NRI Papers No.45 April 1, 2002

Building Performance Measurement Systems with the Balanced Scorecard Approach

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The Balanced Scorecard (BSC) methodology has come in for increased attention and growing popularity among Japanese companies. Indeed, the fact that it has been applied to reforms undertaken by a large number of companies during the past several years has contributed to the rapid development of the BSC concept itself. For example, Kansai Electric Power Co., Inc. has been implementing a PDCA (Plan, Do, Check and Action) management cycle to increase the value of the company through a system of what is called a "Performance Linked Contract" between division managers and senior officials covering a diverse set of performance objectives. Concurrently, the company is also promoting reform by changing its organizational climate through the joint efforts of division managers and top executives. This example by Kansai Electric Power is bringing broader attention to the kind of reform that takes into account the third generation of BSC thinking, and which is advocated by the author and others in this field.

According to the results of BSC consultations by NRI (Nomura Research Institute, Ltd.), the requirements for successful reform can be summarized in the following three points: (1) adopting a problem-solving approach that does not rely on "tools"; (2) ensuring a commitment by management; and (3) creating a cross-functional team that incorporates such functions as corporate planning and personnel administration.

I Using the Balanced Scorecard to Effectively Achieve Value-Based Management

1 What is the Balanced Scorecard (BSC)?

Many scholars and observers of the corporate scene have long advocated value-based management. This refers to managing a business to increase corporate value by considering financial indicators that reflect the cost of capital for the entire company—such as ROE (return on equity) and EVA (economic value added)—in addition to the more traditional indicators such as financial and accounting profits. But there are two major barriers that need to be overcome before management with the ultimate objective of increasing corporate value can permeate the smallest units of an organization and affect the daily activities of its employees.

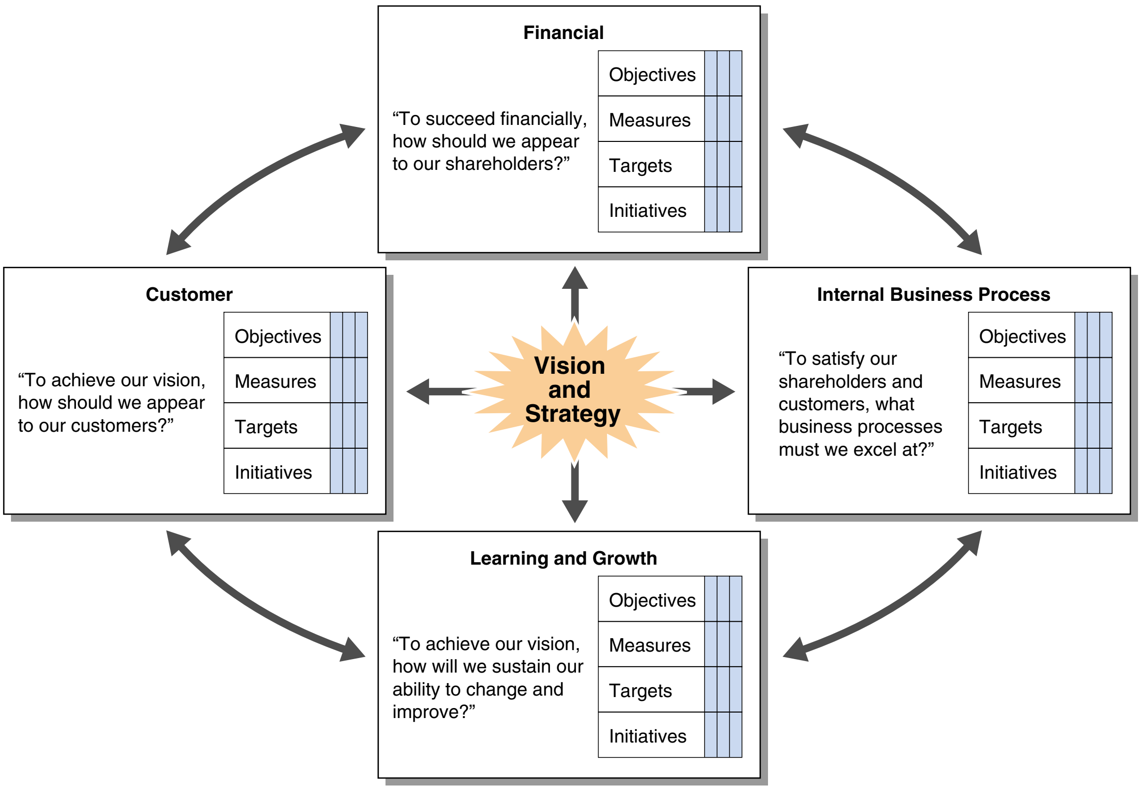
The first obstacle is the lack of sound foundations and the limits of control if management is based on financial indicators only. This is because current financial performance are essentially no more than the outcomes of a number of business activities carried out in the past. Hence pursuing results alone is nothing but reactive management.

The approach in which control is attempted through an analysis of the numerical elements in financial performance indicators (e.g., ROE is defined as the product of the ratio of profit to sales, the asset turnover ratio and financial leverage, and each is analyzed according to its constituent elements) by the tools (such as the ROE and EVA "trees") often used in promoting value-based management is likewise totally insufficient. As the elements included in these trees are still indices of short-term results, they represent only sluggish financial management even if they are realized.

Essentially, those who have the real responsibility and authority for financial performance such as ROE and EVA are limited to only a handful of executives at the highest level of the organization. Most supervisors and general employees are responsible for only a part of a firm's financial performances (such as sales, costs or inventory levels). Moreover, evaluating the performance of administrative and support departments for which it is difficult to quantify numerical achievements cannot be made on the basis of financial indicators alone.

The second barrier is that general employees have only a limited understanding of such concepts as the cost of capital and corporate value. Regardless of whatever instructions they receive to "improve EVA," they can rarely understand how this relates to their own

Figure 1. Basic Concept of the Balanced Scorecard



Source: Prepared by NRI based on Robert S. Kaplan and David P. Norton, "Using the Balanced Scorecard as a Strategic Management System," *Harvard Business Review,* January and February 1996.

work and what actions they must take to help achieve such goals. To identify improvements in activities and operations that will lead to an increase in EVA, it is necessary to create a link between final financial performance and the daily performance indicators of general employees.

One solution to these problems is the business management method called the Balanced Scorecard (BSC), which was developed in the early 1990s by Professor Robert S. Kaplan of the Harvard Business School and Dr. David P. Norton. While the ultimate objective of the BSC approach focuses on financial performance (i.e., the financial perspective), it broadly defines "performance" as diverse non-financial outcomes such as the customer's perspective, the internal perspective, and the learning and growth perspective (see Figure 1). Stable financial performances in the medium to longer term can be expected by means of a thorough quantification of indicators showing the degree to which objectives for each organizational unit have been accomplished and effective communication established with the smallest units within the organization. In addition, this enables employees to recognize their objectives in relation to the accomplishment of the final financial performance, and allows them to identify effective actions for increasing the corporate value.

