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Improving strategic oversight: the CIMA strategic scorecard

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Summary Enterprise governance is an emerging concept which emphasizes the importance of balancing the corporate governance and performance management aspects of the organization. In the light of recent corporate scandals, there has been considerable pressure worldwide to improve standards of corporate governance through new codes of best practice and legislation. While necessary, there is a danger that with so much attention on control issues, the need for companies to create long-term wealth and to pursue the right strategies to achieve this is overlooked. Research has shown that a particular challenge for boards is to maintain effective oversight of the company's strategic position and progress. In response to this "gap" in oversight, The Chartered Institute of Management Accountants has developed a strategic scorecard. The scorecard is currently under development but is introduced here as a potentially valuable strategic management framework.

Keywords Corporate governance, Performance management, Risk management

Introduction

Recent high-profile cases of corporate failure such as Enron, WorldCom, Vivendi, Royal Ahold and, most recently, Parmalat, have brought corporate governance issues to the top of the business and political agenda. As a consequence, many countries, including the UK, have instigated reviews of their corporate governance arrangements. Following the Higgs review of the role of non-executive directors and the Smith review of audit committees, for example, a revised UK Combined Code on Corporate Governance was issued in 2003 and became effective for all reporting years beginning on or after 1 November 2003.

There is no doubt that such efforts to improve standards of corporate governance have been necessary. However, there is a danger that, with so much attention on control issues, the need for companies to create long-term wealth and to pursue the right strategies to achieve this is overlooked. Good corporate governance is a necessary, but not sufficient, foundation for long-term sustainable success.

This has led to the emergence of the concept of enterprise governance, which emphasizes the importance of balancing corporate governance issues with strategic performance. During work on a project led by the International Federation of Accountants (IFAC) to explore enterprise governance in more detail, it became apparent that the ability to exercise effective strategic oversight by company boards was a key issue. While there are well-established oversight mechanisms for boards to oversee control and governance issues such as financial reporting

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(i.e. the audit committee), there is no such equivalent for the oversight of strategy. In response to this "gap," CIMA has developed a strategic scorecard. The development of the scorecard is in its early stages and trials are being initiated in a number of leading organizations.

Enterprise governance explained

Enterprise governance describes a framework covering both the corporate governance and business governance aspects of an organization. It is defined as "the set of responsibilities and practices exercised by the board and executive management with the goal of providing strategic direction, ensuring that objectives are achieved, ascertaining that risks are managed appropriately and verifying that the organization's resources are used responsibly" (Information Systems Audit and Control Foundation, 2001).

This holistic definition reflects the dual role of the board of directors in both monitoring and strategy, acknowledging the inherent short and long term tensions between governance and value creation. It also covers the internal management of the organization as well as the outward-facing aspects.

The enterprise governance framework is illustrated in Figure 1.

It constitutes the entire accountability framework of the organization. In general, the conformance dimension takes an historic view while the performance view is forward-looking. Enterprise governance emphasizes that good corporate governance is only part of the story – strategy is also important.

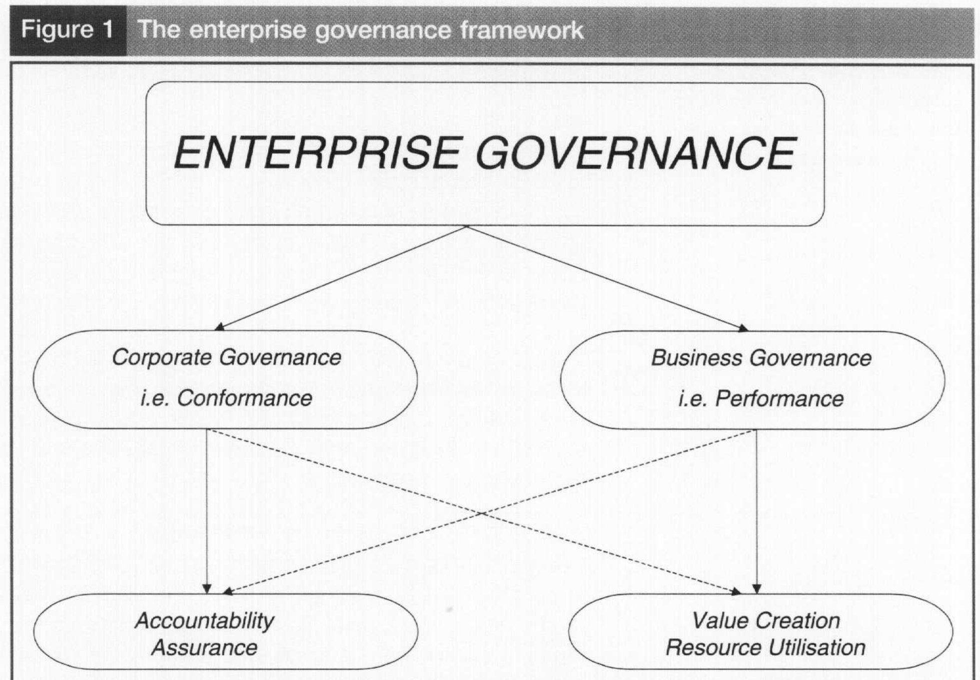
The conformance dimension

The conformance dimension of enterprise governance has had significant coverage in recent years, particularly in the last two years following the various corporate scandals.

