

Using the Balanced Scorecard in Reforming Corporate Management Systems

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- I The Balanced Scorecard Boom
 - 1 Framework of Performance Measurement and Management
 - 2 Status of Introducing the BSC at Japanese Companies
- II Is Success Being Achieved Through the Introduction of the BSC?
- III Five Decisive Measures in Success or Failure
 - 1 Clarifying the Purpose of the Introduction
 - 2 Commitment by Top Executives to the Introduction of the BSC
 - 3 Increasing Awareness and Understanding of Organizations Where the BSC is to be Introduced
 - 4 Fostering BSC Experts at Both the BSC Implementation Office and the Organizations in Which the BSC Will Be Introduced
 - 5 Requiring the BSC Implementation Office Not to Give Up the Operating Reins (Especially in the Early Stages of Its Introduction)
- IV Budgetary Supremacy that Prevents Value Creation by BSC
 - 1 Too Much Weight on Financial Viewpoints
 - 2 Relationship Between Budget, Performance Projections and Performance Evaluation Standards
 - 3 Three Steps to Overcoming the Current Status
 - 4 New Trends from Europe
- V Metrics, BSC and Beyond Budgeting Model

In recent years, using the balanced scorecard (BSC) methodology, a system which enables organizations to measure and manage corporate performance, has been rapidly attracting a great deal of attention in Japan as in other countries. However, not all Japanese companies have achieved success in introducing this technique. According to a questionnaire survey conducted by the Nomura Research Institute, Ltd. (NRI) in June 2003, about one-third of the 35 companies that responded to questions about the introduction of the BSC approach reported that they felt "Dissatisfied, as it left much to be desired." Therefore, unless appropriate measures are taken to correct these deficiencies, the concept may simply collapse under the weight of a growing number of failed cases in Japan and be regarded in the future as little more than a passing fad. As identified in the survey, the major requirements for the successful introduction of the BSC methodology can be summarized in the following areas: (1) clarifying the objectives for its introduction; (2) securing a firm commitment by top management for its introduction; (3) increasing the level of the understanding in organizations in which the BSC is introduced; (4) fostering BSC experts both in organizations where it is introduced and the BSC implementation office; and (5) especially in the early stages of its introduction, requiring that such leadership sections not give up the operating reins. In order to achieve success in introducing the BSC methodology and to enable it to fully display its effects in creating corporate value, it is necessary to do away with the current preoccupation with the idea of "budgetary supremacy" in such analyses. Indeed, the BBM concept (i.e., beyond budgeting model) being advocated as the new approach to corporate management in Europe transcends the conventional framework of budgetary management systems, and we believe this approach will further accelerate the trend towards value-based management in Japan.

I The Balanced Scorecard Boom

1 Framework of Performance Measurement and Management

From among the corporate management approaches imported from Europe and the United States since the 1990s, one method that has rapidly come in for increased recognition over the past several years is the balanced scorecard (BSC). This model, which provides a prescription for corporate performance measurement and management, was developed in the first half of the 1990s by Professor Robert S. Kaplan and others of the Harvard Business School. In specific terms, the BSC methodology suggests building corporate strategies and pursuing quantitative goals based on four perspectives: financial, customer, internal, and learning and growth (human resource development and developing a company infrastructure). The methodology is designed to steadily implement corporate strategies by reflecting the extent to which goals are achieved in measuring performance and determining compensation (Figure 1).

The BSC concept is expressed in two formats: a “Strategy Map” and a “Scorecard.” The Strategy Map uses a single sheet of paper to propose a hypothesis of the core mid-term strategy. This Strategy Map outlines what kind of values should be provided to specific customers and how working methods should be changed

and organizational abilities should be increased in order to realize final financial results (top of Figure 2).

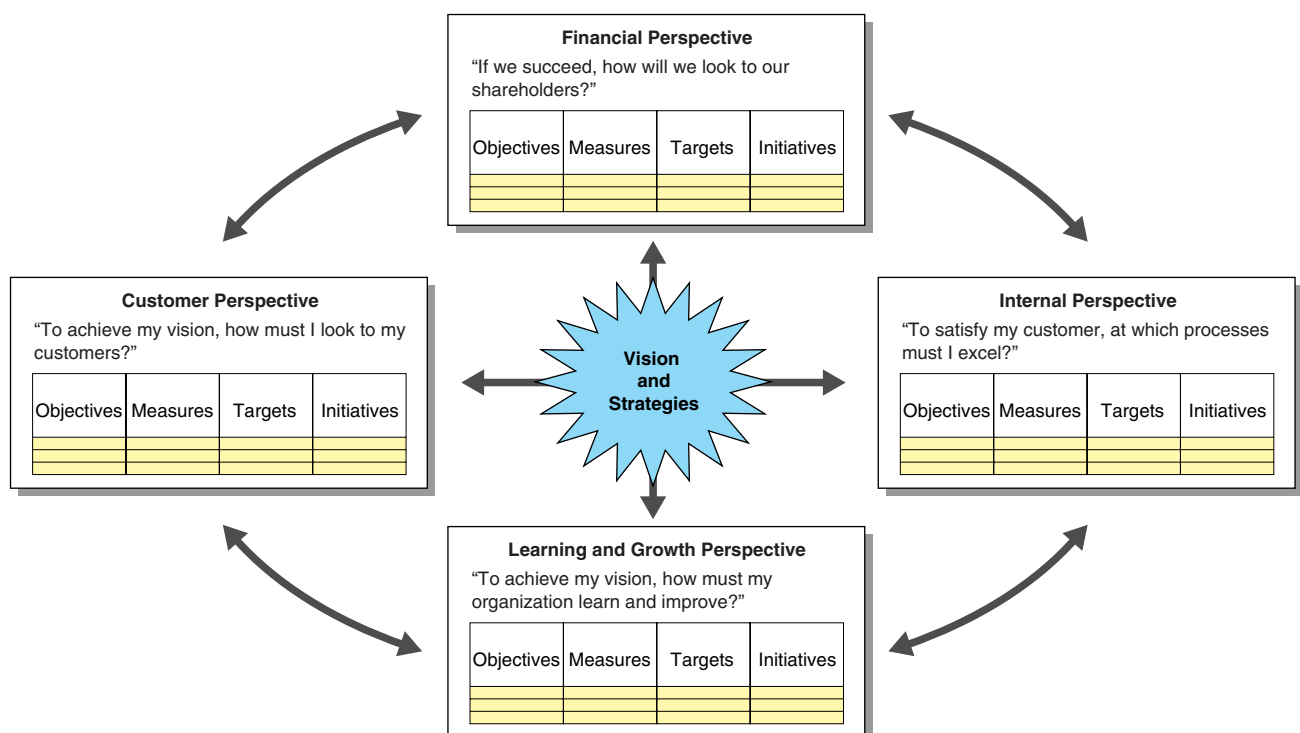
The “strategic goals” are written in the ovals in Figure 2 and the “linkages” (the arrows linking the strategic goals) represent the causal relationship among the strategic goals. The series of flow paths connecting these strategic goals via linkages is the strategy hypothesis. The validity of this hypothesis can be verified in implementing a PDCA cycle (Plan → Do → Check → Action).

The Scorecard is the table that presents three factors: the strategic goals specified in the Strategy Map, the performance index indicating the achievement status, and the specific goal level of each performance index (bottom of Figure 2). This Scorecard is used to manage the implementation status of the given strategies.

