Six Sigma. Company leaders recognized the need for an effective strategy management methodology to exploit these operational improvements and improve their strategic success. A key functional department focusing on innovation was assigned the mission of exploring the BSC as a useful approach to meeting their strategy execution needs and to evaluate possible suppliers for a project.

After an extensive supplier evaluation process, eGate Consulting was selected to support IndustryCo in deploying the BSC Methodology.

The initial project scope included more than 30 functional, manufacturing, and business units, with the charter to develop a Strategy Map and the BSC for each of these units. Considerable effort was devoted not only to establishing vertical alignment from the enterprise map to each of the second-level unit maps, but also to establishing horizontal alignment across these second-level units. Multiple sessions with unit representatives were conducted to identify shared and contributory objectives for each unit.

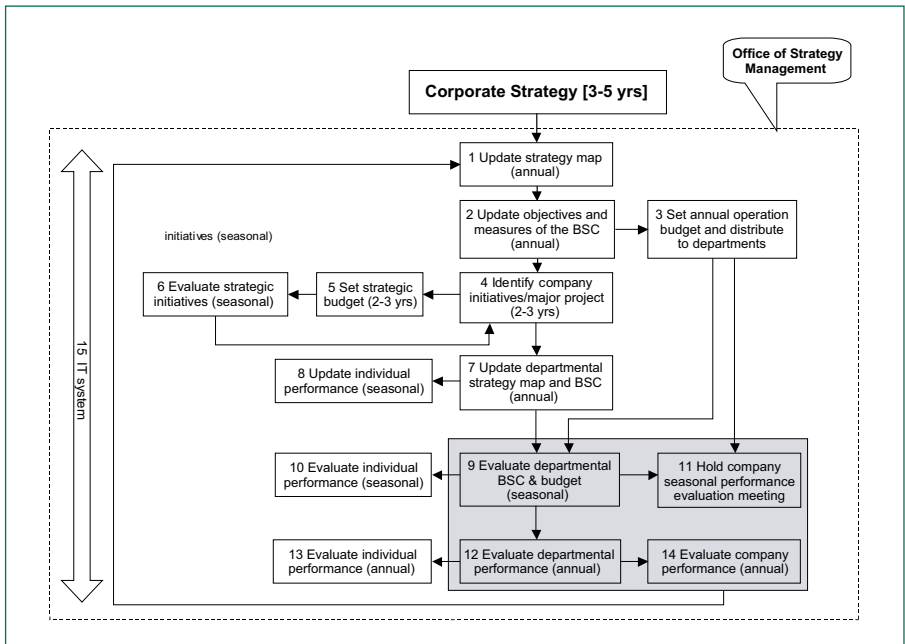
Before the BSC design and implementation, each of these units had established its own annual objectives and measures, with no holistic view of the enterprise strategy for success. The BSC Methodology surfaced critical alignment issues in both vertical and horizontal arenas. The previous performance evaluation system was replaced with one based on unit BSCs. The project team recommended establishing a linkage between the BSCs and other management processes (strategic planning and individual performance management), plus using the BSCs to identify critical Six Sigma projects.

As the project neared completion, company executives decided to implement a major change in organizational structure. The project's executive sponsor was promoted to a higher position in the reorganized conglomerate holding company. He recommended more extensive participation by executive leaders, as well as expansion of the methodology to associated subsidiary enterprises owned by the reorganized conglomerate.

At the time of this writing, IndustryCo had elected to expand the BSC Methodology to its reorganized headquarters and to several

associated subsidiary enterprises, each with more than 15,000 employees. IndustryCo also chose to provide initial BSC training to the management teams of recently acquired multiple enterprises. IndustryCo headquarters and subsidiary enterprises are beginning to use a consistent strategy management process based on tools, such as strategy maps and BSCs. See Figure 14 for an illustration of the draft strategy management process at IndustryCo.

Figure 14: IndustryCo Strategy Management Process



Source: eGate

### PRC Balanced Scorecard Deployment Case 3: A Dominant Financial Services SOE Facing International Competition

FinancialCo provides a wide variety of financial services in the PRC. During the previous 3 years, FinancialCo had experienced rapid growth and had defined its vision of becoming a recognized major global provider of financial services by 2010. The company

had formulated a clear, long-term strategy that included shifting focus from technical service delivery to increased and improved customer service. FinancialCo executives recognized they needed to develop an internal competency for managing this change and executing their new strategy.

By the end of 2006, financial services in the PRC were scheduled by WTO to begin opening up for foreign players. This schedule of market opening included several major competitors of FinancialCo. FinancialCo executives recognized they needed to prepare to compete with mature international organizations on product and service, as well as internal management and human capital. In this strategic context, FinancialCo executives reported a strong sense of urgency for improving internal management capability, including the related areas of organizational structure, business process, performance management and, most importantly, strategy execution.

FinancialCo executives kicked off the strategy management project with consulting support throughout 2006. Project scope included a corporate Strategy Map and BSC, plus the same for 23 departmental units (including one branch company), and 60 individual scorecards for pilot evaluation and learning.

The top executive team demonstrated strong, visible support for this strategy execution project. They were in frequent communication with the project team, who brought implementation issues to them. This open and transparent communication process served to identify hurdles and develop ideas for solutions, as well as stimulate decision making for overcoming the challenges identified.

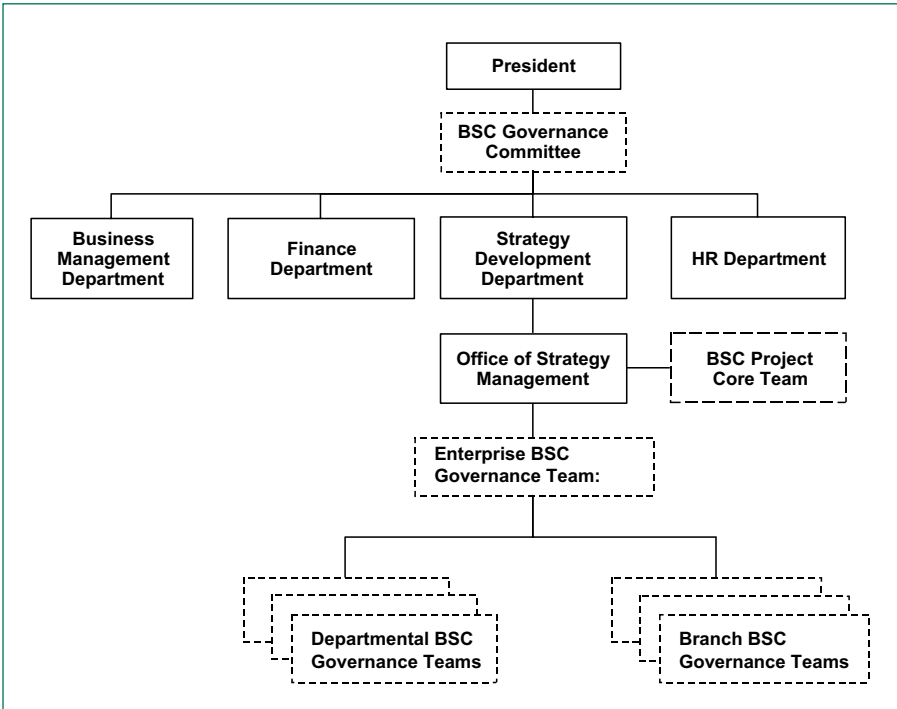
The BSC project was run in parallel with related high-level initiatives for restructuring and reengineering. Both of these latter projects were initiated with the explicit charter to support FinancialCo's long-term strategy, with the definition of that strategy described by the FinancialCo corporate strategy map. The process reengineering project included the objective of better defining cross-functional processes and responsibilities. Some team members participated in both the BSC and the reengineering projects. Both teams appeared to work well together, in part, because of the visible support and interest by top executives.