It is normally called "corporate governance" and covers issues such as:

- the roles of the chairman and CEO;
- the board of directors, e.g. composition, non executive directors, training etc.;
- board committees, e.g. audit, remuneration and nominations committees;

Figure 1 The enterprise governance framework



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- internal controls in an organization;
- risk management and internal audit; and
- executive remuneration.

It is well covered in the literature and there will continue to be developments in this area. Codes and/or standards can generally address this dimension with compliance being subject to assurance/audit.

There are also well-established oversight mechanisms for the board to ensure that good corporate governance processes are effective, e.g. committees mainly, or wholly, composed of independent (non-executive) directors and, in particular, the audit committee. Other similar mechanisms are typically in place in countries where a separate audit committee does not exist.

The performance dimension

The performance dimension does not lend itself as easily to a regime of standards and audit. Instead, it is desirable to develop a range of best practice tools and techniques that need to be applied intelligently within different types of organization.

The focus here is on helping the board to:

- make strategic decisions;
- understand its appetite for risk and its key drivers of performance; and
- identify the critical points at which it needs to take decisions.

In short, the key is for the organization to ensure that the board is truly engaged with the strategic process. Executive management has a crucial role to play in presenting major changes that have been well thought through and that fall within the boundary of acceptable risk.

Implementation of strategy and its ongoing relevance and success must then be assessed on a regular basis.

In countries such as the UK and USA where the unitary board is the norm, it is widely recognized that strategy is the responsibility of the full board. There are, however, a number of companies that have a strategy committee which reviews the strategy development and implementation process, challenges the information provided and assesses the key business drivers.

There are a range of tools and techniques – e.g. scorecards, continuous improvement, strategic enterprise systems and so on – which can help boards to focus on strategic direction and its implications for all areas of the business. But these are not often dealt with as a coherent whole by the board. In other words, there could be what we would term an "oversight gap." This was explored as part of the enterprise governance project led by the IFAC and in which the Chartered Institute of Management Accountants (CIMA) played a leading role.

Testing the framework – the IFAC enterprise governance project

IFAC is the global organization for the accountancy profession with 158 member organizations in 118 countries. Its mission is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies. Not surprisingly, therefore, IFAC has been very concerned about the recent major corporate scandals and has sought to address some of the issues arising such as the reliability of financial information. IFAC published its findings on this subject in "Rebuilding public confidence in financial reporting: an international perspective" in July 2003.

As a continuation of this effort, the IFAC board asked its Professional Accountants in Business Committee (PAIB) to explore the emerging concept of enterprise governance. The project report, "Enterprise governance – getting the balance right" was published jointly by CIMA and IFAC in February 2004.

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A particular focus of the project was to consider what causes corporate failures in terms of the enterprise governance framework. This focused as much, if not more, on reasons of strategic failure as failures of control and/or fraudulent activity. In a more positive vein, consideration was also given to what must be done to improve the chances of success.

In order to test the framework, a series of 27 short case studies were undertaken. These were drawn from ten countries: Australia, Canada, France, Hong Kong, Italy, Malaysia, the Netherlands, Thailand, the UK and the USA. The case studies covered ten industries, including telecoms, retailing, financial services, energy and manufacturing.

The aim was to provide summaries of the causes of corporate successes and failures (as defined by total collapse of the company or severe difficulties resulting in sharp declines in share price and profits, adverse publicity, etc.). Of the 27 case studies, 11 were "successes" and 16 "failures."

The case studies were based on published material and covered both corporate governance and strategic performance issues. Given the approach taken in the project as well as the time constraints, the case studies were intended to be sufficient to draw broad conclusions rather than rigorous academic research.

One of the key themes that emerged was that, while recent corporate failures have led to significant efforts to improve best practice on the conformance or corporate governance side of the equation, there has not been as much attention on the performance side in terms of strategic decisions and implementation. The case studies clearly showed companies where the issue was strategic failure rather than outright fraud. Another point of interest was that governance issues did not feature very strongly in the "success" stories. Strategic factors seemed to be more dominant. It was concluded that good corporate governance is a necessary, but not sufficient, foundation for success. In other words, bad governance can ruin a company, but cannot, on its own, ensure its success.