2 Status of Introducing the BSC at Japanese Companies

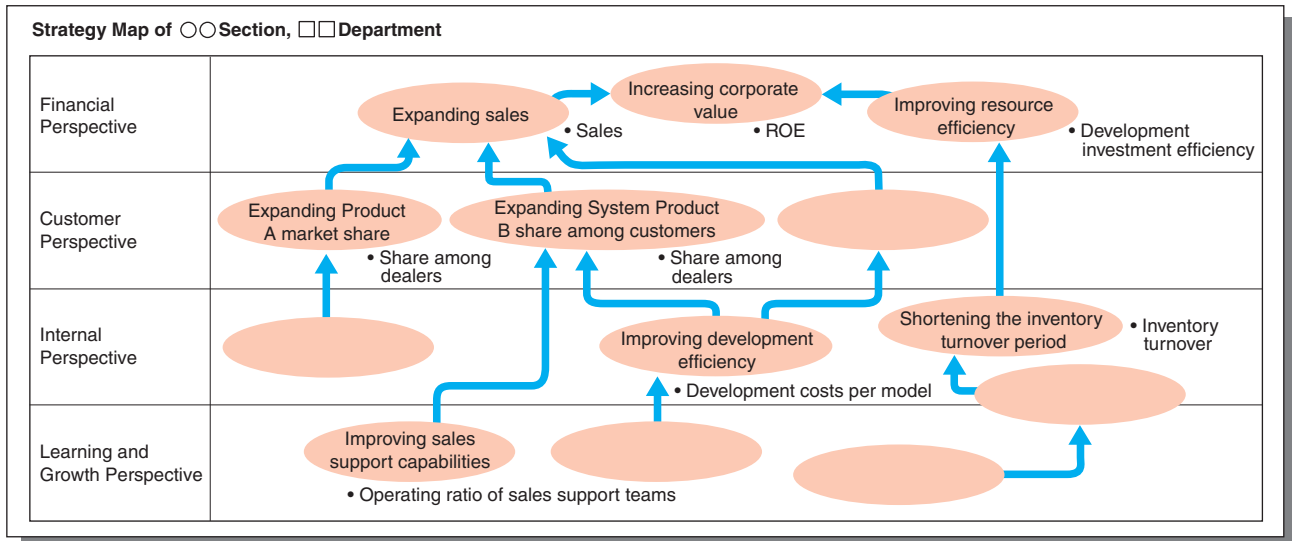
One of the major questions to be answered is how many Japanese companies have actually introduced the BSC. In his recently published book, Professor Michiharu Sakurai of the School of Business Administration at Senshu University introduces the results of multiple surveys concerning the introduction of the BSC at companies in the United States, where the method was introduced and disseminated long before it reached Japan. While the profiles and other details of the responding companies are not necessarily made

Figure 1. Basic Concept of the Balanced Scorecard (BSC)



Source: Compiled from Robert S. Kaplan and David P. Norton, "Using The Balanced Scorecard as a Strategic Management System," *Harvard Business Review*, January/February 1996.

Figure 2. Overview of the Strategy Map and Scorecard



Scorecard of ○○Section, □□Department

Relationship Between Achievement Ratio and score									
110% or more	5 points								
100% or more	4 points								
90% or more	3 points								
80% or more	2 points								
70% or more	1 point								
Less than 70%	0								

	Strategic Goals	Performance Index	Weight	Target Value	Actual Value	Achievement Ratio	Score	Score × Weight × 100	.....	.....
Finance	Increase in business value	ROE	20%	××%	××%	— %	4	80			
	Sales increases	Sales	15%	¥××× million	¥××× million	— %	5	75			
	
Customers	Expansion of Product A share	Market share of Product A	10%	...	...	...	...	...	...	...
	
	
Internal	Shortening inventory turnover	Inventory turnover	10%	...	...	...	...	...	...	...
	
	
Learning and growth	Improvement of sales support capabilities	Operating ratio of sales support teams	5%	...	...	...	...	...	...	...
	
	
								total	/500		

Note: ROE = Return on equity.

clear, the results contribute to understanding the outline (Table 1).

Regarding the situation of introducing the BSC in Japan, the questionnaire surveys conducted by Professor Sakurai and others in January and February 2003 (responses from 107 of the 300 targeted companies, all of which were listed on the First Section of the Tokyo Stock Exchange) revealed that eight companies have already introduced the BSC on a full-scale basis, 12 companies have partially introduced the BSC, and 31 companies were considering its introduction.

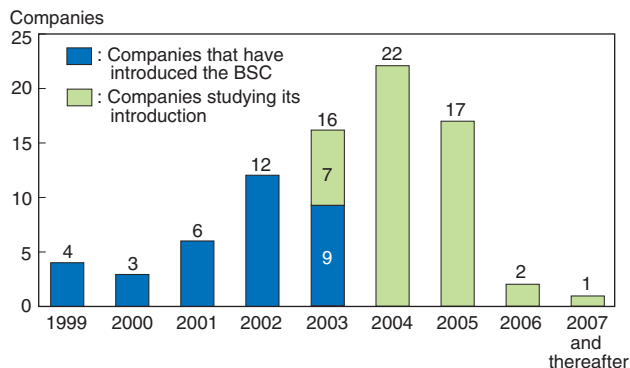
According to the questionnaire survey conducted by NRI in June 2003 among 1,330 companies with sales

Table 1. Surveys on Status of Balanced Scorecard Introduction in the United States

- **Bain & Company, "Surveys Concerning Executive Business Management Practices" (1999)**
→ Companies that have introduced the BSC account for 55 percent of survey targets in the United States and 45 percent in Europe.
- **Hackett Group, "2000 Hackett Benchmarking Solutions— Numerical Value Brochure"**
→ Half of 60 survey targets have introduced the BSC.
- **Surveys by IMA (Institute of Management Accountants) (2001)**
→ Among 1,300 survey targets, 40 percent have introduced the BSC.

Source: Compiled from Michiharu Sakurai, *The Balanced Scorecard— Theory and Case Studies*, Dobunkan, 2003.

Figure 3. Period for Introducing the Balanced Scorecard (Planned)



Note: As this questionnaire survey was conducted in June 2003, companies that had introduced the BSC by June were included in the category of companies that had introduced the BSC, and companies planning to introduce the BSC in June or thereafter were included in the category of companies studying its introduction. Accordingly, companies that had introduced the BSC and companies studying its introduction were mixed in the figure for 2003.

of ¥50 billion or more and traded on the OTC market (including some whose shares were not publicly traded), 35 firms (or 18.5% out of the 189 responding companies) indicated that they had already introduced the BSC. The authors estimate that around 100 publicly held companies in Japan have actually been operating under the BSC methodology.

Our survey also revealed that companies making specific preparations for the future introduction of the BSC amounted to some 9.0 percent, while those collecting information about the possible introduction of the BSC in the future totaled 36.0 percent. Based on the responses to the question about the introduction period (or the planned introduction period), it was estimated that the years between 2003 and 2005 would be the peak period for introducing the BSC approach. As companies that reported they had not yet determined an introduction period were not included in this estimate, this peak might come several years ahead of this projection if plans among these undecided companies start to take shape (Figure 3).

II Is Success Being Achieved Through the Introduction of the BSC?

While the BSC has also started to spread in Japan as described above, the question is whether its introduction is achieving success in actual terms or not. It is difficult to establish objective judgment criteria on what constitutes success or failure. As the first step in measuring this, it would be appropriate to use the self-evaluation factor among companies that have introduced the BSC, i.e., whether or not the initially intended purposes are met, and if the BSC is smoothly being implemented.