FinancialCo decided to form an initial BSC governance structure making use of an Office of Strategy Management (OSM). The OSM is the latest innovation emerging from the case research and innovative practices of Palladium and the BSC Collaborative. The OSM has been adapted for use in the PRC. This innovation is particularly useful in Asian countries that are hierarchically oriented, such as the PRC. It is common for Chinese organizations to use structural change as a lever for attempting to create organizational improvement. Reorganizing complex organizations is not sufficient by itself to create sustainable organizational improvement.

The OSM, however, is an innovative revision of what might be called the restructuring hypothesis, which includes the notion that changing the organizational structure will change some (or many) of the problems interfering with success. Rather than focus on structure per se, the OSM provides a visible and powerful means to create a revision in the organizational structure to clarify roles and responsibilities for strategy management. The OSM creates a focus on the strategy management process. The ongoing process of continuous improvement in strategy management has the potential to create sustainable organizational improvement and improved business results.

As the FinancialCo BSC project neared completion, executives reported their recognition of the need to establish an enduring unit to manage the strategy execution function relying on the BSC as a primary tool. Executives planned for the FinancialCo Office of Strategy Management to be formed under the existing department for Strategy Development. The OSM was chartered with the mission of driving future strategy execution at FinancialCo. Figure 15 illustrates FinancialCo's organizational structure for enterprise governance using the BSC.

Figure 15: FinancialCo Balanced Scorecard Governance Structure



Source: eGate

### AWARD-WINNING CASE: PRC RESOURCES MICROELECTRONICS – FIRST CHINA WINNER OF THE BSC HALL OF FAME

China Resources (CRC) is one of the leading conglomerates in Hong Kong and the Chinese mainland, with assets of approximately \$13 billion (~ HK\$100 billion). The conglomerate is often heralded in the PRC as an example of modern management. CRC’s core businesses include three primary areas: manufacturing and distribution of consumer goods, property, and infrastructure and utilities. These core businesses are divided into 24 profit centers.

The corporate Chief Financial Officer sought to combine an improved use of the BSC with CRC’s internal 6S management system (6 systems that were not in alignment) in a project with one of their subsidiary holding companies—China Resources



Microelectronics (CR-M). CR-M is also a holding company with multiple subsidiaries (SBUs) under its strategic umbrella. CR-M has an integrated supply chain within the organizational structure of its holding company (see Figure 16).

In 2005, CR-M had approximately \$487 million (~ CNY4 billion) in total assets and sales of more than \$244 million (~ CNY2 billion). With a focus on consumer electronics, CR-M engages in design, wafer manufacturing/processing, testing, and assembly of semiconductor products, with a focus on integrated circuits and discrete devices. CR-M seeks to deliver the best price and best quality to the PRC market in key product categories. Company strategy aimed to put chips into every Chinese household, with aggressive growth over the next 3 years.

The CR-M BSC project was supported by eGate and involved three levels: one profit center, six SBUs with six associated functional support units, plus a total of 22 departments from two of the SBUs, for a total of 35 organizational units. Each unit at each level worked with a project team and consultants from eGate to develop a strategy map and BSC.

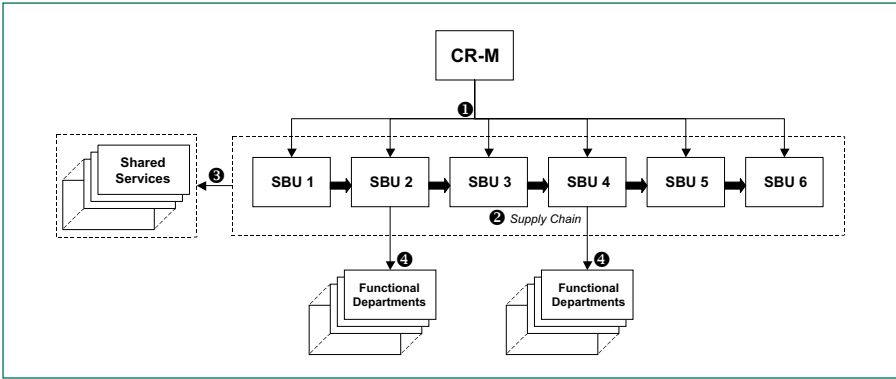
The six SBUs were connected in direct internal supply or support for an integrated supply chain under the microelectronics holding company umbrella. Interviews, discussions, and workshops were held to identify key vertical and horizontal alignment objectives that were consistent with the CR-M business strategy. Strategy maps and BSCs evolved through multiple iterations to reflect the thinking and input from executives at both the CR-M enterprise and SBU level. Two of the key focuses of discussion were the internal supply chain and allocation of resources for new product development.

The corporate CFO and CEO of CR-M planned to establish an Office of Strategy Management to oversee the entire process and assure sustainable linkage with CRC's 6S management system. See Figure 16 for a simplified illustration of the BSC structure and key alignment linkages at three different levels.

In September 2006, CR-M became the first Chinese organization to win the Balanced Scorecard Hall of Fame for Executing Strategy™. Dr. Robert Kaplan gave two leaders of the BSC project team the award in a ceremony during the Asia Summit

Strategy Maps and Balanced Scorecards evolved through multiple iterations to reflect the thinking and input from executives at both the CR-M enterprise and SBU level

Figure 16: China Resources Microelectronics Balanced Scorecard Structure and Alignment



Source: eGate

for Strategy Execution. The application process required extensive documentation of how CR-M applied the principles and best practices of Strategy Focused Organizations to achieve breakthrough results.

#### CR-M Financial Results (3–5 years)

- Total Assets: 10x increase
- Turnover: 7x increase, to HK\$1.45 billion, with compound annual growth of 72%
- Output per Employee: 97% increase, with compound annual productivity improvement of 18%
- Operating Profit: compound annual growth rate of 70% (since 2003)
- Inventory Turnover: improved from 1.62 in 2001 to 3.69 in 2005, with compound annual improvement of 23%

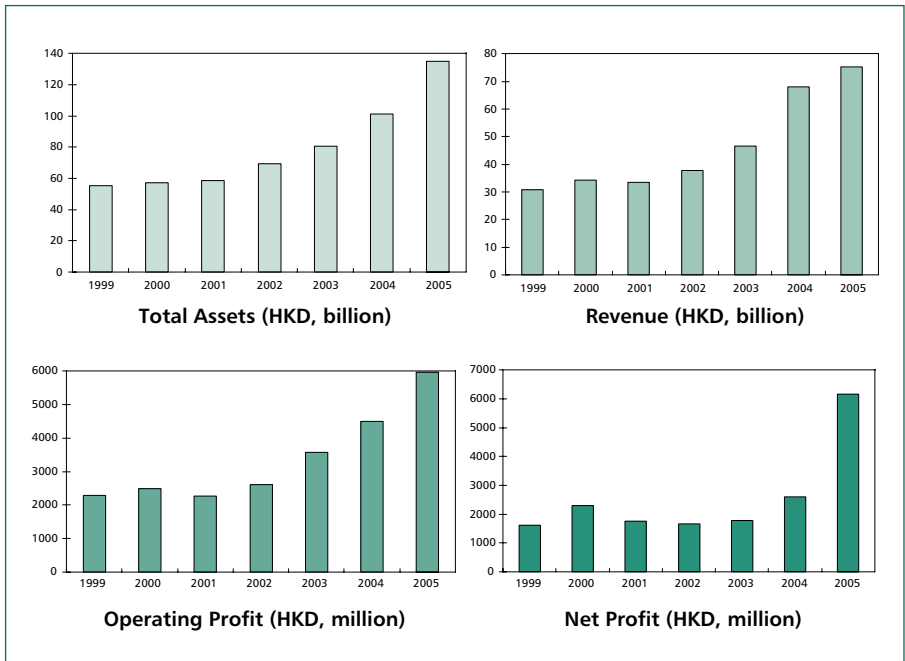
#### CR-M Nonfinancial Results (3 years)