Improving strategic oversight

The enterprise governance framework illustrates the importance of keeping both corporate governance and strategic issues in mind when considering success and failure.

Following the recent corporate scandals, there has been increased emphasis on the role of audit committees as exemplified by the UK Smith Report on audit committees (now included in the Combined Code) and the US Sarbanes-Oxley Act. However, while there are always improvements to be made, it is also fair to say that audit committees are not new – they are well-established mechanisms for ensuring effective monitoring of the corporate governance dimension, particularly with respect to financial reporting.

What does seem to be missing is an equivalent mechanism to ensure effective monitoring of the performance dimension. In other words, there is what we have termed an "oversight gap." This is supported by the findings of the case studies where strategic failure was the major issue. While it is for the management to propose and develop strategy in view of the greater time, knowledge and experience at its disposal, it is still the board's responsibility to understand, challenge, endorse and monitor the progress of the company's strategy.

The particular danger points appear to be at times of transformational change when the executive directors are heavily involved. This can put at risk objectivity and transparency both to the board and outside stakeholders. The presence of independent non-executive directors is meant to be a safeguard against such risks and they certainly have the potential to bring considerable experience to board deliberations over strategy. However, in order for this to happen, they need to assimilate a substantial amount of information within severe time constraints. In situations where they are reliant on information supplied by the executive management, there is a risk that they may fail to spot what is missing. It is difficult for the directors to obtain a true and fair view of the strategic position and prospects of the company.

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Can the balanced scorecard fill the oversight gap?

In a word, no. It is the wrong tool for the job. The balanced scorecard was first developed to improve performance measurement, in particular, to capture the value created from the organization's intangible assets such as processes, people, customer relationships, innovation, technology and so on. In this way, it has usefully brought non-financial performance indicators into better focus. Its use has evolved and, in some companies, it has been used to translate agreed strategy into action.

Although Kaplan and Norton have emphasized that the best balanced scorecards should reflect the strategy of the organization, and that a scorecard can help to force clarification and consensus about what the strategy is, they are quick to acknowledge that "strictly speaking, the balanced scorecard is a strategy implementation tool" and that the "formulation of strategy is an art" (Kaplan and Norton, 2001).

The balanced scorecard is less successful in addressing strategic issues that confront the company as a result of major external disruption such as market collapse, competitor activity or regulator stance. Nor does it help with strategic choices, for example, whether to undertake mergers and acquisitions.

As a means of addressing the oversight gap, therefore, CIMA has developed the "strategic scorecard." It is complementary to the balanced scorecard as will be shown below.

The CIMA strategic scorecard

The fundamental objectives of the strategic scorecard are that it:

- Assists the board, particularly the independent directors, in the oversight of a company's strategic process. It provides a framework for independent directors to challenge the strategies presented to them in a constructive way.
- Is able to deal with strategic choice and transformational change.
- Helps to give a true and fair view of a company's strategic position and progress.
- Tracks actions in, and outputs from, the strategic process – not the detailed content.
- Highlights the key strategic points where the board needs to be involved and ultimately needs to make decisions.

It has four basic elements as shown in Table I:

For each dimension, the management would need to give an adequate description of the activity being undertaken and cover when the last relevant information was put to the board and when the next is due.

Element 1 – the strategic position

A company needs to be continually reviewing its strategic position. The areas that should be reviewed fall into the following categories:

- Micro environment – e.g. market, competition, customers.
- Macro environment – e.g. economic, political, regulatory.
- Threats from significant or abrupt changes.

Table I The CIMA strategic scorecard

Strategic position	Strategic options
Strategic implementation	Strategic risks

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- Business position – e.g. market share, differentiation on pricing, quality, service.
- Capabilities – e.g. core competencies.
- Stakeholders – e.g. investors, employees, suppliers.

There are various models available for such analysis. The point of the scorecard, however, is not to prescribe which framework to use, but to make the board aware of what work is being done and when within the strategic process. There is also an issue with frequency. All too often, environmental scanning is a one-off exercise at the start of the strategic planning cycle, whereas, in today's fast-changing environment, it should be thin but constant. It means that the board must be sensitive enough to spot what could possibly be significant developments and instigate more detailed research if necessary.

Element 2 – strategic options

The board needs to be aware of what strategic options are available to the company in terms of the following.

- Change of scope – e.g. geography, product, market sector.
- Change of direction – e.g. high/low growth, offering of price/quality.