2 The Essence of the BSC

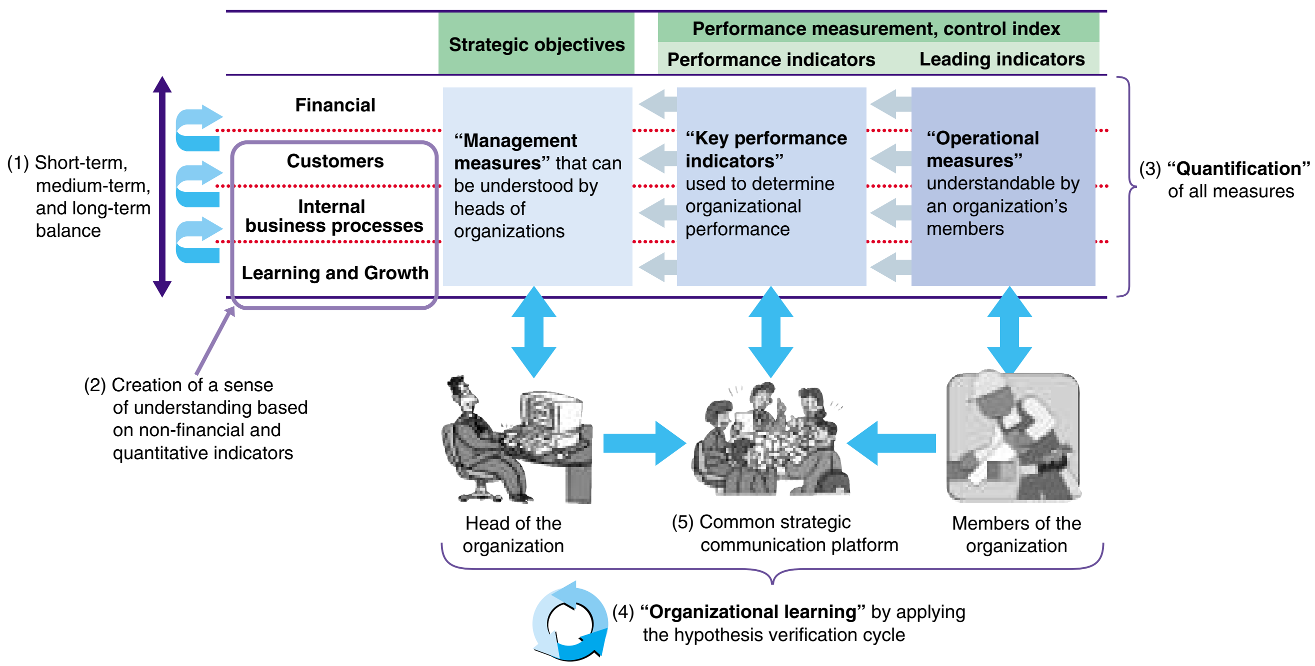
In the past several years, NRI has supported the introduction of the BSC framework at more than 20 Japanese companies. What we consider the essence of the BSC approach on the basis of that experience can be summarized in five points (see Figure 2):

(1) Achieving a balance among short-term, medium-term and long-term management objectives through a diverse measurement of performances.
(2) Creating a sense of understanding by establishing non-financial quantitative indicators (a process index) other than financial indicators.
(3) Eliminating vagueness by keeping to quantitative indicators.
(4) Promoting organizational learning through a repeated cycle of hypothesis verification (i.e., hypothesis at the start of the term, correction at the end of a term, and feedback for the next term's plan).
(5) Providing a common strategic communication platform linking the heads and members of the organization.

The first point reflects the definition of the BSC concept itself, and one that was clearly asserted by Professor Kaplan. Meanwhile, the second emphasizes that the results of important efforts leading to future profits should be seen as a "performance" by expanding the over-simplified interpretation of performance based solely on profit. Through this kind of diverse interpretation of organizational performance, the performance of support departments and cost centers that was difficult to measure in the past can be clearly defined.

The third point indicates that not all indicators used to measure performance necessarily need be financial

Figure 2. Essential Elements of the BSC



Source: Nomura Research Institute.

indicators, but they do all need to be quantifiable. This makes it possible to avoid the establishment of qualitative and vague objectives such as “Tackle XXX to the full extent” or “Strive for XXX.” The performance measurement system as outlined in the BSC are derived from the following perception: “What kind of measures can we adopt to evaluate whether or not our performance was fully achieved?”

In addition, the fourth point shows the directional flow of a series of links (the relationship of cause and effect) such as the leading indicators based on performance indicators that are derived from strategic objectives. The repetition of the cycle of hypothesis verification for these links is nothing but the building-up of organizational know-how by finding key performance indicators that are most effective in measuring the performance of that organization. In other words, this aspect of the BSC is knowledge management for organizational achievement, which itself has been attracting attention recently.

What is shown in the fifth point explicitly promotes communication concerning performance that has traditionally been implicit between the head and members of the organization in Japanese companies. Strategic objectives are most often described in words and expressions used by executives, which are often incomprehensible at the worker level. For their part, workers clearly understand the details involved in daily work processes and operations at the workplace. However, the head of the organization frequently lacks the same level of understanding as the members. If people at these different layers of management can communicate explicitly on the progress of organizational performance and the hypothesis of the link on an identical BSC, this would be very effective in terms of achieving the desired performance, enabling the head of an organization to understand the work process, and in upgrading the skills of the organization’s members.

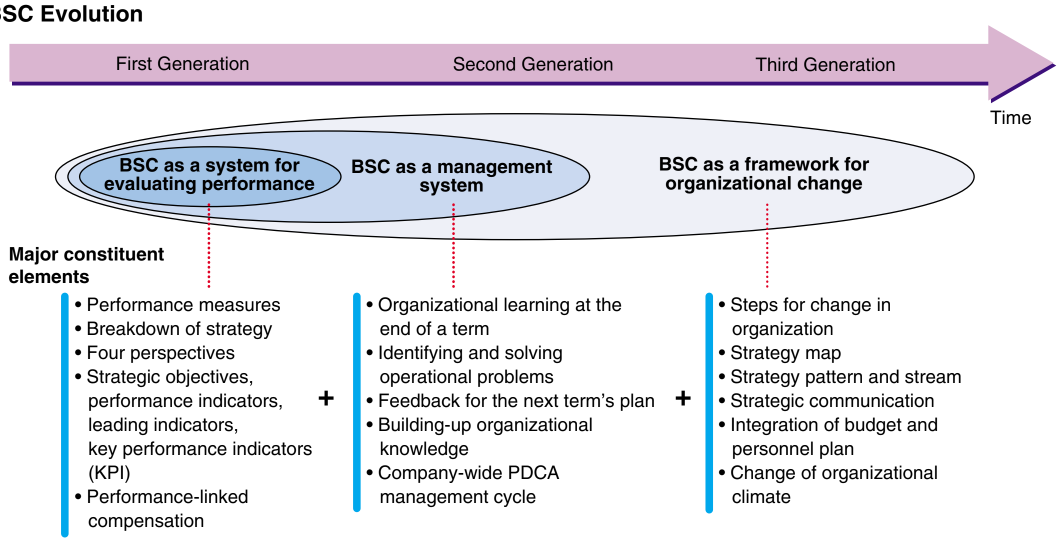
In the past, communication of this type was often implicit or limited to informal occasions at Japanese companies—daily conversations, chats while standing around the tea wagon, and “*nomunication*”(socializing while having a drink). While the BSC concept does not totally deny this business climate itself, it supplies the data for more effective communication. This last point means that the BSC framework meets the past administrative style and climate of the Japanese workplace and is readily acceptable.

3 Penetration State for BSC in Japanese Companies

The BSC methodology has now started to make inroads among typical European and American companies as well as a number of Japanese companies. Ricoh Co., Ltd., Takara Shuzo Co., Ltd., Itoham Foods Inc., and Kansai Electric Power Co., Inc. have also been cited in a Japanese study for their effective use of the framework (see Shinichi Shibayama, et al, *Jissen [Practical] Balanced Scorecard*, Nihon Keizai Shimbun, Inc., 2001). In addition to the firms above, the BSC approaches introduced by Skandia Life Insurance Co. (Japan), Ltd., Philips Japan, Ltd. NCR Japan, Ltd., Oki Electric Industry Co., Ltd. and Nippon Becton Dickinson Co., Ltd., etc., have also been widely reported in the media.