The questionnaire survey conducted by NRI included the question “How do you comprehensively evaluate the results of introducing the BSC?” In answer to this question, the responses by a total of 35 companies that had already introduced the BSC were as follows. “Satisfied so far” (one company, 2.9%), “Generally satisfied, although there are some problems” (22 companies, 62.9%), “Dissatisfied, as it left much to be desired” (12 companies, 34.3%).

Partly because the introduction had just started, no respondents concluded that “It was a failure” at the present stage. However, more than one-third of the companies surveyed expressed general dissatisfaction because of many problems as compared to the results achieved. In order to decrease the number of “failed cases” which is likely to start climbing in the future, appropriate measures should be taken.

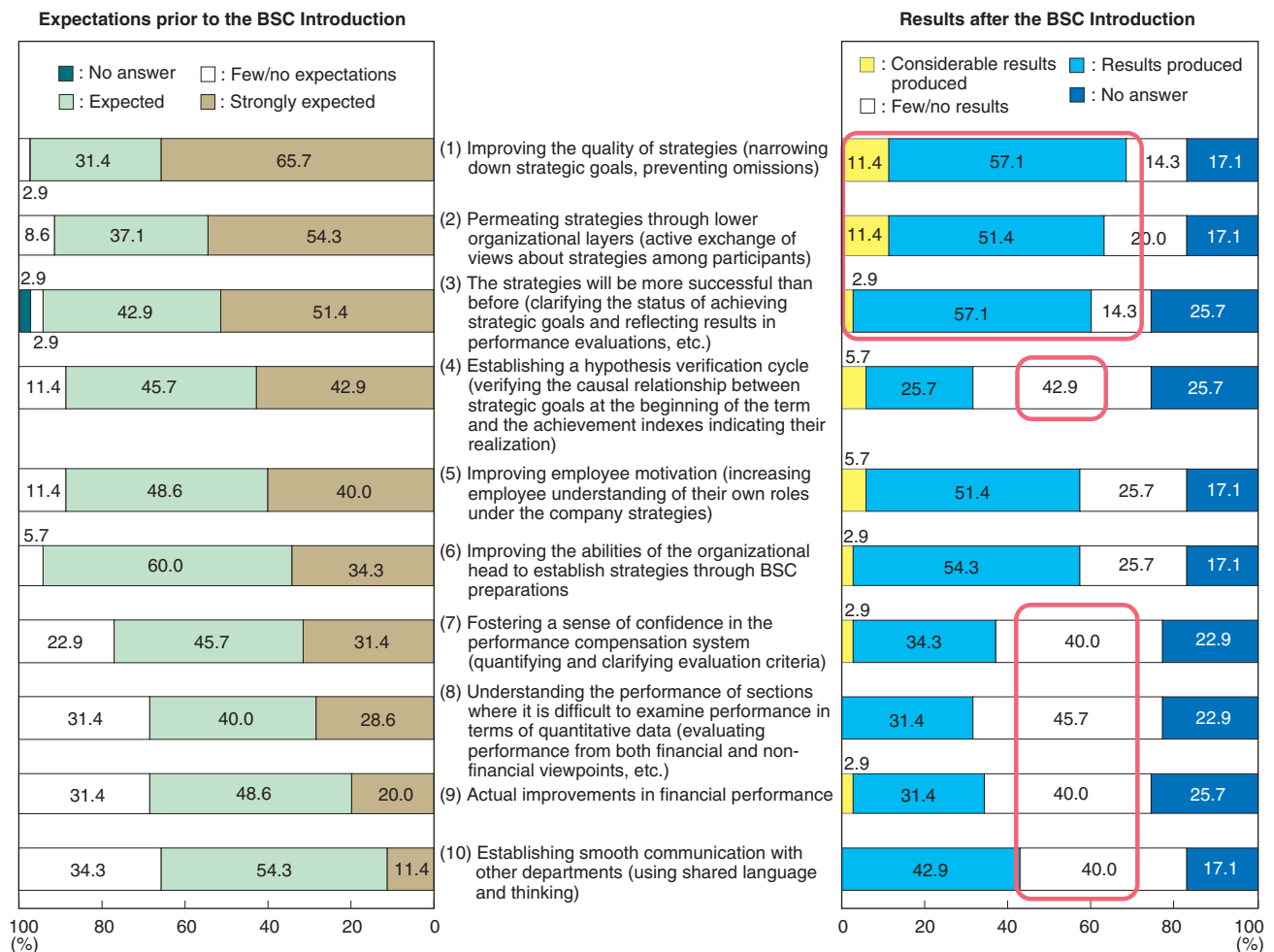
To begin with, what did companies that introduced the BSC expect? While the methodology is a tool that ultimately contributes to both mid- and long-term improvements in corporate value (i.e., a tool that can become the core of value-based management), there are some interim steps along the way before the final goals can be realized.

Take, for example, the question “What did you expect in introducing the BSC?” The ratio of companies that selected “The introduction of the BSC will actually improve financial performance” (which is the ultimate goal) was relatively low (Figure 4). Rather, responding companies seem to have high expectations for the interim results before reaching that final goal of improving financial performance, as indicated in their selection of the following items.

- (1) “The quality of strategies is improved. Narrowing down the important strategic goals and preventing omissions by recognizing four perspectives and linkages among each strategic goal.”
- (2) “Participants can engage in a lively exchange of their views about strategies. Strategies can permeate through the lower organizational layers by means of discussions, etc., among managers and subordinates in the same BSC arena.”
- (3) “As the status of achieving strategic goals becomes clear and is reflected in performance, the strategies will be more successful than before.”
- (4) “A hypothesis verification cycle will be established by verifying the causal relationship between goals determined at the beginning of the term and the achievement indexes to realize such goals.”

With respect to the question about whether the anticipated results could actually be realized, we generally see a trend that suggests the higher the expectations for an item before the BSC is introduced, the higher the

Figure 4. Effects of Introducing the Balanced Scorecard (Expectations and Actual Results)



Note: Items are listed in the order selected for "Strongly expected" by respondents among the total of 35 companies that have introduced the BSC.

evaluation of the actual results. However, the gap between expectations and actual results is large with respect to Item (4) "Establishment of a hypothesis verification cycle." As the anticipated results did not seem to measure up in spite of the high expectations for this item, it can be said that this is an area in which there is much room for improvement before the benefits of introducing the BSC can be realized.

To sum up, no definite evaluation has been established so far with respect to the BSC, whose history in Japan is still relatively short. However, companies facing difficult situations after its introduction certainly exist. If appropriate measures are not taken now, there are fears that the number of "failed cases" may start mounting and the concept may simply collapse and disappear as a passing fad.

III Five Decisive Measures in Success or Failure

What, then, are the decisive factors in determining the success or failure of introducing the BSC? Through our discussions with a number of companies

Figure 5. Elements Behind Success in Introducing the Balanced Scorecard

Purpose of the Introduction	(1) Clarifying the purpose behind the introduction
Attitude Towards the Introduction	(2) Commitment by top executives at the time of introduction
Introductory Preparations	(3) Increasing the awareness and understanding of organizations in which the BSC is introduced
	(4) Fostering BSC experts in both the organizations in which the BSC is introduced and the BSC implementation office
Role of the BSC Implementation Office	(5) Initiative for reform (from setting goals to hypothesis verification) assumed by the BSC implementation office

and actual introductory support in the past, NRI has continued its efforts to pinpoint the elements that lead to success from a broad spectrum of possibilities, ranging from the basics of management reform to technical factors. As part of these efforts, those elements that we could verify from data in the survey were classified into five categories (Figure 5). The following section discusses each item by introducing specific cases.