These options would be those big "strategic bets" that have the greatest potential for creating or destroying shareholder value. Such bets are often difficult to reverse, and in several of the case studies conducted for the IFAC project, perhaps unwisely in retrospect, amounted to "betting the company."

For each business there are probably only about three or four strategic options that will be under active consideration at any one time. For each of these, it is useful for the board to know what analysis has been done, what the resource constraints are, and when the board may be presented with alternatives.

It is also useful for the board to know what other strategic options are available that are not under consideration at that point of time. This should include options that have been considered in detail by management, but have been discounted. A short rationale as to why they are not being pursued informs the board, particularly the independent directors, as to the context of the current strategy.

A summarized presentation of all the options and the actions on the selected few should enable a reasonably informed debate at the board. This can cover why certain options are being explored, whether these are the right ones in terms of value creation, whether certain options are missing or possibly whether the options could be better "framed."

This does not comprise a strategic plan, but rather a scoping of options that can evolve in a dynamic way and allow a "state of preparedness" (Grove, 1996). (The detailed analysis of each of the options would need to be the subject of a separate board discussion. Once the board has agreed the option, management would need to develop it into a workable plan which would also require board approval.) The purpose of the strategic scorecard is to set out the overall landscape.

Element 3 – strategic implementation

Once a project has moved through the evaluation stage to implementation, the board needs to be updated on progress. A balanced scorecard may prove of use for this dimension.

The detailed evaluation of a specific option should develop and set out attainable milestones and timelines that need to be met. These should be reported on regularly, with failures to meet the targets explained along with an outline of any implications and corrective action that has, or needs to, take place.

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Critical success factors should also be clearly set out – what are those things that must happen to make the strategy successful? There may be a critical path linked with the milestones.

The board needs to be aware of where there are breakpoints when board decisions and/or intervention might be required. These decisions would include whether to accelerate, abort, delay or, possibly, switch strategy. Management needs to react to new information rather than sticking rigidly and dogmatically to the original plan.

Also covered here would be the reporting of whether a post completion audit has or will be carried out. Organizations need to learn from experience and an objective review after completion is a key part of this.

Element 4 – strategic risks

Many organizations have now recognized that the modern business environment necessitates a more performance-focused approach to risk management rather than one driven mainly by compliance requirements. This approach needs to help managers to take more risk where appropriate in order to exploit potential opportunities for profit and growth. This has given rise to the concept of enterprise risk management.

A useful perspective has been developed by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). ''Enterprise risk management is not an end in itself, but rather an important means. It cannot, and does not, operate in isolation in an entity, but rather is an enabler of the management process. Enterprise risk management is interrelated with corporate governance by providing information to the board of directors on the most significant risks and how they are being managed. And, it interrelates with performance management by providing risk-adjusted measures, and with internal control, which is an integral part of enterprise risk management.'' (COSO, 2003) With its emphasis on both the conformance and performance aspects of risk management, it is a fundamental component of the enterprise governance framework and, thus, needs to be reflected on the strategic scorecard.

In the context of the strategic scorecard, the types of assurance on risks that would be covered include:

- clarification of the organization's risk appetite;
- a thorough review of risks in the strategy – the 20 tough questions that need asking;
- impact and probability analysis for key risks;
- strategic risks embedded in company/divisional plans;
- the due process to review risks (e.g. risk workshops, stress testing);
- action plans for key risks monitored against milestones; and
- confirmation that risk management is embedded in acquisitions and major projects.

Conclusion

This article has emphasized two key messages:

1. Enterprise governance, with its emphasis on both conformance and performance, ensures that companies do not lose sight of creating long-term value in a climate of more stringent corporate governance requirements.
2. The CIMA strategic scorecard is proposed as a means of addressing one of the key causes of failure identified in the enterprise governance case studies, namely, failure in strategic oversight. It aims to help company boards to receive a true and fair view of the company's strategic position and progress. It is important to note that the scorecard is not designed to involve boards in the detail of strategic planning – that remains the primary task of executive management.

It should be stressed that, currently, the strategic scorecard is very much in its early stages of development and CIMA is in the process of undertaking trials, both within its own organization and with a small number of leading companies. However, the concept of the strategic score-

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card has been well-received. One noteworthy outcome, albeit one that we did not envisage when we first proposed the scorecard, has been its enthusiastic reception by organizations within the public and not-for-profit sector. This looks to be a promising area for further research and development. It is likely that this interest is due to the increased requirements for greater transparency and a more business-like approach within this sector, which in turn, has created a demand for practical strategic management tools.

In summary, while there are no guaranteed formulae for business success, CIMA firmly believes that the enterprise governance framework and greater attention to strategic oversight, possibly through use of the CIMA strategic scorecard, will go some way towards ensuring effective conformance and performance.

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