- Customer Satisfaction rating improved from 72% to 81%
- Product Yield improved from 72% to 97%
- Effectively refocused on target customers, moving from lower-end domestic market to serving a group of customers that were more global, larger, and with better credit rating and more stable recurring orders

- Improved cooperation with more synergy and efficiency across CRC's other business units
- Achieved Top 100 Electronic Enterprise for Quality in the PRC (*Ministry of Information Industry* – June 2005/2006)
- CRHM,CRSM,CRMAT recognized CR-M as a Top 10 enterprise in their respective fields in 2004 (*China Semiconductor Industry Association*, March 2005)
- Wang Guoping, GM of CR-M, was awarded Industry Leader of Chinese Semiconductor Industry from 2003 to 2005 (*China Electronics News* Feb 2004/2006).

It is interesting to note that the China Resources (CRC) holding company parent of CR-M had been using the BSC in some form since 1999. CRC's results are quite impressive (see Figure 17).

Figure 17: China Resources Corporation Breakthrough Results



Source: eGate

The four case studies described in this chapter illustrate how different types of SOEs—operating under different business conditions—have applied strategy maps, BSCs, and cascading to manage strategy and improve alignment. SOEs can use these tools to create improved performance, increase shareholder value, and achieve profitable growth.

The CRC holding company performance data, as well as the CR-M case study, demonstrate that truly dramatic breakthrough results are possible when the BSC tools are effectively applied by SOEs in a logical, rational, and effective strategy management process.

## Chapter 7

# Summary and Conclusions

by Christian C. Johnson and Irv Beiman

A substantial amount of information is presented in this book. The purpose of this chapter is to crystallize the most important points for the reader, to present some conclusions based on the experience of the contributors, and to recommend some areas for further study and development.

The balanced scorecard (BSC) is an important *logical framework, management tool and strategy execution methodology* that enables enterprise leaders, executives, and managers to move their organizations toward achieving long-term, sustainable success. The BSC is, by far, the most widely adopted management approach used today to drive performance measurement and strategic management. More importantly, thousands of organizations around the world have used this tool and its associated methodology to drive improvements in enterprise performance.

A *six-step process* for deploying the BSC approach is introduced in Chapter 3. Using these six steps, a prototype BSC is created for a state-owned microfinance organization and illustrates the process of creating a BSC and strategy map. Any enterprise manager might follow these six steps to implement the BSC in a logical manner. The BSC is most effective when introduced, supported, and championed by the highest levels of an organization's structure or hierarchy.

Three early case studies of state-owned enterprise (SOE) BSC implementations in the People's Republic of China (PRC) are presented in Chapter 3, and three more recent case studies with a more sophisticated approach are presented in Chapter 6. An award-winning seventh case, China Resources, presents impressive

The balanced scorecard is an important logical framework, management tool and strategy execution methodology that enables enterprise leaders, executives, and managers to move their organizations toward achieving long-term, sustainable success

financial and nonfinancial performance data. This performance data attests to the significant value the BSC Methodology brought to that SOE conglomerate and its award-winning subsidiary, China Resources Microelectronics.

These *seven case studies* illustrate how SOEs are practically using the BSC Methodology. These cases highlight the possible improvements from measuring performance, creating and communicating an enterprise strategy, cascading that strategy to lower levels of the organization, and executing the strategy in a *systematic ongoing and replicable process*. Survey data of more than 100 organizations is presented in Chapter 6, indicating such an approach is necessary to achieve the desired breakthrough results.

A *new application* of the BSC is introduced for the first time in this book—using the BSC as a tool for governments to strategically manage their SOEs. Governments may manage their SOEs using the BSC directly or indirectly. Direct management by government would involve designing a BSC for the country's entire SOE sector, as exemplified by the SASAC case described in Chapter 4. Indirect management by government would involve a government stimulating a country's large holding companies or critical SOEs to design specific BSCs at multiple levels of their complex organizational structures, as described in Chapter 6.

In either possibility, there is a wealth of practical data and case studies from both developed and transition economies, indicating that five key aspects are necessary to achieve optimum results from the BSC Methodology:

- Describe your strategy in a strategy map.
- Measure strategic improvement via BSCs at multiple levels of the organizational structure or hierarchy.
- Align all organizational units (vertically and horizontally) to the strategy with the BSC.
- Link strategy to other critical functions and systems, most notably, budgeting, human resources, and information technology.
- Finally, periodically review, analyze, and adjust strategy (objectives, measures, targets, and actionable initiatives)

A new application of the balanced scorecard is introduced for the first time in this book – using the balanced scorecard as a tool for governments to strategically manage their SOEs

in a manner that accurately reflects the internal and external realities faced by the government or enterprise leaders.

A new relative scoring system for measuring enterprise performance using the BSC is introduced in Chapter 4. Historically, an enterprise uses the BSC to measure and compare absolute measures, for example, return on equity (ROE) or perhaps growth of customer accounts within a specific enterprise. A new relative scoring system is introduced that allows a government to measure the relative performance of its enterprises in addition to the more typical approach of measuring each enterprise's absolute performance.

This type of relative performance measurement system may not be appropriate for all countries. However, for those countries and organizations with sufficient available data, the relative scoring system is an important innovation. For example, a holding company may be able to design a BSC to measure the relative performance of its subsidiary SOEs (in addition to the absolute performance of each SOE). Also, an organization with large numbers of stores, branches, or outlets may be able to adopt a similar scoring system using both financial and nonfinancial information from its IT databases.

Another major contribution of this book is the definition of a Country Corporate Governance Rating Index (CGRI) for SOEs as a tool that governments may use to measure, manage, and improve the corporate governance of their SOEs. We recommend that countries with large SOE sectors draft and publish a Country-specific SOE Code of Corporate Governance based on the 2005 OECD Guidelines of Corporate Governance of State Owned Enterprises.

As the PRC is the first application for each of these three innovations, more research and testing will be needed to determine the usefulness of these tools. The Egyptian Ministry of Finance, for example, is in the initial stages of investigating use of the BSC to improve the performance of their SOEs. Egypt is also in the initial stages of creating a CGRI for their SOEs based on their June 2006 "Code of Corporate Governance for Public Sector Enterprises."