Figure 6. Factors Responsible for Success and Failure in Introducing the Balanced Scorecard

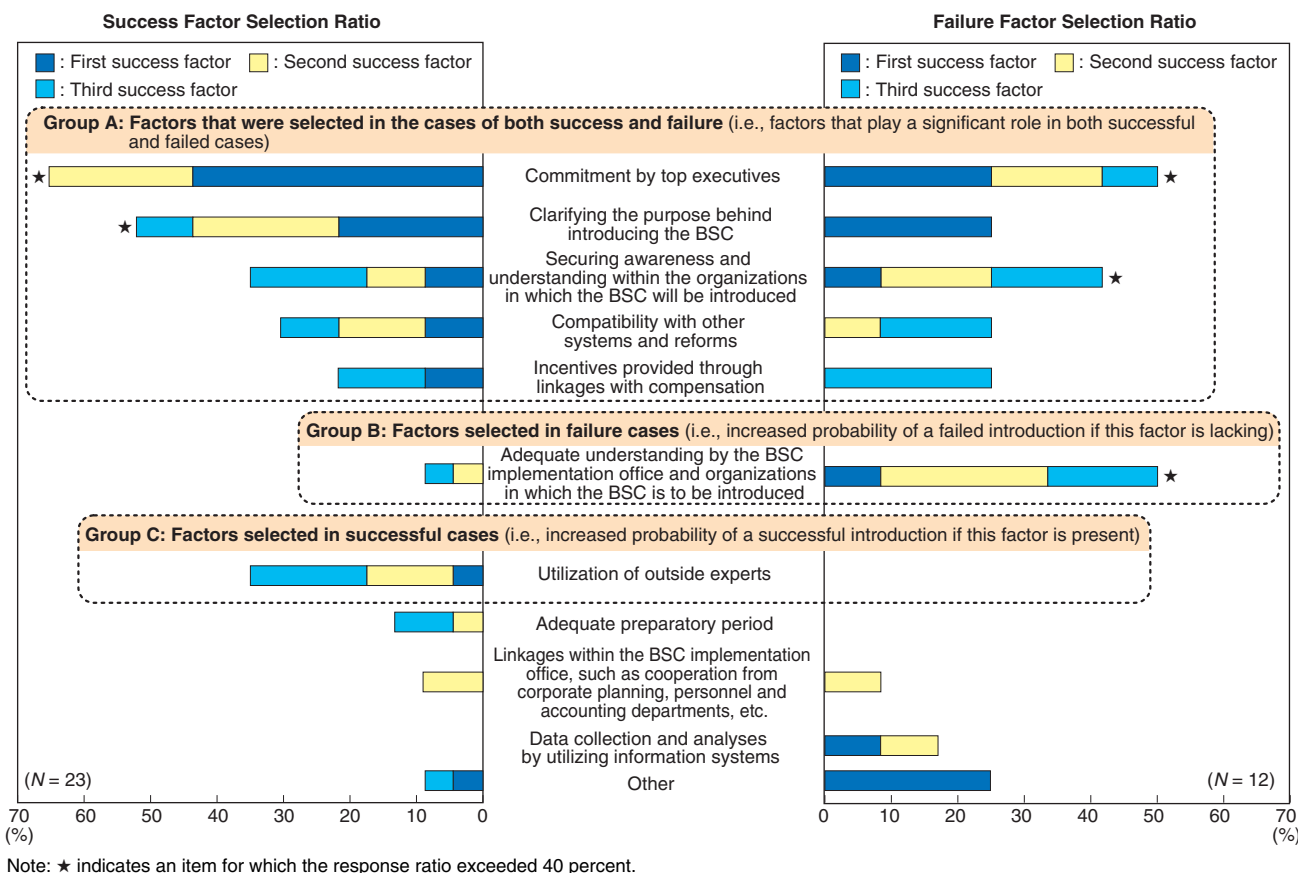
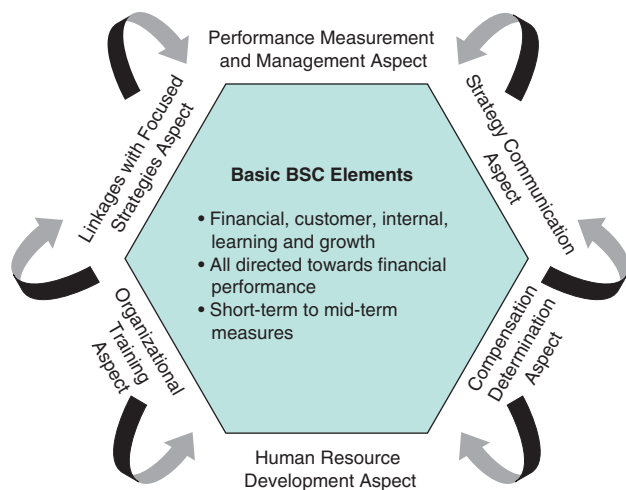


Figure 7. Diversity of the Balanced Scorecard



1 Clarifying the Purpose of the Introduction

The first step is to clarify the purpose for introducing the BSC, and the way in which the methodology will be used to reform a company. One may jump to the conclusion that this is “only a matter of course,” but the cases in which this point is neglected are not few.

In the survey described above, we asked the two-thirds of the total responding companies that selected “Satisfied so far” and “Generally satisfied, although

there are some problems” to further pinpoint the top three success factors. Similarly, we asked the remaining one-third of the companies which selected “Dissatisfied, as it left much to be desired” to pick out the top three failure factors (Figure 6). The results showed that 52.2 percent of respondents selected “Clarifying the purpose behind the introduction of the BSC” as a success factor, while 25.0 percent selected “The purpose was not clarified” as a failure factor—once again indicating the importance of this item.

As the BSC in particular includes substantial diversity, clarifying the purpose behind its introduction becomes important (Figure 7). A tool that incorporates broad diversity enables an organization to flexibly deal with its unique problems. At the same time, however, if the purpose is not carefully narrowed down, preparations beyond the necessary level may be made for a host of purposes, including those of little or no consequence. This may lead to considerable introductory costs and/or operational overload, and may overlap or be incompatible with other existing structures and systems. A failure to clarify the purpose will also make it more difficult to gain employee awareness and understanding of the need for introducing the BSC within the company. This may even result in a reform in which nobody benefits in the end by distorting those elements that should never be surrendered while building a consensus among the various stakeholders within the company.

In order to avoid falling in such a trap, it is appropriate to carry out a diagnosis of the existing corporate management system before making a decision on introducing the BSC. If problems are prioritized and issues that should be addressed by the introduction of the BSC are initially clarified, it becomes possible to establish a basic foundation to return to whenever deviations arise in the course of studying the introduction.

■ An energy company introduces the BSC by narrowing the purpose down to a “focused strategy”

One energy-related firm represents an example of successfully introducing BSC. The firm did not start introducing the BSC before carrying out reforms. The bottlenecks in the corporate management systems were first extensively analyzed and the BSC was applied to those problems that were identified in the course of introducing solutions in specific areas while maintaining reciprocal compatibility. The company sought the objective evaluations of outside consultants with respect to the management reforms it had pursued in the past, and the company decided to use the BSC in addressing the four problems indicated in Figure 8.