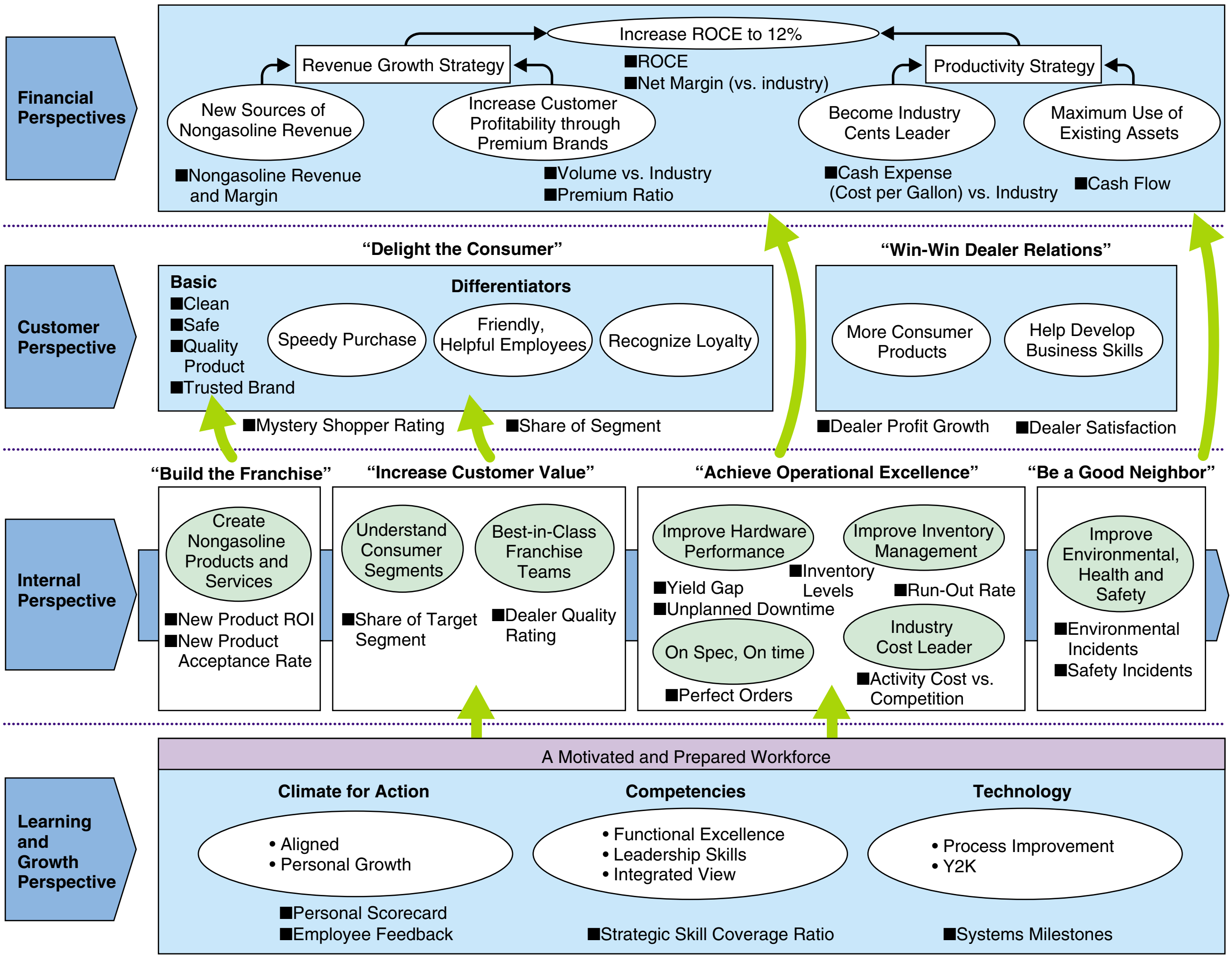
Until several years ago, there was considerable speculation and concern as to whether a framework such as the BSC that emphasizes “quantification and a clear statement” could be accepted, and whether measures of performance and leading indicators could be verified quantitatively at Japanese companies. But it is now apparent that the stage of research and examination has been completed and that Japanese

Figure 3. BSC Evolution



Note: PDCA = Plan, Do, Check and Action.
Source: Nomura Research Institute.

Figure 4. Mobil NAM&R's Strategy Map



Notes: ABC = activity-based costing; QCD = quality, cost, and delivery; ROCE = return on capital employed; ROI = return on investment, Y2K = year 2000 problem.
Source: Prepared by NRI based on the data of Professor Robert S. Kaplan.

companies have already entered the phase of putting BSC methodologies into actual practice. Moreover, a Japanese-type BSC model is starting to emerge.

II Recent BSC Evolution

1 Transition from the First to the Third Generation

Since its development in the early 1990s, the BSC concept has been verified from a number of different angles. As it has been put into practice, it has sometimes been improved by managers in various industries as well as by consultants and management scholars. This process has left a clear trail marking the major evolution in BSC applications, as outlined in the framework shown in Figure 3.

When the BSC concept was developed, Professor Kaplan and his associates initially positioned it as a "tool for performance measurement." Namely, the BSC was seen as a method to recognize and correctly measure the performance of an organization. Calling this the BSC's first generation, its important constituent elements include the breakdown of a strategy along four perspectives (i.e., financial, customer, internal, and learning and growth), strategic objectives, performance indicators, leading indicators, key performance indicators, and a compensation system linked to performance, etc. The BSC of this generation took the most fundamental form, and needed to undergo a transition in moving to the next stage.

But we do know that the first generation is only one facet of the BSC. In fact, many companies that introduced the BSC methodology have started to realize that the method demonstrates not only the effect of the framework, but also includes additional functions to correctly evaluate the achievement of specific organizations while continuing the PDCA cycle through the BSC. Specifically, by analyzing in detail the gap between the evaluated organizational objectives for performance and the actual results, they have started to recognize the causes of unsatisfactory performances, identifying and solving operational problems, reflecting the previous term's details in the next BSC, and identifying problems with the skill-building ability of the organization's head.

This is the stage at which the BSC can function as the core of a management system in company-wide PDCA cycle, and is appropriately called the second generation of the BSC approach. In reality, the best-practice companies of the first generation such as Ricoh and Takara Shuzo have already shifted to this stage, and have begun attaining additional BSC outcomes.

The BSC framework has continued to develop. As described in the latest book by Professor Kaplan and his associates (*The Strategy Focused Organization*, Harvard Business School Press, 2001), the BSC has been greatly improved as a more universal framework of organizational change. Additional elements that are not found in the first and second generations include methods called the "strategy map," which describes the strategic system of an organization as a map, "strategic communication," which communicates the organizational strategy of executives to general employees based on that map, and "change in the organizational climate," which aims at activating supervisors and general employees through strategic communication.

The case of Kansai Electric Power that is introduced in this article is positioned as the first example in Japan of a third-generation challenge by making the most of factors for management reform such as the strategy map, strategic communication, strategy focus, and change in the organizational climate. As this strategy map is a very important method for understanding the reforms of Kansai Electric Power, it is therefore explained below.