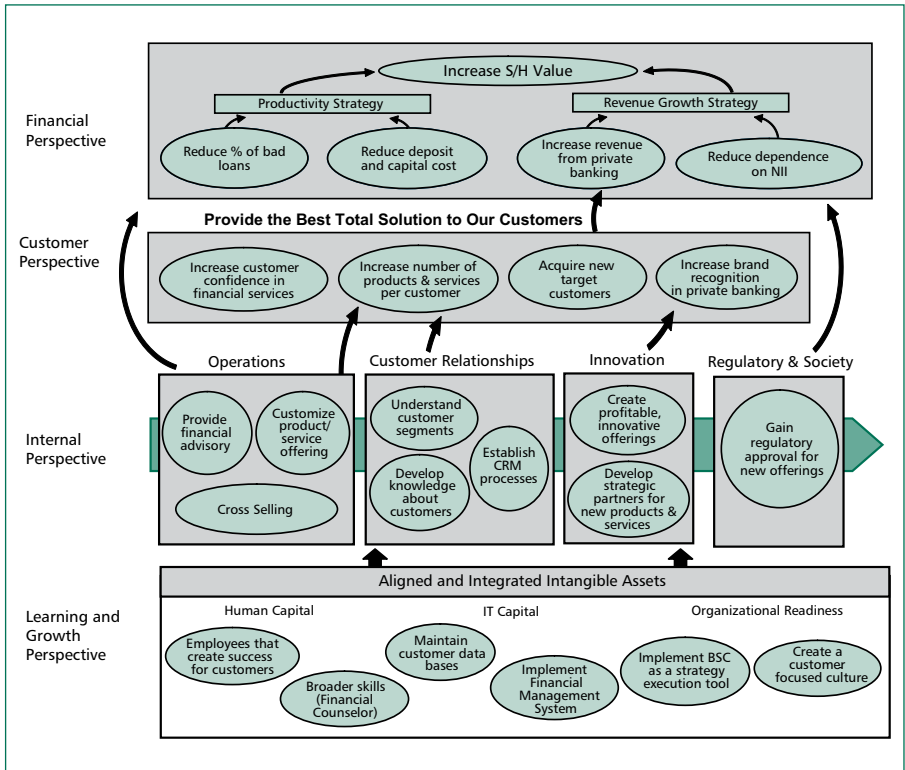
Another major contribution of this book is the definition of a Country Corporate Governance Rating Index (CGRI) for SOEs as a tool that governments may use to measure, manage, and improve the corporate governance of their SOEs

Many governments in the developed and developing world are implementing the BSC for their government organizations and enterprises. The results of these experiences should be closely watched and lessons learned disseminated in a similar fashion as we do in this book. The combination of improved SOE performance by use of the BSC management system and corporate governance rating indexes holds much promise for transitional economies in what is already a tumultuous 21st century!



# Appendix 1

## ABC BANK'S MODIFIED STRATEGY MAP AND BALANCE SCORECARD



	Strategic Objectives	Strategic Measures
Financial	Grow revenue rapidly Reduce cost	F1 Revenue mix (private banking and fee coverage) F2 Profitability F3 Funding cost F4 Bad debt ratio F5 Deposit servicing cost
Customer	Increase brand recognition in private banking Acquire new target customers	C1 Market share in private banking in the local market C2 # of and revenue from new target customers C3 Customer satisfaction
Internal	Cross sell Improve customer service Offer new products/services Improve efficiency	I1 % of revenue generated from cross selling I2 % of Timely Customer database maintenance and updates I3 % of Completion of CRM processes I4 # of new offerings I5 Success rate of process improvement projects
Learning and Growth	Develop employee competency Increase knowledge about customers Achieve strategy execution success	L1 Competency development L2 CRM system and financial system implementation L3 Access to Strategic Information (BSC implementation)

# Appendix 2

## DVFA SCORECARD FOR GERMAN CORPORATE GOVERNANCE

### Scorecard for German Corporate Governance® (according to GCG-Code May 21, 2003)

DVFA Evaluation Method based on the 'German Corporate Governance Code'

DVFA Corporate Governance Working Group (Prof. Dr. Alexander Bassen (Speaker), Prof. Dr. Otto Lohst, Christian Strenger)

#### Methodic Remarks:

Important basis is the official 'German Corporate Governance Code' in its current version (May 21, 2003)

References in brackets are printed in bold for 'Shall-Recommendations'. For 'Should-Suggestions', references in brackets are printed in italics. The different criteria of the Scorecard refer to each chapter of the Code.

The degree of fulfillment of every single question is being determined by marking the applicable field in column. (1)

Weighting of the questions: In addition to the Standard Weighting an Individual Weighting can be made in columns (3) and (5). The sum of the weightings of all points per criterion must add up to 100%.

Total Score: Summary of the results of the partial criteria shown on page 5.

Information Source: The respective source of every point should be indicated in column (6)

#### Partial Criterion

Partial Criterion	Fulfillment (1)			Standard Weighting (2)	Individual Weighting (3)	No. Of Points (4) = (1) × (2) Standard Partial Score	No. Of Points (5) = (1) × (3) Individual Partial Score	Information Source (6)
	1	0	no					
	yes	no						
I. Corporate Governance-Commitment (10%)								
1.1 Does the company have its own specific corporate governance principles based on the German Corporate Governance Code?				20%		0.0%	0.0%	
1.2 Are these principles based on the Code easily available to all stakeholders (e.g. via Internet) in an up-to-date version?				10%		0.0%	0.0%	
1.3 Do these company principles include an explicit commitment to adapt them to best practice developments of corporate governance?				15%		0.0%	0.0%	
1.4 Do the management and the supervisory board report annually about the company's governance?								
a) Is any non-compliance with the 'Shall-Recommendations' of the CGC-Code explained? (3.10)				10%		0.0%	0.0%	
b) Are the 'Should-Suggestions' commented? (3.10 p.2)				15%		0.0%	0.0%	
1.5 Is a sufficiently neutral corporate governance officer in charge of the implementation of the principles and the compliance with them?				15%		0.0%	0.0%	
1.6 Is the report of the corporate governance officer regularly discussed in the Supervisory Board?				15%		0.0%	0.0%	
				100%	0%	0%	0%	

Partial Criterion		Fulfillment (1)		Standard Weighting (2)	Individual Weighting (3)	No. Of Points (4) = (1) × (2)		No. Of Points (5) = (1) × (3)		Information Source (6)
		1	0			Standard Partial Score		Individual Partial Score		
		yes	no							
<b>II. Shareholders and the General Meeting (12%)</b>										
							12%	12%		
II.1	Are the agenda of the General Meeting, any opposing shareholder proposals, management comments thereto and the voting results made available to all shareholders on the internet in a timely manner? (2.3.1, 2.3.2)			20%			0.0%	0.0%		
II.2	Can voting rights be exercised (at least via proxies) using the internet? (2.3.3, 2.3.4)			20%			0.0%	0.0%		
II.3	Can shareholders follow General Meetings also via the internet? (2.3.4)			10%			0.0%	0.0%		
II.4	In case of acquisition-related share placements of more than 20% of the existing share capital with exclusion of pre-emptive rights, is a particular authorization of the General Meeting required?			15%			0.0%	0.0%		
II.5	For acquisition-related share placements with exclusion of pre-emptive rights: Are shareholders given timely access to all material information?			15%			0.0%	0.0%		
II.6	For share placements of more than 10% of the existing share capital at or near the existing market price: Are shareholders given pre-emptive rights?			20%			0.0%	0.0%		
				100%		0%	0%	0%		
<b>III. Cooperation between Management Board and Supervisory Board (15%)</b>										
							15%	15%		
III.1	Is there a written understanding between the Management and Supervisory Boards with regard to regular, timely and comprehensive information by the Management Board? (3.4)			20%			0.0%	0.0%		
III.2	Do terms of reference exist for the Supervisory Board detailing its rights and duties, stipulating inter alia the transactions requiring approval and the information duties of the Management Board? (3.3, 5.1.3)			20%			0.0%	0.0%		
III.3	Do the representatives of the shareholders and of the employees of co-determined Supervisory Boards meet separately to prepare the Supervisory Board Meetings? (3.6)			20%			0.0%	0.0%		
III.4	Is a General Meeting generally convened in case of a takeover offer? (3.7)			30%			0.0%	0.0%		
III.5	Does an appropriate deductible exist for any D&O insurance policies for Management and Supervisory Board members? (3.8)			10%			0.0%	0.0%		
				100%		0%	0%	0%		

