



Balanced Scorecard: Necessary but not sufficient!

Andrew Smart,
Managing Director, Manigent



MANIGENT
the Management Intelligence company

Introduction

- Andrew Smart is the co-founder and Managing Director of Manigent, a specialist business and technology consultancy.
- He is the originator of the Risk-based performance methodology and has spent the last 10 years delivering performance and risk management solutions in the UK, Europe and the Middle East.
- He holds an MBA from Henley Business School and is a Professional member of the Institute of Operational Risk.
- As part of his MBA studies, Andrew undertook a year long research project which focused on the integration of performance and risk management.
- Email : andrew.smart@manigent.com
- Blog : www.riskbasedperformance.com

-
- **Business is fundamentally about risk and reward (performance).**
 - ***So why don't management methodologies and systems enable executives to manage the relationship between risk and reward on a day-to-day basis?***

Objectives

It is my contention that taking a performance-only approach to strategic execution is no longer sufficient.

Therefore my objectives for today are:

1. Recognise the value of the Balanced Scorecard.
2. Demonstrate the oversight of not considering risk alongside your BSC.
3. Introduce the Risk-based performance methodology.

Agenda

- 1 Balanced Scorecard - A quick recap
- 2 Risk and the Balanced Scorecard
- 3 Introducing Risk-based performance

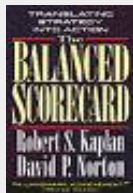
Balanced Scorecard

Since its inception, the Balanced Scorecard has continued to evolve

Performance Measurement

Raison d'être for Balanced Scorecard was to provide a 'balanced' set of performance measurements.

"What you measure is what you get"
- **Kaplan & Norton, 1992**



Performance Management

With adoption, the Balanced Scorecard evolved to become more focused on strategy.

Introduced the 5 principles

1. Translate the Strategy into operational terms
2. Mobilise change through executive leadership
3. Make Strategy a continual process
4. Make Strategy everyone's everyday job
5. Align the organisation to the Strategy

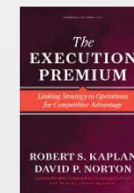
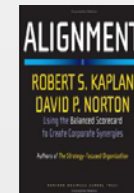


Strategy Execution

The Balanced Scorecard is now positioned as a framework for enhancing strategic execution.

A closed loop system of strategic execution

1. Develop the Strategy
2. Plan the Strategy
3. Align the organisation
4. Plan operations
5. Monitor and Learn
6. Test and Adapt the Strategy



Balanced Scorecard

Often cited benefits



Benefits from the Balanced Scorecard

- Improved financial results
- Improved customer satisfaction
- Improved communications about, and understanding of, Strategy
- Improved organisational alignment

Balanced Scorecard

Some unintended consequences of a **performance-only approach**

- **No link between strategic intent and risk appetite** – What is an acceptable level of Risk? Can this be articulated? Monitored?
- **Strategy is not considered fully** – its about hitting performance targets.
- **Reinforces silo processes** – performance management and risk management rather than integrated performance and risk management.
- **The metric-focused organisation** – lots of measures, but few true indicators.
- **Performance targets to guide strategic execution** – a more comprehensive set of ‘levers’ are required.
- ***Fundamentally business is about balancing risk and reward (performance)*** – so how does risk fit into the Balanced Scorecard?

Agenda

1 Balanced Scorecard - A quick recap

2 Risk and the Balanced Scorecard

3 Introducing Risk-based performance

Kaplan & Norton on Risk and the Balanced Scorecard

- “Risk management is an overlay, an **additional objective** that should complement whatever expected return strategy the business unit has chosen” (Kaplan and Norton, 1996).
- “Linking the scorecard to manage operational risk seems like an excellent idea” - Professor Robert Kaplan, 25 September 2006 (email)
- “The high-level objective in BSC's financial perspective is growing and sustaining shareholder value. Traditionally, we have advocated two methods to drive shareholder value: revenue growth and productivity improvements. The **third method for sustaining shareholder value, missing in many companies' strategies, should be risk management.**” - Professor Robert Kaplan, 19 December, 2008 (blog)

Integrating Performance & Risk Management

Why is it important ? Why now?