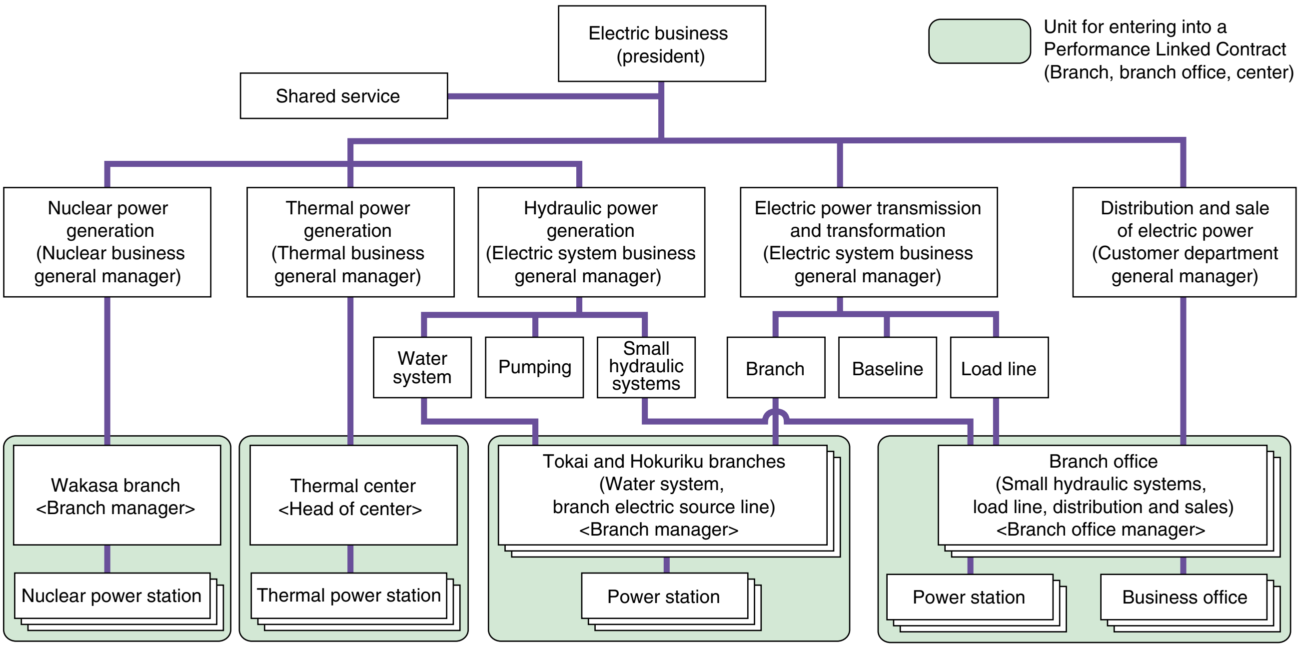
2 What is a Strategy Map?

A strategy map is a diagram that gives a two-dimension depiction of the operations (functions) and strategy of an organization. The map shows financial objectives as a final goal, with the strategic objectives from each of four perspectives connected to each other by arrows indicating links. All objectives are shown in connection with the financial performance (see Figure 4, as a case representing the Mobil North America Marketing and Refining Division of Mobil Oil Corporation). This strategy map includes the following important elements (characteristics), which were not found in the format of the former scorecards:

- The links and flow in a series of strategic objectives up to ultimate objectives of financial performance are clearly visible.
- As a result, a group of initiatives that are too broad and mutually unrelated to form a clear strategic flow are excluded from the strategy map after sorting and consolidation.

Which should be selected: the scorecard-type BSC or the map-type BSC? The answer is either, depending on the critical points of the problems facing the business management of a company or organization. One

Figure 5. Units for Measuring Performance at Kansai Electric Power



Source: Prepared by NRI based on Kansai Electric Power data.

can never say which method is better. If the focusing (narrowing-down) of strategies and the clarification of links are recognized as a problem, the map-type BSC is more appropriate. Where the desired emphasis is given to performance measurement and a brief reporting of the results, the scorecard type is suitable.

III Changing the Performance Measurement Systems: The Kansai Electric Power Example

1 Profile of the Company and its Organization

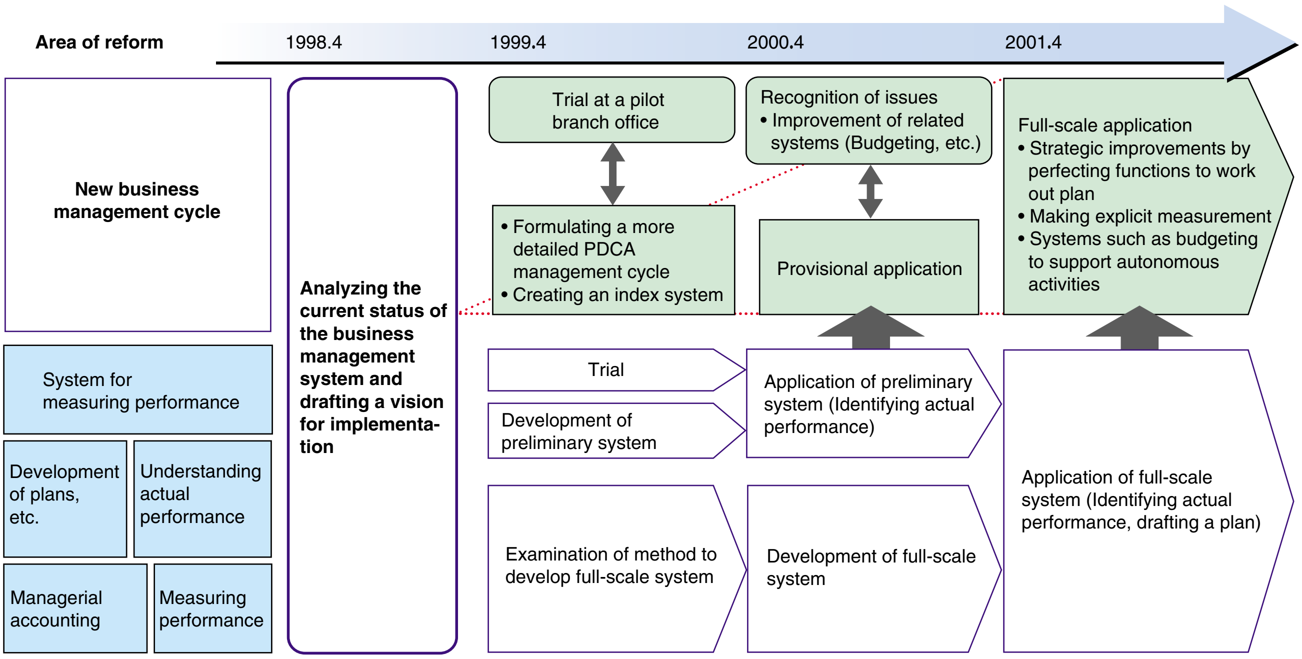
Kansai Electric Power Co., Ltd. is the second largest electric power company in Japan. For the fiscal year ending on March 31, 2001, it registered ¥2,581.4 billion in revenues, reported ¥7,212.5 billion in assets, and had 25,988 employees. Sales of electricity totaled 142,852 million KWh. Figure 5 shows the "unit for measuring performance," which is the unit applied in the performance Linked Contract that Kansai Electric Power has adopted.

With the phased deregulation of the Electric Utility Law that has long protected the power industry through regional monopolies and the general costing method, Kansai Electric and other domestic power companies have been facing a situation since the late 1990s in which they have to compete or cooperate with newcomers and third-party suppliers in various value-chain fields (power generation, transmission, distribution, sales). In addition, competition with other energy sources as well as dispersed power resources has intensified. Like other power companies, Kansai Electric Power has an urgent need to further reduce costs and use its assets more efficiently.

The organization of Kansai Electric Power adopts a matrix structure with value-chain business divisions (power generation, transmission, distribution, and sales) and a branch, branch office and thermal center-type organization that divides territories by region. The organizations of the power generation division, branch and thermal center (the Wakasa branch, thermal center, and the Tokai and Hokuriku branches) constitute a relationship that provides for easy linkage. On the other hand, other branch offices have two or three related business divisions at the head office, such as transmission and transformation, distribution, and sales, which thereby allow matrix problems to remain. For example, certain group and division leaders have two direct superiors in the form of a business division manager and a branch office manager.

While Kansai Electric Power has not solved this matrix problem completely, it has promoted reform through the Performance Linked Contract since 1999 to achieve a performance measurement system that is more transparent and understandable than that in the past. Under this system, branches, branch offices, and thermal centers are positioned clearly as profit centers. The company aims to produce a schema in which the heads of the above organizations reach an agreement with management on the shared objectives for each term, and are then evaluated and compensated in accor-

Figure 6. Series of Steps for Implementation of the Performance Linked Contract



Source: Prepared by NRI based on Kansai Electric Power data.

dance with the extent to which the objectives are achieved.