Partial Criterion		Fulfillment (1)		Standard Weighting (2)	Individual Weighting (3)	No. Of Points (4) = (1) × (2) Standard Partial Score	No. Of Points (5) = (1) × (3) Individual Partial Score	Information Source (6)
		1	0					
		yes	no					
IV. Management Board (10%)								
IV.1	Does the Management Board issue business principles, company policy guidelines and terms of reference, which regulate inter alia co-operation within the Management Board? (4.2.1)			20%		0.0%	0.0%	
IV.2	Are the fixed and variable compensation elements of the Management Board published separately and by individual? (4.2.4)			15%		0.0%	0.0%	
IV.3	Is the variable compensation of the Management Board linked to the relative value creation (e.g. relative performance, economic profit)? (4.2.3 p.2)			15%		0.0%	0.0%	
IV.4	Does the variable compensation contain components with long-term incentive effect and risk elements? (4.2.3 p.4)			10%		0.0%	0.0%	
IV.5	Does the company report about stock option programmes and similar incentive systems, as well as about their valuation and accounting treatment ? (4.2.3 sect.3)			10%		0.0%	0.0%	
IV.6	For company stocks and stock grants from option plans as variable compensation element: does there exist a multi-year blocking period and are retroactive changes (like option repricing) in variable compensation benchmarks excluded? (4.2.3 p.4, p.6)			15%		0.0%	0.0%	
IV.7	Do conflicts of interest, transactions and other activities have to be communicated and approved, e.g. all transactions with the company or its board members, company loans? (3.9, 4.3.4, 4.3.5)			15%		0.0%	0.0%	
				100%	0%	0%	0%	
V. Supervisory Board (15%)								
V.1	Do defined criteria exist to ensure the qualification of Supervisory Board members (e.g. professional qualification and experience, sufficient time, international experience)? (5.4.1)			15%		0.0%	0.0%	
V.2	Are there no more than two former members of the Management Board on the Supervisory Board and do Supervisory Board members refrain from directorships or advisory tasks for important competitors of the company? (5.4.2)			15%		0.0%	0.0%	
V.3	Do re-appointments of Management Board members take place at the earliest one year before the end of the original appointment period and with due consideration of age limits? (5.1.2)			5%		0.0%	0.0%	
V.4	Does the Supervisory Board have a sufficient number of committees in order to adequately handle complex issues? (5.3.1)			15%		0.0%	0.0%	

Partial Criterion		Fulfillment (1)				Standard Weighting (2)	Individual Weighting (3)	No. Of Points (4) = (1) × (2) Standard Partial Score	No. Of Points (5) = (1) × (3) Individual Partial Score	Information Source (6)
		1		0						
		yes	no							

(still Supervisory Board, V)										
V.5	Does an Audit Committee exist? (5.3.2, 5.2)				15%			0.0%	0.0%	
V.6	Is the Audit Committee not chaired by the Chairman of the Supervisory Board? (5.2 sect.2, p.2)				5%			0.0%	0.0%	
V.7	Does the Supervisory Board receive a performance-related variable compensation linked to the long-term company results, which is reported individually in the Notes of the Financial Statements? (5.4.5)				5%			0.0%	0.0%	
V.8	Is additional compensation received for advisory or agent services of Supervisory Board members separately listed on an individual basis? (5.4.5)				5%			0.0%	0.0%	
V.9	Are conflicts of interest and own-account transactions disclosed to the Supervisory Board and in important cases to the General Meeting (such as transactions with the company or its board members, company loans, directorships with important competitors)? (5.5.2, 5.5.3)				5%			0.0%	0.0%	
V.10	Does the Supervisory Board conduct an annual review of its activities? (5.6)				15%			0.0%	0.0%	
					100%	0%		0%	0%	

VI. Transparency (20%)										
					20%			20%		
V.1	Are all investors (not only shareholders according to § 53a AktG - German Securities Act) and financial analysts informed equally (‘Fair Disclosure’) via the internet and also in English? (6.3, 6.4, 6.8)				30%			0.0%	0.0%	
V.12	Are regular capital market conferences (like analyst meetings) held?				15%			0.0%	0.0%	
V.13	Is there a detailed analysis of deviations from major previously published performance and strategy targets?				15%			0.0%	0.0%	
V.14	Is all information disclosed outside Germany by the company and its group members in fulfillment of relevant provisions of capital market laws also disclosed without delay in Germany? (6.5)				10%			0.0%	0.0%	
V.15	Are the actual shareholdings (including options and derivatives) and any changes thereto published without delay individually and separately by Management and Supervisory Board members in the Annual Report? (6.6 sect.2)				20%			0.0%	0.0%	
V.16	Is a current ‘financial calendar’ available? (6.7)				10%			0.0%	0.0%	
					100%	0%		0%	0%	

Partial Criterion							Information Source (6)
VII. Reporting and Audit of the Annual Financial Statements (18%)							
Fulfillment (1)	Standard Weighting (2)	Individual Weighting (3)	No. Of Points (4) = (1) × (2) Standard Partial Score 18%	No. Of Points (5) = (1) × (3) Individual Partial Score 18%			
					1	0	
					yes	no	
Vii.1	Are the Reports prepared according to IAS / US-GAAP (7.1.1), and are International Standards on Auditing (ISA) or the US Generally Accepted Auditing Standards (US-GAAS) applied complementary to the IDW (German Institute of Auditors) Standards on Auditing?		10%				
Vii.2	Is sufficient independence an important criterion for the selection of the auditors? (7.2.1)		20%				
Vii.3	Does the Supervisory Board set an appropriate level for the auditing fee?		15%				
Vii.4	In case of audit work conducted by different auditors for the group: are special accounting standards and measures made transparent?		10%				
Vii.5	Are the Consolidated Financial Statements published within 90 days of the end of the financial year and the interim reports within 45 days? (7.1.2)		10%				
Vii.6	Are interim reports prepared according to IAS or US-GAAP? (alternatively: DVFA Reporting Standards or DSR - German Standardisation Council)? (7.1.1)		10%				
Vii.7	Do the Consolidated Financial Statements contain details for the following shareholdings: (7.1.4)			0%			
a)	Shareholdings of at least 5 % of the equity capital (also in non-listed companies).		5%				
b)	Mutual shareholdings		5%				
Vii.8	Has the Supervisory Board mandated the auditor to report all relevant deviations from the 'German Corporate Governance Code'? (7.2.3)		15%				
			100%	0%			

0%	Standard CG Score	0%	Individual CG Score
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0%	0%
Standard CG Score	Individual CG Score





# Appendix 3

## SAMPLE LISTING OF CHINESE CORPORATE GOVERNANCE LEGAL FRAMEWORK

Law/Regulation	Date	Coverage
Law on Industrial Enterprises owned by the Whole People	1988	SOEs
Company Law of the PRC	1994	All Companies
Auditing Law of the PRC	1994	All Companies
Accounting Law	1995	All Companies
Code of Corporate Governance for SOEs (Provisional)	2000	SOEs
Code of Corporate Governance for Listing Companies	2001	Listed Companies
Basic Guidelines for Establishing Modern Enterprises and Enhancement of Management for Large- and Medium-sized SOEs	2000	SOEs
Interim Regulations on Supervision and Management of SOEs	2003	SOEs
Guidelines on Introducing Independent Directors to the Board of Directors of Listed Companies	2003	Listed Companies



# Appendix 4

## CGRI INDEX FOR NON-100% PRC GOVERNMENT-OWNED COMPANIES

	Not 100% Owned by Government
I. Role of the Board	25 points
II. Transparency and Disclosure	25 points
III. Audit	20 points
IV. Stakeholders and Corporate Citizenship	10 points
IV. Treatment of Shareholders	20 points
<b>Total</b>	<b>100 points</b>

### I. ROLE OF THE BOARD OF DIRECTORS

Board Composition	10 Points
Board Meetings	4 Points
Board Policies	4 Points
Board Responsibilities	7 Points
<b>Total</b>	<b>25 Points</b>