- Approximately **70% of companies fail to execute** their strategy – various studies
- **Take cost out of the business** - *cost saving achieved by reducing error rates (losses from operational risks) can far outweigh the savings achieved via more traditional cost reduction measures.* – McKinsey
- **Drive Shareholder value** - The **third method for sustaining shareholder value**, missing in many companies' strategies, **should be risk management.** - Professor Robert Kaplan
- **THE CREDIT CRUNCH** – and the emerging changes in the business environment.

The biggest, single failure of strategic execution?



Failure to correctly manage the relationship between 'risk and reward' goes to the heart of the current financial crisis.



MANIGENT
the Management Intelligence company

An inside view

The problem was that a reduced margin strategy is predicated on the need for improvements in cost control and at the same time massive increases in sales. It is now clear that this **disastrous “grow assets at all costs” strategy** was what led to HBOS’s downfall and humiliating demise by the forced acquisition by Lloyds. Paul Moore

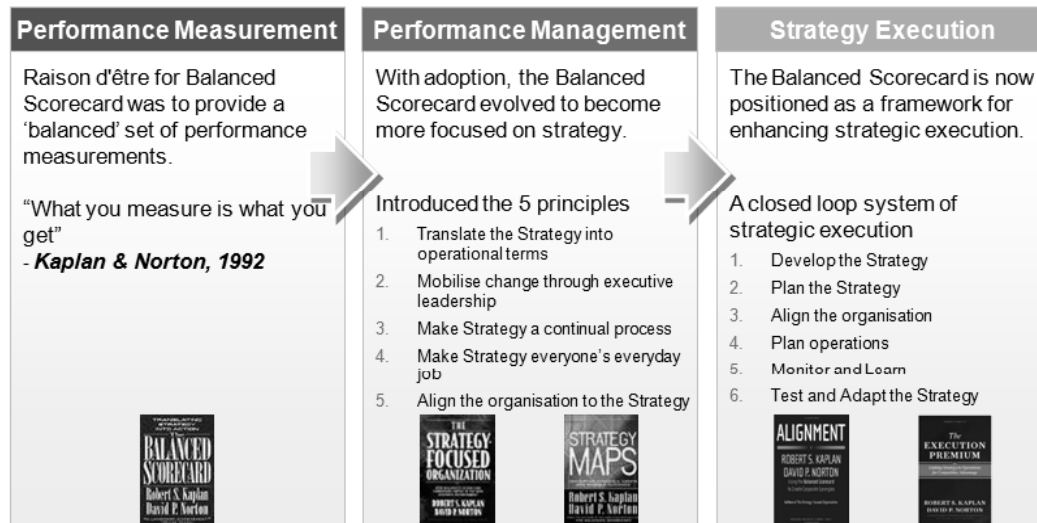
Key challenges, as we see them

- Developing a single, enterprise-wide view of performance and risk
- Driving strategic execution
- Aligning strategic intent and risk appetite
- Improving transparency around risk and performance
- Reducing risk-related losses
- Eliminating silo processes
- Developing the right culture

Risk-based performance

Integrating Performance and Risk Management is the next, natural evolution.

- Executing Strategy takes more than monitoring performance targets.
- Minimising and exploiting risk is critical.



Risk-based performance

Risk-based performance enables executives to manage with ***one eye on performance & one eye on risk.***

Comprehensive strategic execution framework

- Aligns strategic intent with Risk Appetite
- Integrated performance and risk reporting and analytics
- Embedded governance and ownership model



Agenda

- 1 Balanced Scorecard - A quick recap
- 2 Risk and the Balanced Scorecard
- 3 Introducing Risk-based performance**

What is Risk-based performance?