The Kansai Electric reform case, known as the Performance Linked Contract using the BSC, is the most spectacular among the over 20 cases NRI has supported in the past. It has positioned the BSC concept at the core of its business management system. Other peripheral systems are matched to it, and the organizational climate change is made clearly visible through up-front strategic communication between the heads of organizations and management. The following outlines the actual case of Kansai Electric Power.

2 Background to the Implementation of the Performance Linked Contract

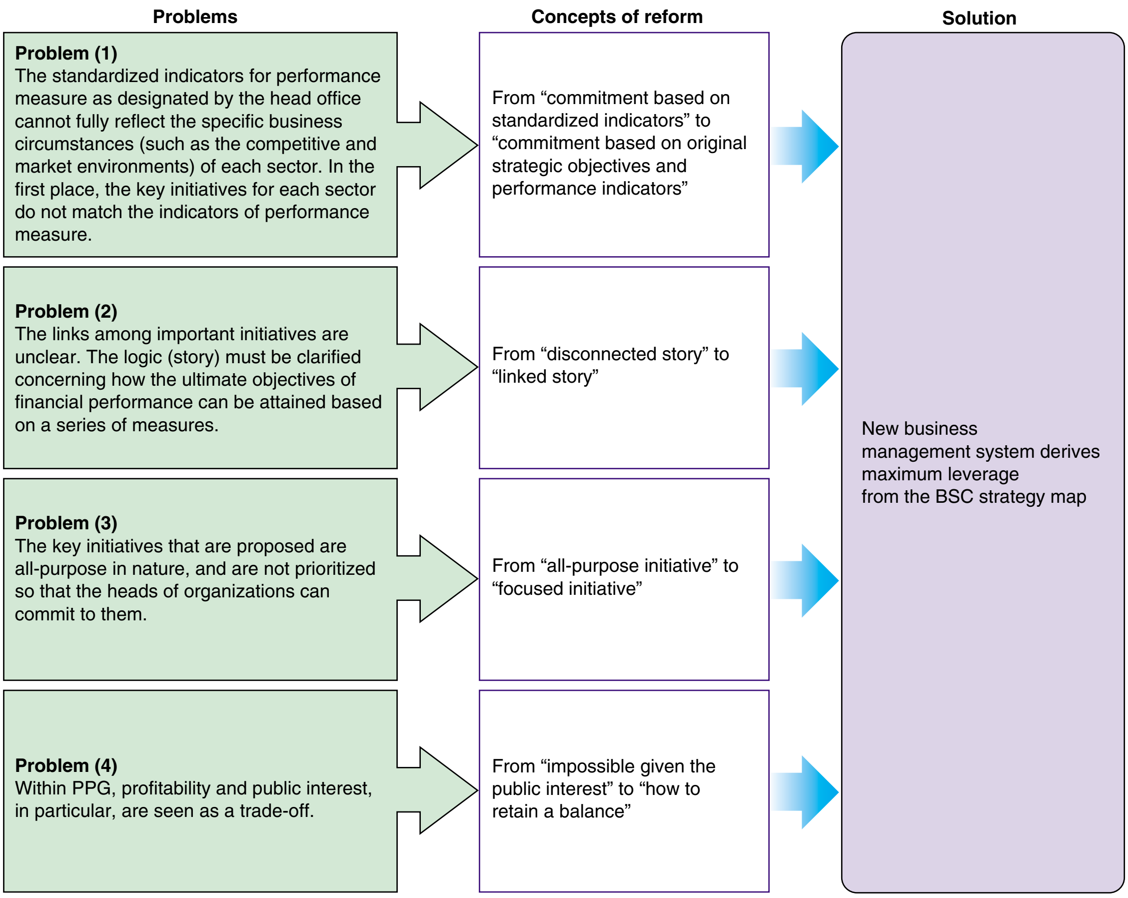
The reform grew out of an analysis of the current state of the business management system and the drafting of a vision for the program conducted in 1998. The vision was developed on the basis of a series of self-evaluations that pointed to the need to reform the business management system then in use. That system was found to have shortcomings in terms of identifying outcomes, measuring systems and budgeting procedures in preparation for the coming era of free competition (see Figure 6).

Characteristic of this approach, the subject of reform was not defined in a narrow sense as simply a performance measurement and compensation system. Instead it covered the business management system in a broad sense that included related management systems such as budgeting and the MIS providing managerial accounting data. This approach made it possible to initiate sweeping reforms of the entire PDCA scheme without simply introducing patchwork modifications or management indices.

In an attempt to start a provisional application of a new business management cycle between 1999 and 2000, the company carefully examined the index system for performance measures. From the beginning, there was a shared recognition that the ultimate goal of the company was to continue to pursue improved corporate value. For that purpose, Kansai Electric Power designed a performance indicator known as PCA (profits after costs of assets), a unique EVA index positioned as a management measure for the entire company.

The company also developed motivation indicators and evaluation indicators that are closely related to the daily work of employees at various sites, in addition to indicators on the efficiency of assets and financial soundness (hereinafter collectively referred to as profit indicators), together with PCA. Specific examples of the

Figure 7. Former Management Reforms: Problems and Solutions



Source: Prepared by NRI based on Kansai Electric Power data.

motivation indicators include preventing power supply and transmission events, jobs handled by direct shops, reductions in the days required for regular inspections, declines in the number of accidents, and the incidence of problems within three months of completing construction work. These indicators supplement those for performance measurements that are determined by the head office through a bottom-up approach, and play a role in raising the morale of employees at the workplace.

The framework of the profit indicators and the motivation indicators is consolidated and organized into three characteristics (profitability, public interest, and growth potential, hereinafter known as “PPG”) based on subsequent discussions and examination. Rather than seeing the profit and motivation indicators as a group of separate indicators, this shifts the approach to one that links performance measurements to a better appreciation of the company’s ultimate mission—namely, improving profitability, ensuring public interest, and maintaining growth potential. In a sense, this is an unprecedented development that focuses the eye on the element of “balance” in the BSC.

Notwithstanding any improvements in the performance measurement system, however, no real benefits of reform can be expected unless the heads of organizations commit themselves to accomplishing their objectives by activating the new system. Given the awareness of this problem, Kansai Electric Power made the daring decision to call the performance measurement system a Performance Linked Contract. This name reflects the desire of management and the reform team to create an operating principle that clearly spells out how the participants (those covered by the contract) will be measured (using the evaluation indicators and criteria) based on performance (the details of the contract), and compensated (compensation linked to performance).

3 Evaluation by Outside Consultants

The reform team engaged NRI as consultants to accelerate the reforms by incorporating the BSC framework, which it had been examining for several years as part of its Performance Linked Contract. The details of NRI’s support were broadly divided into two areas: (1) an objective evaluation of the reforms carried out by Kansai Electric Power to date, and specific advice on any suggested changes in track; and (2) support for working out a strategy map—strategic objectives and the performance index system—for business divisions, the entire company, branches, branch offices, and thermal centers. This outside evaluation yielded four key points for consideration (Figure 7).

(1) The standardized indicators for performance measurement as designated by the head office cannot fully reflect specific business circumstances (such as the competitive environment and market environment) of each sector (i.e., branches, branch offices, and thermal centers). In the first place, the major initiatives of each sector do not match the indicators of performance measure.

(2) The links among the major initiatives for each sector are unclear. The logical story is not clarified with respect to how the ultimate objectives of financial performance can be attained based on a series of initiatives.

(3) The key initiatives cited are too diverse as well as too general, and are not prioritized. This makes it difficult for the heads of organizations to commit to them.

(4) Within the PPG framework, profitability and public interest, in particular, are seen as a trade-off (antinomy).

With respect to the first point, the provisional application called for each sector to select and agree on performance measures applicable to each location from among the indicators for each sector designated by the reform team. This method involved two major problems. One was the fact that each sector could not emphasize the strategy and key initiatives adopted by each sector because the head of the sector was more concerned about measures than strategy. And another was the difficulty of reflecting a flexible strategy and key initiatives by each sector due to the low flexibility of measures established by the executive office. This was the result of limitations in the choice of measures under the company’s K-MAX managerial accounting systems. The reform team turned to the method known as the BSC strategy map as a means of resolving these problems, and decided to drastically change the paradigm from the Performance Linked Contract driven by measures to a Performance Linked Contract based on a series of systematic strategic objectives plus the ensuing measures.