Board Composition (10 Points)	Justification
<p>1. (2 Points) The ideal size of a Board of Directors is 9–15 members. If your Board has ≤ 3 members – Award 0 Points 4–8 members – Award 1 Point 9–15 members – Award 2 Points 16–18 members – Award 1 Point &gt;= 19 members – Award 0 Points</p>	<p>Article 112 of the PRC Company Law requires that companies to have a Board of Directors of 5–19 members. International best practices generally indicate an optimum board size of 9–15 members. WSOCs are required by Article 68 to have between 3 and 9 members on the Board of Directors. Article 45 of the PRC Company Law requires a limited liability company to have a Board of Directors of 3–13 members.</p>
<p>2. (1 Point) Is there a limit to the number of total board seats directors may hold?</p>	<p>The PRC limits any individual to five board seats on public companies.</p>
<p>3. 2 Points) Are the offices of Chairperson of the Board of Directors and CEO (or Managing Director) separated?</p>	<p>Article 120 of PRC Company Law allows for separation of office, but Chairperson and CEO may be the same. OECD Principles recommend that separation be considered. Most institutional investors favor separation. In view of PRC's problem of strong managers' weak oversight, separation is recommended.</p>

Board Composition (10 Points)	Justification
<p>4. (2 Points) What percentage of the Board of Directors are independent directors? If less than 20% – Award 0 Points If between 20% and 49% – Award 1 Point If 50% or more – Award 2 Points</p>	<p>Code of Corporate Governance for Listed Companies (paragraph 49) requires independent directors, but does not specify number.</p>
<p>5. (1 Point) Does the Board have Remuneration and Nomination committees?</p> <p>6. (1 Point) Is each of these committees chaired by an independent director?</p> <p>7. (1 Point) Do independent directors represent a majority of committee members?</p>	<p>Paragraphs 52–58 of the Code of Corporate Governance for Listed Companies deal with specialized committees of the Board. These include a corporate strategy committee (not covered in this system), the audit committee (covered separately), as well as remuneration and Nomination committees. The duties of these committees re as noted in the system. The OECD Corporate Governance Principles note the importance of director independence on key committees.</p>

Board Meetings (4 Points)	Justification
<p>8. (1 Point) Over the last 12 months, did the Board meet at least 6 times and conduct meetings that lasted for at least a half-day?</p>	<p>Article 116 of the PRC Company Law requires boards to meet twice per year. International practice indicates that more frequent meetings are necessary. Code of Corporate Governance for Listed Companies indicates that Board should meet as necessary (Paragraph 45).</p>
<p>9. (1 Point) Over the last 12 months, did all members of the Board of Directors receive notification of board meetings at least 7 working days in advance of meetings? Can Directors place items on the meeting agenda? If answer is yes for both questions, award 1 Point.</p>	<p>PRC Company Law requires notification of meeting 10 days in advance. Code of Corporate Governance for Listed Companies requires that material be available with sufficient time and that independent directors may object if not received in time (Paragraph 46).</p>
<p>10. (1 Point) Did the Board of Directors keep meeting minutes, attendance records, and voting records for all meetings over the last 12 months? Are these meeting minutes and records available to all board members and SASAC? If answer is yes for both questions, award 1 Point.</p>	<p>The Code of Corporate Governance for Listed Companies establishes guidelines for the preparation of records of the meeting.</p>
<p>11. (1 Point) Do the independent members of the Board meet without management present?</p>	<p>This practice is frequently recommended as a means of improving oversight by independent directors.</p>

Board Policies (4 Points)	Justification
12. (1 Point) Does the Board of Directors have a policy specifying the professional qualifications and training requirements for board members?	The Code of Corporate Governance for Listed Companies requires directors to have adequate professional background (Paragraph 41) and to familiarize themselves with the duties of directors (Article 37).
13. (1 Point) Does the Board of Directors have a policy specifying tenure limits for board members (such as a requirement for retirement and/or rotation of directors)?	Articles 56–57 of the PRC Company Law disqualify persons having been found guilty of certain crimes or responsible for bankruptcy through failure to perform duties from serving as directors.
14. (1 Point) Is there a Code of Conduct for directors and does the company have a manual on Corporate Governance approved by the Board of Directors?	Specific training as directors, and the mix of skills and policies regarding rotation and retirement are standard corporate governance practices.
15. (1 Point) Does the Board of Directors have a policy that a director is required to excuse (dismiss) himself when the Board considers issues in which the Board member has a personal interest?	<p>The OECD Corporate Governance White Paper for Asia recommends specific training for directors. The PRC also has begun an Institute of Directors in which many directors have received training.</p> <p>Paragraph 41 of the Code of Corporate Governance for Listed Companies requires directors to have adequate professional background and to familiarize themselves with the duties of directors (Article 37). Specific training as directors, as well as the mix of skills and policies regarding rotation and retirement, is included in many codes for directors. The OECD Corporate Governance White Paper for Asia recommends specific training for directors. The PRC also has begun an Institute of Directors in which many directors have received training.</p>

Board Responsibilities (7 Points)	Justification
16. (1 Point) Is the Board responsible for (1) the selection and compensation of senior management; (2) adjudicating conflicts of interest and review of related party transactions; (3) changes to capital structure; organization and conduct of shareholder meetings; (4) capital plans; (5) acquisitions, joint ventures, and divestments; (6) deciding on whether to pay dividends and the amount of such dividend payments; and (7) taking interests of stakeholders into accounts?	Article 120 of PRC Company Law specifies the responsibilities of the Board. All items are covered by the PRC Company Law. The Code of Corporate Governance for Listed Companies (paragraphs 12–14) cover related party transaction but do not identify the Board as specifically responsible. However, independent directors are mandated to assure that the interests of minority investors are respected against interested parties. The OECD Principles identify a similar set of responsibilities and, in addition, specify that the Board should be responsible for the other items mentioned in this section.
17. (1 Point) Is the Board responsible for business plan budget and strategic plans?	
18. (1 Point) Is the Board responsible for review and approval of annual reports?	
19. (1 Point) Is the Board responsible for legal and ethical compliance?	
20. (1 Point) Is the Board responsible for integrity of financial controls?	
21. (1 Point) Is the Board responsible for disclosure and communications?	
22. (1 Point) Is the Board responsible for developing a risk management system?	

## II. TRANSPARENCY AND DISCLOSURE #2

Annual Report	10 Points
Audited Financial Statements	10 Points
Corporate Communications	5 Points
<b>Total</b>	<b>25 Points</b>

Annual Report (10 Points)	Justification
1. (1 Point) Did the company provide its shareholders with an annual report within the last 12 months?	Article 175 of the PRC Company Law stipulates that the annual accounts must be audited. The OECD Principles also require an annual audit of financial statements. The OECD Corporate Governance White Paper for Asia calls attention to the need for high-quality audits of company accounts. Also, the Statements on Corporate Governance by Hermes (a major UK pension Fund) and the Asian Development Bank identify an audited annual report as a requirement. Because the whole people own companies that are 100% owned by the PRC Government, it follows that an annual report should be publicly available to all citizens of the PRC.
2. (1 Point) Did the annual report provided to shareholder within the last 12 month include financial statements audited by an external auditor?	
3. (1 Point) Did the company provide formal quarterly and semi-annual reports to shareholders within the last 12 months?	
4. (1 Point) Does the company's latest annual report identify the company's main executives and their responsibilities?	Main executives and their compensation are items that are identified as requiring disclosure in the OECD Principles and the OECD Corporate Governance White Paper for Asia.
5. (1 Point) Does the company's latest annual report include the compensation of the company's main executives and is this information disclosed in the annual report?	
6. (1 Point) Does the company's latest annual report include a management discussion and analysis of the company's finances and operations?	OECD Principles identify the need for a company's management to provide an analysis of the company's current finances and operations.
7. (1 Point) Does the company's latest annual report include the management's assessment of the company's outlook for the future and identify important risks that the company faces in the future?	OECD Principles identify the need for management to provide an accurate assessment of the company's outlook for the future and future risks. Such disclosure helps ensure the company's management focuses on the future and on possible risks.
8. (2 Points) Has the company produced and included in its annual report a statement of its corporate objectives ("mission statement") and does it periodically update this statement?	A "mission statement" is an important tool to communicate to all a company's stakeholders the reason for a company's existence. It aligns all employees with the company mission so that there is no confusion.