Without going into detail on each, the directions of the four reforms listed below can be summarized as follows. Previously established all-encompassing and overly comprehensive strategies were narrowed down by using the characteristics of the BSC Strategy Map (four perspectives, linkages, and performance indexes). Moreover, the mechanisms to properly manage and evaluate the achievement status of these strategies were established. Items that had a weak relationship with

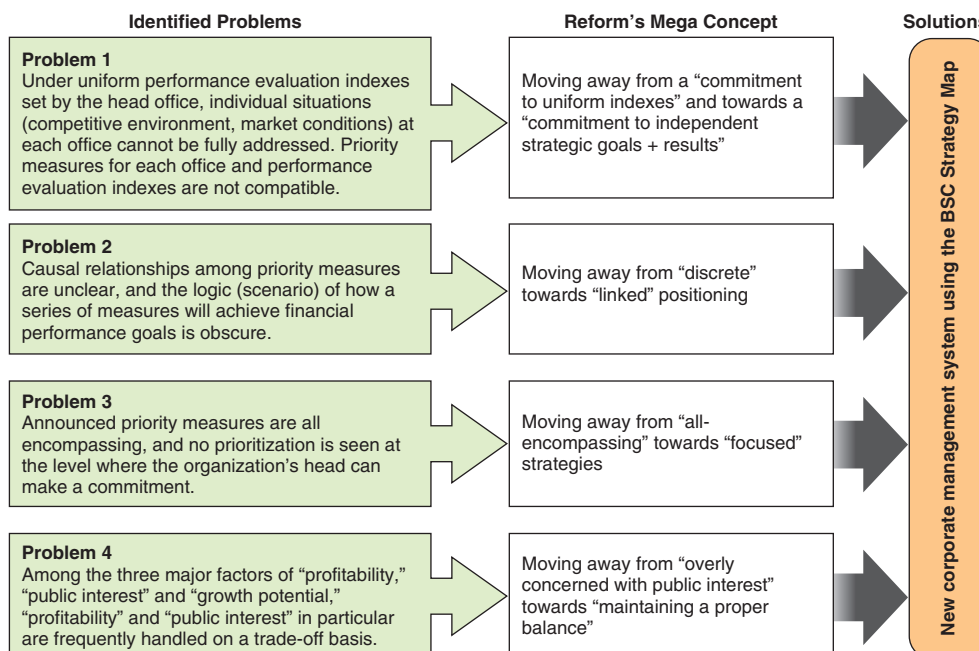
these directions, such as the link between organizational performance and compensation, were put aside as issues to be dealt with in the future. Such processing prevented the discussions related to studying the introduction of the BSC from spreading beyond the level that was necessary. Conversely, an adequate dialog was facilitated by providing a venue for discussions in a workshop format with respect to narrowing down strategies. As such, it became possible to study the introduction in such a way in which the important points were stressed and the less crucial aspects could be moved to the back burner.

2 Commitment by Top Executives to the Introduction of the BSC

The second point is the commitment by top management in introducing the BSC. According to the NRI questionnaire, 65.2 percent of companies selected this as a success factor, and 50.0 percent selected it as a failure factor. As such, a commitment by top executives is recognized as an extremely important requirement that significantly influences the results of reform efforts (Figure 6).

Let’s consider the meaning behind the expression “Clear commitment by top management.” First of all, top executives must publicly announce that they are firmly behind the introduction of the BSC. What is most important is that discussions concerning the formulation of strategies and the evaluation of performance after introducing the BSC must be held within the framework of the BSC. For example, regardless of how good the Strategy Map may be, and how diligent

Figure 8. Energy Company: Identifying Management Reform Problems and Directions of Solutions Utilizing the Balanced Scorecard



the efforts are to implement strategies in accordance with such a map, no one would try to seriously discuss the formulation or implementation of strategies based on the BSC if the top executives declared that no other approaches would be considered if the financial goals are not met.

In short, can the BSC be introduced if a commitment by senior management cannot be secured? People may complain that nothing can be done unless the top executive is replaced—and it is true that such lamentations are not infrequently heard. But our experience suggests that such cases often can be traced to the failure of mid-level managers in the corporate planning section to fully and properly make efforts to obtain the understanding of top executives and to elicit their commitment.

In order to secure the understanding of top management with respect to introducing a new system, it is necessary to make careful preparations to fully explain what elements of the company will be affected by the adoption of the new system and whether or not the system is truly effective as indicated by cases in which it functioned well and/or the problems that arose in failed cases. If adequate information is not available on effectiveness of the system in particular, consideration should be given to engaging outside experts such as academics and consultants.

■ A manufacturing company where the president himself is making good use of the BSC as his own tool

In the case of a manufacturing company that introduced the BSC several years ago, the president himself has shown a strong commitment throughout the entire process from its introduction to its operation. His commitment is especially apparent in terms of the operational aspects. The company is using the BSC at a strategy planning meeting to set organizational goals for each semester. In formulating and evaluating such goals, the president follows up with his own comments concerning the establishment of goals by each department, and carries out lengthy and sometimes heated discussions for some 30 hours or more concerning BSC operations in all 20 departments.

The following is an episode that indicates how the president makes good use of the BSC as his own tool. For the first few terms after the BSC was introduced, the corporate planning staff provided a briefing to the president that outlined the major BSC issues of each department and matters that should be discussed prior to the meetings to set goals and evaluate the performance for each term. Shortly after this, however, the president announced that such briefings were not necessary. Instead, he has been reading the direction of strategies pursued and goals to be achieved by each department by means of utilizing the BSC as outlined on the single sheet of paper for each department, and

was carrying out discussions concerning such possibilities and problems.

As the president himself recognizes the importance of establishing and pursuing high goals and the dangers when the BSC is reduced to a shell, he is demonstrating his serious commitment to the BSC both inside and outside the company. This is the very factor that has become the driving force behind the efforts of each department to seriously discuss and implement the BSC. By accumulating experience in BSC operations, the accuracy of the “judgments” of top executives with respect to each business field has been rapidly improved, and this has been leading to organizational training on a company-wide basis.

3 Increasing Awareness and Understanding of Organizations Where the BSC is to be Introduced

The third point is to introduce the BSC after fully increasing awareness and understanding throughout those organizations where the BSC will be introduced (i.e., organizations whose performance is to be evaluated by the BSC). In the NRI questionnaire survey, 34.8 percent of companies selected this point as a success factor, while 41.7 percent of respondents selected this item as a failure factor (Figure 6).

The sense of resistance among organizations in which the BSC is to be applied could include the following: (1) freedom might be compromised (e.g., promising financial results makes it hard to commit to other aspects); (2) the office workload may be increased; (3) the affected personnel are fully used to the way in which things are now being done; and (4) suspicions by front-line personnel about head-office motives (e.g., being forced in the past to adopt various systems that disregarded actual front-line situations). These feelings are unavoidable to some extent. Among companies for which we provided support, there were almost no companies where 100 percent of the employees wholeheartedly welcomed the introduction of this type of system.

However, it is also true that the BSC includes aspects whose advantages become clear only after its usage. For example, if discussions are held concerning strategies by using the Strategy Map, a new sense of increased awareness can be generated. Whether or not one senses this heightened awareness largely influences if that person supports disseminating the BSC inside the company.

In parallel with the efforts to increase the quality of the Strategy Map, NRI provides a “Workshop for Creating Strategy Maps” as a venue for key persons in organizations preparing to introduce the BSC. Such workshops can introduce a fuller understanding and recognition of BSC concepts through this sense of increased awareness. Comments from people who have participated in this workshop approach include: “Our

company had almost no experience in focusing on specific strategies. We have become aware that the essential concept of management (i.e., allocating management resources to strategic operations on a priority basis) can finally be realized if the BSC is used.” A telling comment offered by another participant: “We would like to roll out activities from which practical and useful measures are created in working towards the full-scale operation of the BSC in the future, rather than simply establishing the principle and/or putting up appearances.”