With respect to the second point, while plausible measures that take into account the management condition of each sector were shown, it remained unclear how these measures would flow towards the final financial performance. The reform team decided to deal with this problem as well by deriving maximum advantage from the element called “linkage among strategic objectives” included in the strategy map. Namely, they established a firm rule that every key initiative needed some link to the ultimate performance objective of increasing corporate value. If an initiative did not link to this objective, it should not be included in strategic objectives no matter how important it may be.

What is shown in the third point closely reflected a perennial problem that had long plagued the development of policies at all Kansai Electric Power sites. Each sector worked out an annual plan every year and submitted it to head office. These plans consisted of four sections: the management environment, basic policy, annual policy, and objectives. In particular, the volume of data dealing with the annual policy and objectives involved a massive input that often entailed several dozen pages outlining problems and improvement initiatives at the workplace level in each sector (some branch offices described their initiatives in several hundred sentences).

The reform team and management decided to replace the "concept for the development of comprehensive policies" with a new approach: "agreed strategic objectives and commitment on focused measures." The reformers managed to overcome what resistance did emerge from various sectors and the new tack was accepted.

The problem brought to light in the fourth point was handled by returning to the basic BSC concept. Whenever key initiatives were about to be proposed on the basis of the PPG framework, a trade-off argument—such as sacrificing profitability to preserve the public interest (i.e., energy security and equality in energy supplies)—was invariably put forward. If a public interest perspective were to emerge, it could have worked as a loophole that would hinder a determined attempt to improve financial performance.

The reform team closed that loophole, and intentionally avoided using the public interest perspective so as to concentrate the awareness of the heads of organizations on balancing competing interests to increase long-term corporate value. In short, the focus was on how to attain financial performance objectives (based on approaches that considered both customer and business process perspectives) while maintaining the public interest objective as well. The team then redefined the diverse axes to map out a strategy based on the original four BSC criteria.

Using these techniques, the reform team paid particular attention to the BSC strategy map and tried to solve the company's problems one by one by fine-tuning the Performance Linked Contract. What should be noted here are the specific concepts of reform that were embraced. These included: (1) a move from measures to strategic objectives; (2) the establishment of links rather than disconnects; and (3) a shift from the mindset that saw things as impossible given the public interest to one that focused on how to retain a balance. This made clear to management and the heads of organizations in each sector what provisional elements of the Performance Linked Contract would be retained, and what elements would be subject to a change in course. This became a critical turning point in accelerating the reforms and making them successful.

4 Building a Strategy Map

The next task for the reform team was to work out an actual strategy map for each sector that would be used for the full-scale application starting in 2001. This work took about three months to complete. In the first step, strategy maps for business divisions (for example business divisions such as nuclear power, thermal power, hydraulic power, transmission, distribution, and sales) were prepared and then consolidated into a strategy map of the entire company by comparing them with the company's management policy.

As the next step, the reformers adopted a method whereby branches, branch offices and thermal centers worked out their own strategy maps (subject to the strategy map of the entire company and that of the business division having jurisdiction over them). Strict consistency among the strategy maps for a business division, the entire company, a branch, a branch office and a thermal center was not addressed at that stage. Rather, priority was given to the accurate preparation and description of a strategy map for each profit center.

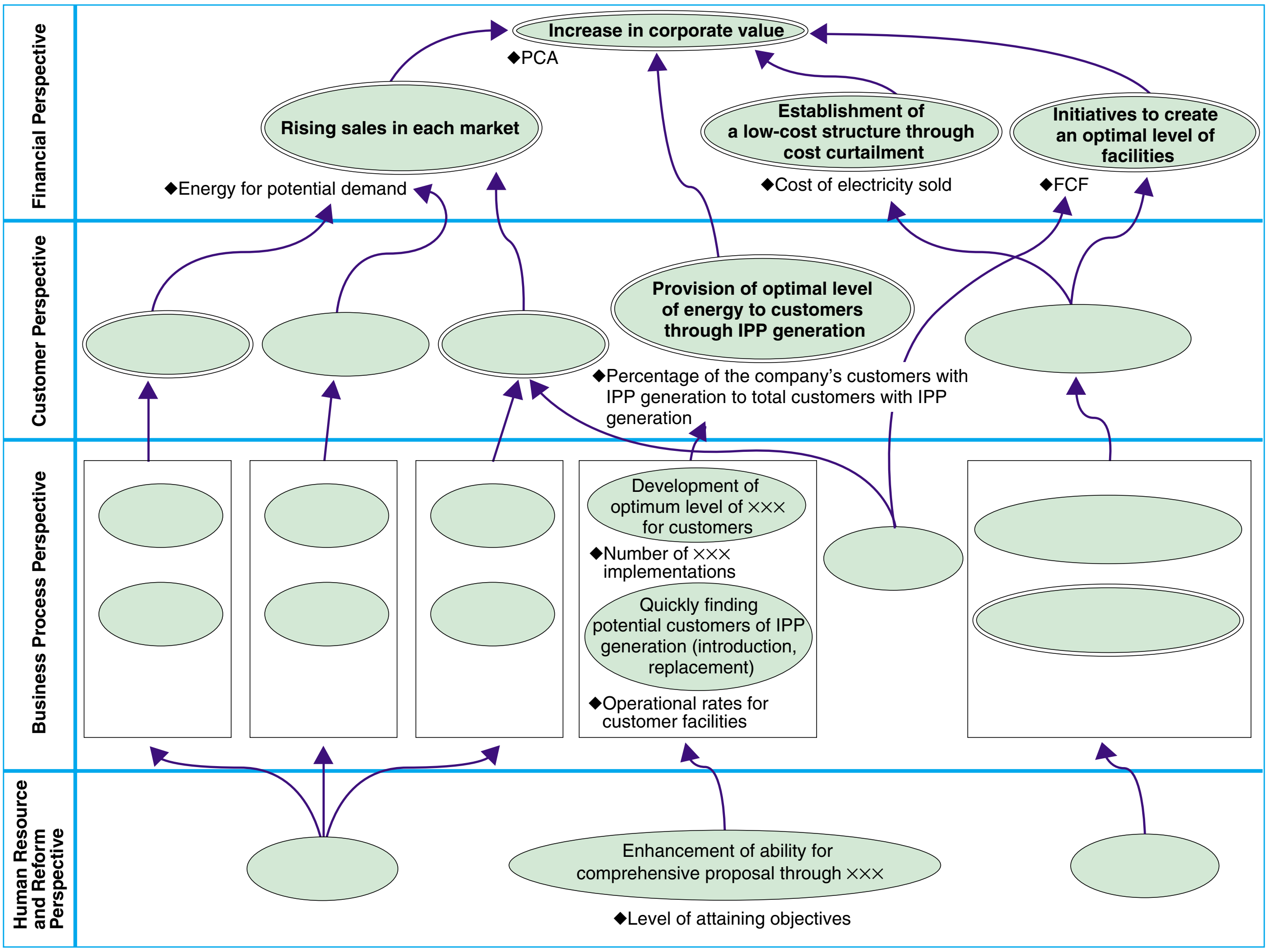
Branches, branch offices, and thermal centers worked out their strategy maps in a workshop format. This first involved a joint meeting to explain the workshop approach that consisted of planning personnel from the 11 branches and branch offices that would prepare strategy maps. With the support of NRI consultants, the reform team explained in detail the purpose of the reform, how to solve problems within the context of the current business management system, the basic BSC concept, and the procedures for preparing a strategy map.