Annual Report (10 Points)	Justification
<p>9. (1 Point) Does the company's latest annual report disclose significant "related party" transactions (that is, loans, contracts, or other large transactions with key stakeholders)?</p>	<p>OECD Principles identify the need for management to disclose "related party" transactions. Such disclosure reduces the risks that unfair deals are made with stakeholders.</p>
Audited Financial Statements (10 Points)	Justification
<p>10. (3 Points) Does the company's financial accounts comply with the "Accounting System for Business Enterprises" adopted by the MOF in January 2001?</p>	<p>Older Chinese accounting standards allowed for different rules to be applied in different sectors of the economy. The "Accounting System for Business Enterprises" (the System) imposes greater homogeneity of accounting rules. Although SOEs require approval from "the relevant government authority" to adopt the System, it is widely recognized that the System provides the most advanced accounting rules that are closest to IAS. In addition, if a parent company adopts the System, it is required that the System be adopted by all the parent's subsidiaries.</p>
<p>11. (2 Points) Within the last 12 months did an external auditor audit the company?</p>	<p>Article 175 of the PRC Company Law indicates the financial statements that firms are expected to produce. The OECD Principles identify the basic accounts that are normally produced by companies. Many companies have misrepresented their true situation by failing to report of balance sheet operations and/or operations by other companies within a group.</p>
<p>12. (2 Points) Did the external audit contain a balance sheet, income statement, and cash flow with auditor's explanatory notes?</p>	<p>Article 175 of the PRC Company Law indicates the financial statements that firms are expected to produce. The OECD Principles identify the basic accounts that are normally produced by companies. Many companies have misrepresented their true situation by failing to report of balance sheet operations and/or operations by other companies within a group.</p>
<p>13. (1 Points) Are year-end audited financial reports produced within 120 days of the end of the fiscal year?</p>	<p>Article 175 of the PRC Company Law stipulates that reports are to be produced within 120 days of the end of the reporting period.</p>
<p>14. (2 Points) Does the CEO and company's Board of Directors both separately certified the company's financial reports and annual reports as truthful and accurate?</p>	<p>A 1999 amendment of the <i>Accounting Law 1985</i> clarified the respective roles and responsibilities of the State, organization managers, and accountants for accounting procedures and accounting information. First, the revised law makes the person in charge of a corporation legally responsible for the truthfulness of accounting information. The more precise statement of responsibility is expected to strongly motivate enterprise leaders to work harder on internal management in pursuit of a good image. Second, accountants were previously responsible for</p>



Audited Financial Statements (10 Points)	Justification
	<p>monitoring financial operations on behalf of the State and organization owners. In addition to assigning responsibility to organization managers, the revised law personalizes the activities of accountants, who are now responsible for themselves rather than acting on behalf of the State. Finally, the revised law reinforced role clarity by introducing a range of financial penalties for contraventions. (An example of such a statement is as follows: "The Board of Directors of Anhui Gujing Distillery Company Limited hereby confirms that there are no important omissions, fictitious statements or serious misleading information in this report, and shall take all responsibility, individual and/or joint, for the reality, accuracy and completion of the whole contents." This statement is from Anhui Gujing Distillery Company Limited. 2000. (<i>Annual Report for the Year ended 31 December 1999</i>.)</p>
Corporate Communications (5 Points)	Justification
<p>15. (1 Point) Does the company produce periodic reports and press releases to indicate significant developments?</p> <p>16. (1 Point) Does the company have a corporate communications program?</p>	<p>The Code of Corporate Governance for Listed Companies requires disclosure on an ongoing basis of information that has a material influence on the decisions of shareholders and stakeholders and to deliver that information efficiently (Paragraphs 87–88).</p>
<p>17. (1 Point) Does the company disclose in its annual report and elsewhere a discussion of company policies in relation to legal and environmental issues?</p> <p>18. (1 Point) Does the company disclose (in its annual report and by other formal documentation) its commitments to stakeholders such as its workforce, suppliers, customers, and local communities?</p>	<p>The Code of Corporate Governance for Listed Companies outlines the responsibilities of the company to stakeholders. In the interest of transparency, it is suggested that commitments to stakeholders be disclosed (Paragraphs 81–88).</p>
<p>19. (1 Point) Does the company provide its current financial and nonfinancial company information using electronic communications techniques, such as the company website?</p>	<p>The Code of Corporate Governance for Listed Companies requires disclosure on an ongoing basis of information that has a material influence on the decisions of shareholders and stakeholders and to deliver that information efficiently (Paragraphs 87–88).</p>

III. AUDIT #2

Audit Committee Procedures	8 Points
Audit Committee Structure	3 Points
Internal Audit	3 Points
External Audit	6 Points
<hr/>	
Total	20 Points

Audit Committee Procedures (8 Points)	Justification
1. (1 Point) Does the Board of Directors have an Audit Committee?	<p>The Code of Corporate Governance for Listed Companies (Paragraphs 52 and 54) stipulates that the company must have an Audit Committee. Paragraphs 52 and 54 also specify the duties of the Audit Committee.</p> <p>The OECD Principles also refer to the need for an Audit Committee.</p> <p>In the last few years, best practices on the Audit Committee have become better defined. For example, see Carolyn Brancato and Christian A. Plath, <i>Corporate Governance Best Practices: A Blueprint for the post-Enron Era</i>. The Conference Board. New York. 2003. pp. 36–47.</p>
2. (1 Point) Do the procedures governing the Audit Committee state the Audit Committee is responsible for the selection of, oversight of, and all Board of Directors communications with external auditors?	
3. (1 Point) Do the procedures governing the Audit Committee state the Audit Committee is responsible for the oversight of the company's financial accounts?	
4. (1 Point) Do the procedures governing the Audit Committee state the Audit Committee is responsible for the reviewing and ensuring the effectiveness of internal controls and risk management?	
5. (1 Point) Do the procedures governing the Audit Committee state the Audit Committee is responsible for reviewing and ensuring the company's audits are in compliance with applicable laws, regulations, and company policies?	
6. (1 Point) Did the Audit Committee meet at least six times during the last 12 months?	
7. (1 Point) Are minutes of the audit committee meetings maintained and circulated to the full board?	
8. (1 Point) Are there procedures and rules governing the Audit Committee approved by the full board?	