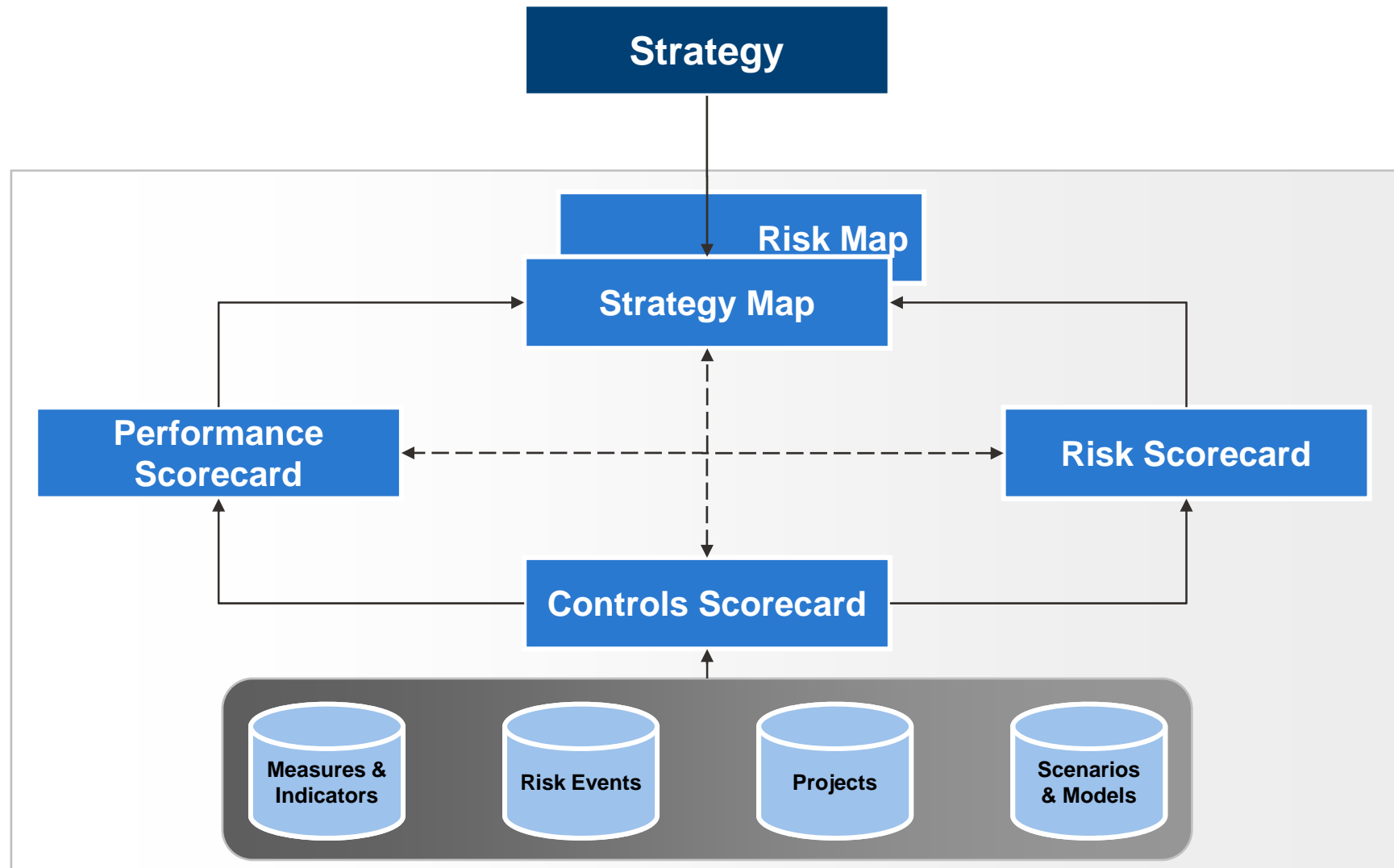
- A strategic execution methodology integrating performance and risk management.
- Designed to enhance strategic execution through improved management discussions, decision-making and action-taking.

Manage with one eye on performance & one eye on risk!

Background

- Developed with financial services clients during Balanced Scorecard, Basel 2 and SOX related projects.
- Refined during a 12 month academic research project conducted in 2006/2007, involving 19 financial services companies.
- Thought-leadership website launched in July 2008 to encourage continued development of the methodology.
(www.riskbasedperformance.com)
- Builds on existing methodologies, Balanced Scorecard and COSO frameworks.
- Has become increasingly relevant in the wake of the credit crisis.

Risk-based performance framework



Risk-based performance

Understand and manage the relationships within your strategic framework



Risk-based performance

Align Strategic Intent and Risk Appetite

Objectives	Risks	Risks			Controls	
		Assessments	Var	Assessments	Controls	Assessments
24	167	163	66.7m	211	211	
11	22	22	14.2m	49	49	
21	32	32	2.7m	56	56	
8	27	27	5.8m	44	12	
5	39	39	13.3m			
55	189	171	150.8m	338	336	
9	94	94	24.6m	305	305	

- For each objective and risk, determine your 'Appetite' – what level of risk are you comfortable taking?
- Compare with your risk exposure.
- Iterative process designed to align your strategic intent with your appetite.