■ Another manufacturer that implemented a workshop to establish a Strategy Map on a company-wide basis

This manufacturing firm began to study the introduction of the BSC when it recognized a problem in which a PDCA cycle centered on annual goals had not yet been established. Initially, one organization was selected for a trial introduction (i.e., the pilot organization), and discussions began between the BSC implementation office, outside consultants and the pilot organization. As part of these discussions, various ideas were accumulated at a workshop that was held to determine the Strategy Map. Participants in these discussions became aware of the following points.

- Despite the fact that the company is providing products to many and unspecified final consumers, the firm had pursued a product-push concept. In other words, discussions were concentrated at the tactical level on how to push the firm’s products to its customers. It became clear because of this that the strategic goals required by the BSC, such as improving those business processes that transcend the time axis and human resource development, could not be specified, and that linkages between these strategic goals and the financial goals cannot be identified.
- What market segments did the company target in particular? Customers select our products rather than those of our competitors only because of the values we offer to such segments. It was brought home anew to the participants that such discussions had not evolved.
- When major measures described in the former planning documents were plotted on the Strategy Map, some were not compatible with a series of flows that should be linked by linkage arrows, and some omissions needed to complete the story began to emerge.
- Before anything else, facilitating discussions among the participants on the theme spelled out on only a single sheet of paper called the Strategy Map was seen as new and fresh. It was recognized that the sense of ownership and motivation that were created from such discussions was extremely valuable.

Through such experience, the corporate planning section responsible for organizing the reform at the company noticed that discussing the Strategy Map among

all concerned (i.e., the organizations in which the BSC is to be introduced, the BSC implementation office and outside consultants) in the workshop venue was very effective in eliciting understanding within the pilot organization about the advantages of the BSC and in increasing the recognition of these heightened points of awareness. This made it clear that even if additional time and labor was required when rolling out the BSC on a company-wide basis following its introduction in the pilot organization, this process was actually a shortcut to the program’s realization in the long run. Accordingly, the company adopted this caravan-like approach through company-wide workshops in incorporating the BSC into its operations.

4 Fostering BSC Experts at Both the BSC Implementation Office and the Organizations in Which the BSC Will Be Introduced

The fourth point is the matter of the human resources responsible for operating the system. According to the NRI survey, only 8.7 percent of responding companies selected “Understanding the BSC by the BSC implementation office and the organizations in which it is introduced” as a success factor. However, 50.0 percent of responding companies singled out this item as a failure factor (Figure 6). Unlike the three points previously addressed, the factor of “understanding the BSC” appears to be merely a matter of course, as any attempt to introduce the BSC seems bound to fail without it. While it may be assumed that it’s only natural to deepen one’s understanding of the BSC in preparation for its introduction, the situation is not that clear-cut in actual terms.

What is required here, for example, is not only an understanding of the procedures in drawing up Strategy Map, but also the know-how on how to proceed with reforms by using the BSC and the know-how necessary to resolve the many difficult problems in terms of operational aspects as they emerge one after another. Human resources equipped with such know-how and capable of assuming core roles in promoting such reforms are BSC experts.

The importance of BSC experts can also be verified by the following. Only nine out of the 35 companies that have introduced the BSC carried out trial operations in some departments prior to the full-scale introduction of the BSC. It can be said that the companies that conducted such trial operations fall into what might be called a minority group. However, all the nine companies selected “Generally satisfied, although there are some problems” in evaluating the results of introducing the BSC as described previously. This would indicate that the success probability is 100 percent.

What does this mean? Essentially, it tells us that what can be achieved through such trial operations

relates to the various “operational difficulties” that come to light only after implementing the BSC, and the know-how to resolve such difficulties. Furthermore, human resources equipped with the necessary experience and know-how concerning BSC operations were what comes out of such operations, and it is this human factor that can direct the BSC-based reforms of corporate management systems towards success. There are a number of cases in which BSC experts were developed through such activities even among the cases where NRI provided support.

5 Requiring the BSC Implementation Office Not to Give Up the Operating Reins (Especially in the Early Stages of Its Introduction)

The last point is the need for the BSC implementation office to stay appropriately involved in operational terms. In other words, BSC operations should not be left entirely up to the organizations where the BSC has been introduced. The importance of this point can be confirmed by the responses to the NRI survey as well in the respective processes of setting goals and verifying performance.

In the first place, the involvement of the BSC implementation office (i.e., the extent to which the head office planning department intervened in the BSC approaches created by each department) was surveyed with respect to the goal-setting stage. Calculations were made by dividing the responding companies into a group of companies that selected “Satisfied so far” and “Generally satisfied, although there are some problems” to the question about the comprehensive evaluation of the results from introducing the BSC (hereinafter called “companies achieving success in the introduction”) and a group of companies that selected “Dissatisfied, as it left much to be desired” (hereinafter called “companies failing in the introduction”). It was possible to observe a clear distinction from these results.

Among the companies achieving success in the introduction, 65.2 percent selected “The BSC implementation office provided adequate feedback comments concerning the contents and the level of strategic goals to the organization where the BSC is introduced.” However, only 33.3 percent selected this item among the companies failing in the introduction, and the ratio of such companies that selected “Limited to only nominal checking” and “Simply collected data” amounted to 50.0 percent (Figure 9).

The typical pattern of failure at the strategy-formulation and goal-setting stages was that the BSC was merely written out, or that the BSC was not preceded by adequate discussions. In short, the BSC concept received pro forma approval without any real checking, leading to little possibility of realizing or actually

implementing such goals. Moreover, the goals themselves were confined within the boundaries of existing concepts, and not narrowed down to strategic goals. In order to prevent this, a firm commitment by top executives is vital as noted previously. In addition, it is also important for the BSC implementation office to play an appropriate oversight role from a company-wide standpoint (especially at the initial stage of operations).

With respect to verifying the results from implementing the strategies, this process entails a format that focuses on a “verification of linkages” in the case of the BSC. The appropriateness of the strategic hypotheses expressed by multiple strategic goals and their linkages is verified at the end of the term and reviewed with an eye on future improvements.

When the NRI survey asked if such verification was carried out “Mainly by organizations where the BSC has been introduced” or “Mainly by both the organizations in which the BSC has been introduced and the BSC implementation office,” a clear distinction was observed between companies succeeding in the introduction and companies failing in the introduction (Figure 10). Specifically, the largest number of companies succeeding in the introduction (52.2%) selected “Mainly by both the organizations in which the BSC has been introduced and the BSC implementation office,” whereas the bulk of the companies failing in the introduction (50.0%) selected “Mainly by organizations in which the BSC has been introduced.” These results correspond to the extent of involvement by the implementation office at the stage of BSC strategy formulation.

■ Company where the BSC implementation office continues to be appropriately involved

The case highlighted when the second point (i.e., the commitment by top executives) was discussed can also be evaluated as a success with respect to the involvement of the BSC implementation office in terms of operations.

This company has assigned eight staff members of the Corporate Management Section to oversee BSC operations in addition to their other responsibilities, and the BSC is managed jointly with staff members responsible for the BSC at organizations where it has been introduced. Prior to goal-setting meetings for each term, these eight staff members review the original BSC plans prepared by each department and provide feedback commentary from the standpoint of the overall company. Each department approaches this feedback as an initial exercise before carrying out discussions with top executives at the goal-setting meetings, and utilizes it to revise their original BSC plans.