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Audit Committee Structure (3 Points)	Justification
9. (1 Point) Does the Audit Committee have between five and seven members?	The Conference Board document (see Item 1) suggests the optimum size for the Audit Committee is between three and five members.
10. (1 Point) Does the Audit Committee have a Chairperson that is an independent director?  11. (1 Point) Are at least 50% of the Audit Committee members independent directors?	The Code of Corporate Governance for Listed Companies (Paragraphs 52) species that the chairperson of the Audit Committee and the majority of members must be independent and that one member must be a specialist in accounting. The Conference Board document (see Item 1) proposes more rigorous standards.
Internal Audit (3 Points)	Justification
12. (1 Point) Does the company have an internal audit department?  13. (1 Point) Does that internal audit department report directly to the Audit Committee of the Board and not the CEO or Company Director?	The Fundamental Code On The Modern Corporate System (Article 43) refers the need to strengthen the internal audit process. More precise guidelines are available in the Conference Board document (see Item 1) pages 45–46.  All companies (SOE and non-SOE) are required to establish accounting procedures and associated internal controls in line with Article 27 of the 1995 Accounting Law (Amended) and associated regulations.
14. (1 Point) Is there a system of protection for employees and others who report infractions to the internal audit function or the external auditors (“whistle blowers”)?	The OECD Principles refer to the need to protect employees who reveal shortcomings in company practices (“whistle blowers”).

External Auditors (6 Points)	Justification
<p>15. (1 Point) Does the company have external auditors?</p> <p>16. (1 Point) Are the external auditors appointed by shareholders upon the recommendation of the Board of Directors following screening by the Audit Committee?</p> <p>17. (1 Point) Is an annual external audit performed?</p> <p>18. (1 Point) Are the auditors certified or licensed by an appropriate body responsible for regulating the auditing profession?</p> <p>19. (1 Point) Has the external auditor ever been sanctioned by courts or by bodies responsible for regulating the auditing profession?</p>	<p>The Fundamental Code On The Modern Corporate System (Article 43) refers the requirement of an annual external audit of accounts. The OECD Principles identify the need for an annual audit by an independent auditor and recommend strict oversight by the Audit Committee.</p>
<p>20. (1 Point) Does the Audit Committee have policies to mitigate conflicts of interest facing the external auditor, such as rotation of auditors?</p>	<p>The OECD Principles note possible conflicts of interest between audit and other services and the need to strengthen auditor independence. IOSCO Principles of Auditor Oversight (2002) and Principles of Auditor Independence and the Role of Corporate Governance in Monitoring Auditor Independence are also relevant standards.</p>

## IV. STAKEHOLDER AND CORPORATE CITIZENSHIP

Workplace Safety	3 Points
Financial Obligations	7 Points
<b>Total</b>	<b>10 Points</b>

Workplace Safety (3 Points)	Justification
1. (1 Point) Does the company have a written policy toward its personnel covering a) employment security or b) training, promotion, or mobility?	Article 55 of the PRC Company Law requires the company to take account of the interests of its workers when formulating policy. The Fundamental Code On The Modern Corporate System (Articles 16–17) refers to the need to engage highly qualified personnel through training and to produce in ways that reduce environmental damage. Articles 20–22 deal with improving the quality of labor and taking the interests of workers into account. Article 25 obliges the enterprise to respect the rights of workers. Article 26 requires the firm to make timely payments to social security account. Articles 63–64 cover employee training. The Code of Corporate Governance for Listed Companies (Paragraphs 81–83) stipulates that the company shall respect the legal rights of employees, creditors, consumer, the community, and other stakeholders. The OECD Principles state that the rights of stakeholders that are protected by law should be respected, that employees should have access to legal redress in cases of violation of their rights, and that performance-enhancing mechanisms for employee participation should be permitted.
2. (1 Point) Does the company have a written policy regarding social, ethical, worker safety, and environmental issues?	The Fundamental Code On The Modern Corporate System (Articles 56–62) specifies the obligation to observe norms of employee safety and environmental protection.
3. (1 Point) Has the company committed infractions of worker safety or environmental laws or regulations in the last 3 years?	<p>The Code of Corporate Governance for Listed Companies (Paragraph 86) notes the company's obligation to promote sound environmental policies and to contribute to the community where it is located.</p> <p>The OECD Principles enjoin the Board to observe high ethical standards. The OECD Principles further recommend that companies develop in-house codes on issues on worker safety and the environment.</p>

Financial Obligations (7 Points)	Justification
4. (1 Point) Is the company in arrears in payments to social security funds?	The Code of Corporate Governance for Listed Companies requires to respect the rights of banks and other creditors and to provide creditors with adequate information. The position of creditors and the respect of creditor rights are recognized as important issues in Asian countries by the OECD Asian Corporate Governance Roundtable. Similarly, the revised OECD Principles identify the insolvency framework and the protection of creditor rights as important priorities in strengthening the governance framework.
5. (2 Points) Is the company well rated better than A or equivalent, [2] or better than B [1] or equivalent by its creditors?	
6. (1 Point) Does the company have relations with more than three creditors?	
7. (1 Point) Has the company agreed to a postponement of payments of principal with any of its creditors?	
8. (2 Points) Has the company been in arrears on tax payments in the last 3 years?	

## V. EQUITABLE TREATMENT OF SHAREHOLDERS

Annual Meetings	8 Points
Shareholder Rights	8 Points
Shareholder Relations	4 Points
<b>Total</b>	<b>20 Points</b>

Annual Meetings (8 Points)	Justification
1. (1 Point) Did the company hold an Annual General Meeting (AGM) at a convenient time and place that was open to all shareholders?	Articles 102 and 104 of the PRC Company Law indicates that there shall be an annual meeting of shareholders (AGM) open to all shareholders. Article 106 indicates that all shares have equal votes.
2. (1 Point) For the last AGM, was the notice of the AGM sent to shareholders at least 30 days before the meeting?	Article 105 of the PRC Company Law requires that notice of the AGM and a detailed statement of items to be considered must be given 30 days in advance of the meeting.
3. (1 Point) For the last AGM, did the notice sent to shareholders contain a detailed agenda?	
4. (1 Point) Do the company's by-laws allow non-controlling shareholders place items on the agenda of an AGM?	
5. (1 Point) Is there a mechanism in place for shareholders to use cumulative voting procedures at an AGM?	The Code of Corporate Governance for Listed Companies (Paragraph 31) stipulates that shareholders can use cumulative voting procedures. It also indicates that voting procedures should enable non-controlling investors to representation.
6. (1 Point) Can shareholders vote by proxy at an AGM?	Article 108 of the PRC Company Law stipulates that shareholders may vote by proxy.
7. (1 Point) Does the company's by-laws state that shareholders may ask questions at the AGM?	It is common practice to allow shareholders to ask questions at AGMs.
8. (1 Point) Do the company's articles of association allow shareholders holding 10% of equity to request an extraordinary shareholder meeting?	Article 104 of the PRC Company Law specifies conditions under which various parties, including the Board or investors holding 10% of the equity of the company can request a special meeting.
Shareholder Relations (4 Points)	Justification
9. (4 Points) Does the company have an investor relations program?	The Code of Corporate Governance for Listed Companies (Paragraphs 87–94) establishes the obligation of companies to communicate basic information to shareholders and spells out the general kinds of information that must be disclosed. The Code (Paragraphs 87–94) establishes the right of shareholders to have information related to the performance of the company.

Shareholder Rights (8 Points)	Justification
10. (1 Point) Does the company's by-laws require shareholder approval for the appointment and removal of directors?	Article 108 of the PRC Company Law enumerates the issues on which the AGM is normally expected to vote. This corresponds with the list of questions shown above.
11. (1 Point) Does the company's by-laws require shareholder approval for the appointment, compensation of, and removal of the external auditor?	
12. (2 Points) Does the company's by-laws require shareholder approval of amendments to the company's statutes, articles, and by-laws?	
13. (2 Points) Does the company's by-laws require shareholder approval for major corporate transactions, mergers, acquisitions, divestments, and/or takeovers?	
14. (1 Point) Does the company's by-laws require shareholder approval of the company's annual report that contain the company's financial accounts?	
15. (1 Point) Do all company shares have equal voting rights?	
	Article 106 of the PRC Company Law indicates that all shares have equal votes.



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# About the Editors and the Contributor

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