Several branch office personnel were already thoroughly familiar with the BSC, and they provided their full support from the beginning. While some branch office staff offered vague resistance to the strategic focus and the clear link with financial performance based on objective rationale. But the reform team requested that they prepare the first draft of the strategy map for each branch office with the understanding that individual obstacles and difficulties would be examined at the workshop. The team clearly conveyed to all participants that the strategy maps would be positioned as a trial (exercise), and not as an official performance measure.

The first workshop was held within an interval of several weeks. Eleven branches and branch offices were divided into three groups based on their characteristics, and three to four branch offices met together at each workshop. The person who prepared the strategy map for each branch office explained its details at the workshop, following which NRI consultants, the reform team, the branch office staff, and personnel from other branch offices discussed how to position the strategic objectives one by one. The general flow of the discussions followed the course shown below.

(1) The competitive business environment of branch offices was examined through SWOT (Strengths, Weaknesses, Opportunities and Threats) analyses.

Figure 8. Branch Office Strategy Maps



Notes: (1) Double frames indicate a strategic objective based on the entire company's strategic objectives; (2) FCF = free cash flow; PCA = profits after capital costs.
Source: Compiled by NRI based on Kansai Electric Power data.

(2) The final financial objectives and key initiatives for branch offices were clarified.
(3) The linking of a series of strategic objectives to attain the financial performance objectives was verified.
(4) Performance indicators to evaluate the degree to which the strategic objectives are met were verified.
(5) In a series of brainstorming sessions, participants tried to see if they could find any possible alternatives for strategic objectives and performance indicators.
(6) All members formed a consensus as to the level of completion of a final strategy map (balance, flow of strategy, number of strategic objectives and performance indicators, and points for improvement concerning linkage before the next workshop).

Each workshop took about six hours (the strategy maps for two branch offices were discussed at each session). These maps were then formulated on a step-by-step basis through second and third drafts. The third draft represented a strategy map with a high level of completion (see Figure 8). Moreover, as a result of a self-review process upon completing the series of workshops, the reform team was able to confirm that the workshops had created the following intangible assets in addition to the tangible assets of the strategy maps.

- A "meeting ground" for direct strategic communication between the reform team and branch managers and staff
- A common recognition of the importance of "focusing" strategies by making financial objectives the main axis
- A shared understanding about the future direction of business management system reform
- Improvement and mobilization of the competence to set up objectives for branch managers and staff who participated in the workshops

Those managers who participated in the strategy map workshops offered the following thoughts.

Figure 9. Performance Linked Contract

Performance Linked Contract between the president and branch manager for Year 2XXX

Contracted Date :

President	Branch Manager

	Measures	Objectives (criteria)	Allocated Points	Actual	Achieved Rate	Points Obtained
Strategic objectives	PCA	¥○○	250	¥△△	104.8%	307
	Energy for potential demand	○○kWh	100	△△kWh	88.0%	88
	Cost of electricity sold	¥○○/kWh	50	¥△△/kWh	92.0%	46
	Percentage of company's customers with IPP generation to total customers with IPP generation	○○%	70	△△%	115.05%	70
	•	•	•	•	•	•
	•	•	•	•	•	•
	•	•	•	•	•	•
	•	•	•	•	•	•
	•	•	•	•	•	•
	Subtotal		750			714
Universal service standard	Customer service index	90	100	90	100.0%	100
	•	•	•	•	•	•
	•	•	•	•	•	•
	•	•	•	•	•	•
	Subtotal		250			250
	Total		1,000			964

Scores on contracted measures	Scores adjusted by senior management	Details of score adjustments	Total score	Evaluation
964	—	—	964	B

Source: Compiled by NRI from Kansai Electric Power data.

"The link between each performance indicator and management strategy has become clear to me, and I think that a convincing agreement can be made. Moreover, with the addition of process-related measures as well as result-related measures, I think that steady efforts at the workplace will pay off in medium- to long-term results."

"I think it is good because the key strategy adopted by branch managers has been clarified. The past annual plan of branch offices was all-purpose and included daily operations. This did not make the strategy clear."

"The workshops were good, because I could understand the situation at other divisions and the way in which they differed from my own division."

"I felt that the BSC would become a powerful tool for communication between management and division managers."

"Our company has hardly ever taken the approach of focusing on strategies. I felt that using the BSC (strategy map) tool could embody a new management idea to selectively distribute management resources to strategic businesses."

In addition, working out the strategy maps enabled the reform team to derive strategic objectives and measures for their performance that are particularly important for determining organizational performance, and led to the development of an "Performance Linked Contract" that is entered into between management and the head of the organization in question (see Figure 9).

5 Results of Reform and Future Issues

With respect to the reformed Performance Linked Contract under the new system that started in 2001, Kansai Electric Power confirmed the following results as of December 2001.

(1) The BSC strategy map made it possible to build a strategy system that closely reflects the circumstances unique to each division and branch office. The result is focused and not a statement of all-purpose objectives.
(2) The four perspectives were organically connected, and the link with measures for the final financial objectives became clear.
(3) The importance of entering into contracts based on "strategic objectives and performance indicators" rather than "standardized indicators" was reconfirmed.
(4) Resistance at the workplace was tempered by modifying agreements to include "routine work" as "standard objectives," as these tended to be dropped from strategy maps.

Interview with **Toyokazu Misono**,
Manager, Operations Group
Planning Office
Kansai Electric Power Co., Ltd.

(NRI) What were the origins of the series of reforms to the Performance Linked Contract?

(Mr. Misono) The reforms had their origins in a project for analyzing the current state of the business management system, which was carried out in 1998. The business management system at the time was considered inadequate for making accurate management judgments quickly in an environment of intensifying competition following the adoption of deregulation measures in the Electric Utility Law. We needed an autonomous and decentralized type of decision-making mechanism and organizational structure that would be able to respond flexibly to changes in the environment. The new organizations also needed timely administrative accounting data. We also recognized again the need for a performance measurement system based on a results-oriented principle that befits a decentralized organization. From this background, a series of business management system reforms was commenced.

(NRI) Does that mean that the reforms did not originally aim at introducing the BSC?

(Mr. Misono) That's right. The BSC framework was merely an excellent tool that took shape as we moved forward on the reform continuum. We had already made repeated independent attempts to measure achievements from multi-faceted approaches and to find indices that would stimulate financial performance. We ultimately adopted the strategy map method advocated by NRI because it was effective at that point in time in solving various issues that we could not resolve internally. We saw the BSC as a means for us, and not an end in itself.

(NRI) What were the issues on which you worked the hardest and took the most pains to promote during this phase of the reforms?

(Mr. Misono) I think there were two key points. The first was the response of those around us to the development of strategies that dared to move away from the axis of "public interest," on which electric power companies place their primary emphasis. We felt that we had to avoid illogical and emotional resistance, such as "the BSC cannot be used as a tool as it lacks a public interest axis." But that anxiety was needless. As a result of examining many strategy maps at workshops, we were able to verify that objectives that were set forth from a public interest perspective in the past can be fully reflected in the perspectives of the customer or internal business process. This meant that the objective of the public interest was not the ultimate goal in itself, but was positioned as a requirement that had to be met in order to attain the ultimate objective of creating corporate value. The second point was how to convert the paradigm for the implementation of the broad initiatives that had been taken before. For this, we needed to give a logical explanation to those people about the good elements and those elements that needed to be changed in existing *hoshin* management by carefully collecting data from the workplace. This required considerable effort. But I think we were ultimately able to effectively and consistently integrate the *hoshin* management and the BSC.

(NRI) When it comes to members of the reform team, what considerations were on your mind or what difficulties did you face?

(Mr. Misono) We had no particular difficulties because the members had promoted reforms on a similar theme together with me for many years. But the reforms would have been meaningless unless they could get to front-line employees at the actual workplace in the future. Therefore, we thought about how the team could take a comprehensive approach by putting the emphasis on the actual workplace (business-related organizations such as head office divisions, branches, branch offices, thermal centers, and business offices). Indeed, the understanding and cooperation of those at the workplace were indispensable in the process of obtaining results for this phase.