Moreover, the BSC implementation office requires that BSC results for the current term be submitted prior to carrying out discussions on the BSC for the next

Figure 9. Involvement of BSC Implementation Office in Setting Goals

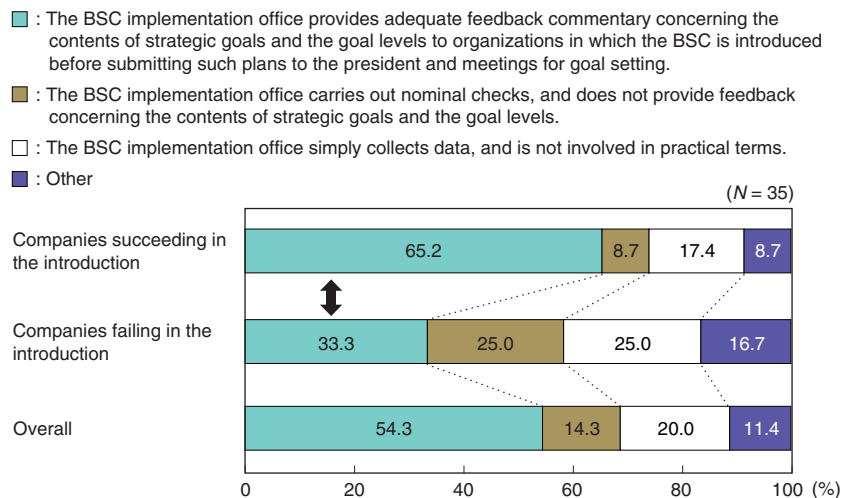
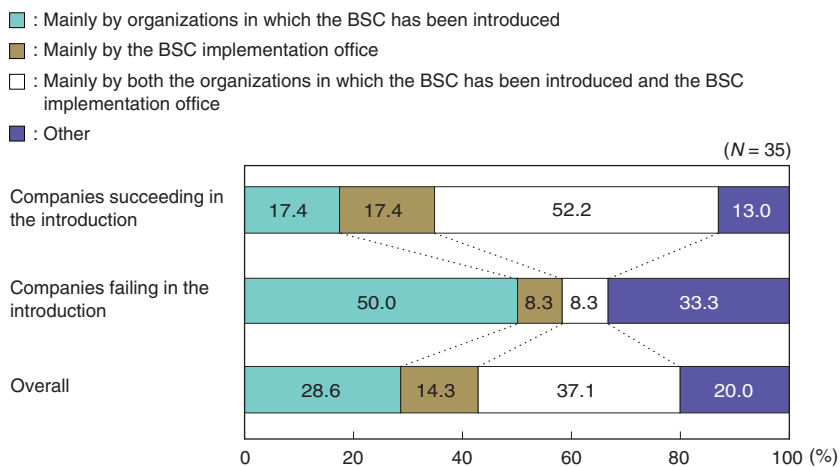


Figure 10. Organization Playing Core Role in Verifying Strategic Hypotheses



term. Efforts are being made to formulate plans that take into account the verification of results by questioning how the results for the current term are reflected in the BSC for the next term. These procedures are also undertaken within the venue of a goal-setting meeting in which top executives also participate.

IV Budgetary Supremacy that Prevents Value Creation by BSC

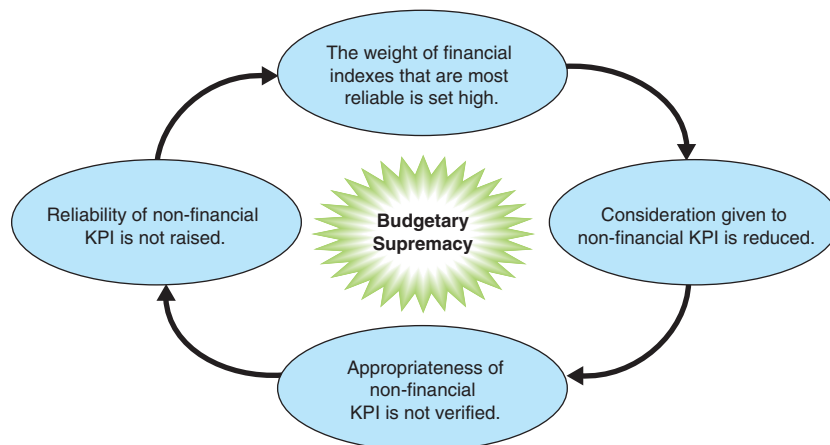
1 Too Much Weight on Financial Viewpoints

The five points discussed in the previous chapter concerning how to succeed in introducing the BSC can be seen as the essential requirements for the BSC to start steadily moving forward in pursuit of its purposes. However, whatever purposes are intended at the time of its introduction, the BSC is a tool whose ultimate purpose is assisting value-based management. From this standpoint, there is much more room to link the BSC to

greater value creation even if companies are currently satisfied with the results from introducing the BSC.

What, then, prevents the further facilitation of value creation by the BSC? We consider this is attributable to “budgetary supremacy,” a concept that looms large in most corporations. We have conducted a number of interview surveys on Japanese companies that are utilizing the BSC as part of performance evaluation standards. These surveys reveal that the weight occupied by “financial data (i.e., the total weight of multiple performance evaluation indexes included in financial perspectives)” among overall performance evaluation standards is extremely high (e.g., an average weighting of some 60 percent to 70 percent, with extreme cases going as high as 80 percent or more). We consider this high rating of financial data among Japanese companies is attributable to the vicious circle shown in Figure 11, and ultimately to the debilitating effects of budgetary supremacy. When the evaluator and the person being evaluated are both committed to financial performance before anything else, they invariably set the financial weighting at a high level. At the same time, the consideration given to non-financial KPI (key

Figure 11. Vicious Circle that Favors High Financial Weighting



performance indicators) that do not have a major impact on performance evaluation results is substantially decreased. As a result, the validity and appropriateness of non-financial KPI is never verified, leading to a repeat of this vicious circle of again over-weighting financial data in the subsequent term.

Budgetary supremacy essentially validates an in-house value judgment that says: “If financial budgets make the grade, the methods and strategies to achieve such figures are never questioned.” This value judgment reduces the BSC to an empty shell. In other words, because activities to identify and improve true non-financial KPI are not promoted, mid-term growth potential can never be fully realized—thus damaging value creation in the end. In order to truly lead the BSC to value creation, this mistaken value judgment must be overcome.

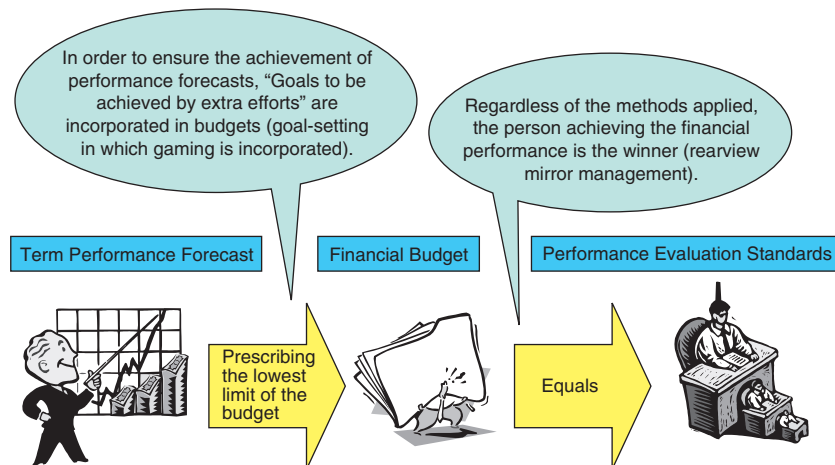
2 Relationship Between Budget, Performance Projections and Performance Evaluation Standards

The performance projections for the fiscal year, the internal budget (especially the income and expenditure

budget), and departmental performance evaluation standards are closely related in Japanese companies. The performance forecast that is publicly announced outside the company is treated as the minimum level performance goal that must be achieved in terms of the internal budget. Practically speaking, a budget to which a certain percentage has been added to the projected performance forecast is assigned to each department in anticipation that some department may not achieve its performance goal. In sum, the externally announced performance forecast constitutes the lowest value of the internal budget. And this financial budget plays the core role among the performance evaluation indexes for the relevant department (Figure 12). This unified relationship between the performance forecast, the budget and performance evaluation standards leads to considerable actual harm.