(NRI) How do you evaluate the role and contributions of NRI consultants in the reform?

(Mr. Misono) What I appreciated most was the fact that the NRI consultants fully understood the depths of the internal conditions at our company, and never failed to see the true nature of problems and maintain a professional approach in dealing flexibly with those aspects for which we could not give logical explanations based on theoretical ideals. I think the reason this reform was able to reflect a practical condition was because of this stance. They set very high standards in the many examples presented at each meeting, as well as in the design and operating methods of the workshops.

(NRI) Finally, what are your opinions about the results to date and future issues?

(Mr. Misono) While the reforms will continue to percolate through our system for a long time, I think that the great achievement of this phase is that the basic framework of the prototype for value-based management at Kansai Electric Power has been determined. The skeleton of a business management system with the ultimate goal of creating corporate value has been completed in feasible form. But many issues still remain. In particular, we must develop a method to verify the numerical criteria of performance measures that are needed to actually apply to the Performance Linked Contract. In addition, we have to push towards an evolution of the current system, aiming at a truly consolidated business management system that also involves group companies for the future. While there are many issues, I think we are on the right course. The scheme under which the company can promote reform has also been established. I am confident that it will become best practice for the management of a Japanese utility in the future.

(5) Evaluations and compensation based on the outcome of the contracts were confined to such non-monetary remuneration as "division commendations" in the early stages of full-scale application. That made it possible to synchronize the reforms to the measurement and compensation systems of the Personnel Department.
(6) A top-down strategy that derived maximum advantage from the strategy maps was clearly positioned as a long-term management initiative, thereby recognizing the role of the strategy maps.

As previously mentioned, the first three points had been targets of the BSC strategy map methodology from the very beginning, and the results were expected. The fourth point illustrated the problems and initiatives concerning "routine work" that cannot be covered by a strategy map. The contents of the contracts originally focused on matters that were the responsibility of heads of organizations (branch managers, branch office managers, and thermal center managers). But many people expressed the concern that important issues connected to routine work might be dropped if strategy maps were over-emphasized. Therefore, it was decided that the Performance Linked Contract should include routine work in the form of "universal service standard items," subject to a limit of 25 percent of the total score.

With respect to the fifth point, the measurement of the head of an organization should essentially be fully consistent with the measurement of the performance of that organization. However, since the Personnel Department of Kansai Electric Power was in the midst of trial reforms of a performance-oriented change in its personnel system, a soft landing was engineered in the form of division commendations. But to inspire true achievement, it is necessary to reflect the results in the evaluation and compensation packages (principally bonuses) of organization heads, not in commendations. This problem needs to be resolved as soon as possible.

In terms of the sixth point, the reform in this phase made clear the role of *hoshin* ("policy") management and the BSC. Specifically, the BSC is strictly a framework to measure performance based on the degree to which numerical indicators are attained by addressing diverse strategic issues for the entire company through each division in a top-down approach. However, policy management is a thought process involved in instituting a specific action program to accomplish individual performance indicators.

The reform team of Kansai Electric Power recognized the following points as issues for the medium-term future.

- The incentive system should be changed from commendations to one specifically linked to compensation.
- The drafting of strategies should be tied together with the drafting of budgets.
- The drafting of strategies should also be connected to the drafting of personnel plans.
- The system should evolve into a new business management system on a consolidated basis that also involves group companies.

IV Requirements for Successfully Reforming Performance Measurement Systems Using the BSC

Based on the results of NRI consultations, we have verified empirically that the following three requirements need to be satisfied in order to achieve success with performance measurement systems that derive maximum leverage from the BSC. We would like to conclude by examining these requirements in light of the elements of the Kansai Electric Power case.

1 Selecting a Solution by Understanding the Total Picture of Management Issues

The BSC methodology is not a panacea. There are cases in which it is effective, and cases in which it is not. In this sense, reforms predicated solely on "tools" must be avoided at all costs. Promoters of reform must first enumerate internal business management problems, and determine whether the BSC approach may be an effective solution. Otherwise, they need to look for an effective way to use the BSC.

In this respect, Kansai Electric Power took the right steps in its management reform. The company correctly and comprehensively analyzed the current state of its business management system, and drew up a vision for reform in the early stages (fiscal 1998) of a series of reforms. Importantly, the Kansai Electric Power case was never a reform based solely on the BSC. Rather, the company finally found the BSC framework after it had tried many approaches (such as profit and motivation indicators, as well as PPG) aimed at developing diverse performance measurement systems in its own way. This approach turned out to be ideal.

2 Commitment by Management to Realize Reform

Management commitment is a point that is frequently raised, and one that cannot be over-emphasized. Here, commitment is not simply window dressing, such as having the president chair the management reform promotion committee. Rather, the commitment of management to a reform of the performance measurement system simply means that management itself will act on the basis of the new standard that is established as the result of the reforms, and will assume responsibility for the results.

Taking the example of the BSC, the old method of evaluating organizations and their heads based only on final sales and profit should be discontinued. It is essential to establish a firm determination to measure performance based on all the BSC contents (postulating diverse objectives in the areas of finance, customers, business processes, and learning and growth) that were agreed at the opening of a term.

In the case of Kansai Power Electric, committees such as its Management Committee (a senior management decision-making organization) and the Business Management System Review Committee (an advisory committee chaired by the managing director in charge of the Planning Office) were repeatedly involved. At the time of the shift from the provisional to full-scale application in 2001, the managing director in charge himself verified the effectiveness of the new business management system, and made a commitment to shift to a full-scale application with the senior management (president) by fully supporting the reform team. In this respect, we can say that Kansai Electric Power approached reform with exactly the right organizations.

3 A Cross-function Team Consisting of Planning and Personnel Functions

NRI has long used a number of different channels to convey the message that “planning and personnel divisions need to cooperate in reforming the performance measurement system.” This is because the goal of such reforms is to “measure performance fairly and clearly based on the degree to which planned and committed objectives are attained, and to undertake fair and rational treatment based on that measurement.”

In many companies, the planning division in charge of mapping out strategies and the personnel division responsible for end-of-term evaluations (chiefly, personnel evaluation, and performance measurements) apply different systems in separate organizations. Therefore the key to this kind of reform is to break down the wall between the planning and personnel divisions, and to unify strategies and evaluations. As noted above, a problem still remains with respect to this point in the reforms undertaken by Kansai Electric Power. The company’s reform team recognized that further cooperation with the personnel division was a task yet to be addressed. Several meetings between the planning division and the human resources activation division (the equivalent of the Personnel Department) have been held to allow for examinations on a cross-functional basis, and vectors for the direction of future reform were adjusted.

4 Expectations for Future Reform at Kansai Electric Power

The current round of reforms at Kansai Electric Power have excelled because a series of reforms starting in 1998 and the solutions derived from them were properly connected using the strategy map method of the BSC. Kansai Electric Power employed the BSC framework as an effective way to implement from start to finish the corporate reforms it promoted, and was successful in tapping the full potential of the BSC. From this perspective, the Kansai Electric Power case represents what can be called the best practice from among the more than 20 companies that NRI has assisted with reform.

In this reform case, the workshops involved the organization heads of actual workplaces. This enabled the objectives of the reform to become known to all and concurrently provided strong support to aid the pilot organizations in devising strategy maps. These aspects particularly impacted the awareness of branch office managers and, ultimately, the success of the strategy-mapping paradigm. In that sense, at least in the organizations covered by the current trial, positive secondary benefits included changes in the awareness of managers concerning PDCA and a change in the paradigm concerning the mapping-out of strategies.

There are still several issues to resolve before the Performance Linked Contract is perfected by Kansai Electric Power. But if the company promotes reform by taking the same focused, objective-oriented approach involving actual work sites that it used in the past, it is very likely to represent the best practice among Japanese companies in near future.

Finally, we would like to express our sincere gratitude to those officials at Kansai Electric Power who agreed to disclose reform information for inclusion in this paper.

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