First, an enormous expenditure (both the time and energy consumed by competent staff members, management executives and department managers) is required to establish the budget for the fiscal year. Many companies spend four months at the minimum to six months or more in some cases formulating the budget for the next term. Under the fast changes resulting

Figure 12. Relationship Between Term Performance Forecasts, Budgets and Performance Evaluation Standards



from the severe management environment of recent years, however, the budget thus formulated will be immediately reduced to an empty vessel. In short, formulating a budget is an in-house activity with an extremely low cost effectiveness. The origins behind such enormous expenditures can be found in internal negotiations between operating departments, each of which wants to set the budgeted performance level as low as possible, and a management that must achieve performance forecasts that have been publicly announced.

The second problem is that financial budgets are set on a fixed basis at the end of the previous term. This forces department managers to shy away from strategic thinking and value creation activities, and instead concentrate on simply trying to achieve term-end performance forecasts. In cases where the business environment is as severe as it has been in recent years and monthly budgetary goals cannot be achieved from the very inception, department managers will be totally immersed in immediate operations and simply strive to achieve the target for the remaining eleven months. Indeed, it is only after a year when the new plan is to be formulated that the department manager can return to strategic thinking and can come up with a view of the market structure and competitive trends from a semi-annual perspective.

The third problem is that strategy formulation quickly falls by the wayside under circumstances in which the financial budget becomes the subject of in-house negotiations. Discussions concerning how to produce profits (strategies) in any company come after the sales and profit goals are determined. Essentially, strategies mean the logic of how to convert management resources into financial results, and the financial budget and strategies must be discussed in parallel. Even when the budget is formulated ahead of strategies, a mechanism is necessary whereby the ensuing discussions about strategies can be reflected within the financial budget in some format.

In order to restore the appropriate relationship between financial budgets and strategies, the existing relationship between “term performance forecast, financial budget and performance evaluation standards” must be challenged and overcome.

3 Three Steps to Overcoming the Current Status

The first challenge begins with flexibly interpreting the term performance forecasts and changing the disclosure method to a format that conforms to the company's own business cycle. Many companies are not aware of the fact that substantial freedom is allowed in interpreting the guidelines for term performance forecasts (the disclosure of which is required by stock exchanges as part of the annual report).

For example, HOYA Corporation promotes diversified management on the basis of its core optics technologies and is known for its advanced approach to information disclosure and corporate governance. The company explains its policy on disclosure in a brief statement in its annual report as follows: “We implement quarterly account closing for quick and accurate information disclosure in order to make it easy for market participants including securities analysts to forecast our performance. For your reference, we announce our performance forecasts on a consolidated basis for the mid-term at the July announcement of our first quarter (April through June) performance results, and our consolidated performance forecasts for the entire fiscal year at the January announcement of our third quarter (October through December) performance results.”

In sum, HOYA adopts the following principles: Because of the rapidly changing business environment in which it operates, the company cannot assume responsibility for issuing performance forecasts for the entire year. Instead, it discloses semi-annual forecasts for which a certain level of accuracy can be guaranteed when three months + α (which is the period from the end of the quarterly term to the announcement of the account settlement), have passed since the relevant term began.

Nomura Holdings, Inc. discloses information on the basis of the SEC (Securities and Exchange Commission) standards of the United States. It takes the posture that: “The company rolls out investment and financial services on a diversified basis in the capital markets of various countries, which markets include various uncertainties stemming from the economic situation, market environment, etc. Accordingly the company announces its performance reports on the basis of actual quarterly results, and does not provide performance forecasts” This can be interpreted as a unique disclosure stance adopted under circumstances in which the company's dependence on market conditions is high.

Beyond such a drastic approach to disclosures, an effective means to mitigate problems caused by current performance disclosure practices might be found in what is known as a “rolling performance forecast.” This method continually rolls over performance forecasts up to a maximum period to allow the company a dynamic view over time until the period just before the relevant projections become obsolete. For example, performance forecasts for the next six months can be provided every three months. If such a method is adopted, timely and appropriate information disclosure can be realized within a scope that does not go beyond the forecasting abilities of the relevant company. Many Japanese companies are expected to adopt this performance forecasting approach in the future.

The second step is to provide flexibility in the company's in-house financial budget. To the extent that the

period of publicly announced performance figures can be shortened, internal budgets can be flexibly edited and implemented accordingly in a rolling-like manner.

SONY, whose “SONY shock” became the core topic of conversation at the beginning of fiscal 2003, set the following policy measure to improve performance management. This approach called on the company to “strengthen operations by studying the weekly summaries of corporate management information and reflecting changes in the budget plans every quarter.” This is exactly what is needed to incorporate greater flexibility in positioning the financial budget and to set goals in a format of staying abreast of ongoing changes in the business environment. As one would naturally expect from a financial budget that is re-edited at a faster cycle, the strategies themselves with respect to the ways in which such financial results are realized must also be flexibly formulated and implemented.

The third step is the verification of non-financial KPI. Multiple non-financial KPI factors clearly have an impact on the final financial performance in any company. Examples include customer satisfaction and production lead-time. What is first required is to thoroughly verify these KPI elements and to increase their reliability. It will only be after non-financial KPI factors that truly affect financial performance are identified in the future that the weight of financial factors as a performance evaluation index can be reduced.

4 New Trends from Europe

Problems surrounding traditional budgeting management systems have also been discussed overseas and progress has been made in researching such systems. Representative moves include the Beyond Budgeting Round Table (BBRT) organized in January 1998 under the Consortium for Advanced Manufacturing-International (CAM-I). With the joint efforts of universities and private sector corporations, the BBRT is conducting research on a new corporate management model that transcends the framework of the conventional budgeting management systems. This new model is called the beyond budgeting model (BBM).

The BBRT White Paper proposed in June 2003 outlines the elements of this new model and introduces various companies that have already started to implement this new model (Borealis, Svenska Handelsbanken,

Volvo, etc.) All of these advanced companies have resolutely implemented reforms with the same direction as that explained in the three steps above.

V Metrics, BSC and Beyond Budgeting Model

The importance of corporate value was recognized together with the concept of cash flow in the 1990s. In line with this, European- and US-type metrics management (i.e., corporate management to quantitatively understand the company status by such management indexes as economic value added (EVA) and return on equity (ROE) and to strive to improve such indexes) has become common among Japanese companies. Furthermore, moves away from rearview mirror management that backtracks financial performance to the management of processes that led to such performance outcomes have improved the overall recognition of tools such as the BSC. And as described in this paper, success factors that have contributed to BSC-based reforms to improve corporate value are now being clarified.

However, these success factors are requirements that actually relate to the design and introductory phases of a reform. In order to link the BSC to value creation at the actual implementation phase, it is necessary to incorporate the BBM elements that were recently introduced. The direction of BBM will further accelerate the current flow of value-based management in Japan.

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- (1) Michiharu Sakurai, *The Balanced Scorecard—Theory and Case Studies*, Dobunkan, 2003.
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