Risk-based performance

Align Strategic Intent and Risk Appetite

- Use common, broad buckets for monitoring appetite and exposure.
- Focus on developing understanding and meaningful management information.

Likelihood Matrix

New Actions Settings						View: All Items
Title	Likelihood Level	Indicative Frequency	Indicative Occurrences	Indicative Probability	Probability	
Almost Certain	4	3 months		Failure is almost certain.	80%	
Likely	3	12 months		High probability of occurrence.	50%	
Possible	2			Medium probability of occurrence.	30%	
Unlikely	1			Low probability of occurrence.	10%	

Impact Matrix

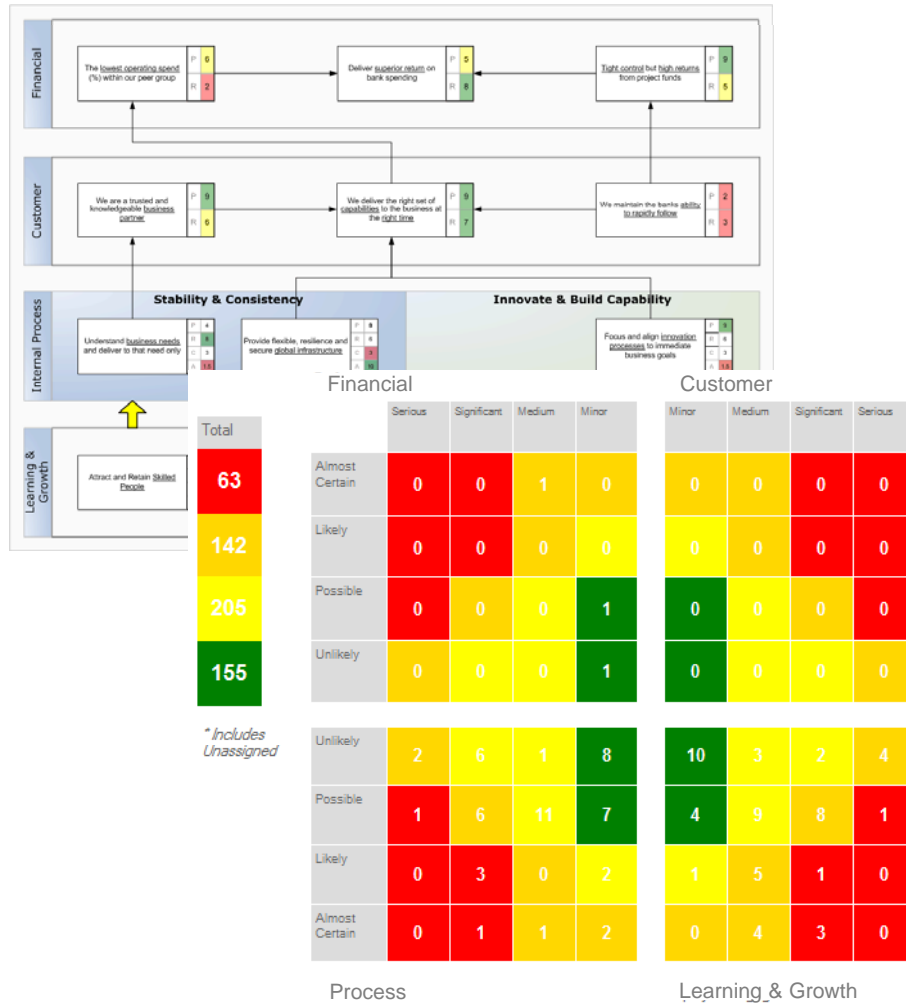
New Actions Settings							View: All Items
Title	Notes	Risk Dimension	Impact Level	Lower	Upper	Mid Point value	
Serious	Financial loss that would severely impact on overall profitability.	Financial	4	£1,000,001	£10,000,000	£5,500,000	
Significant	High financial loss, the effect of the loss would have an overall effect on the overall profitability.	Financial	3	£500,001	£1,000,000	£750,000	
Medium							
Minor							

Heat Matrix

New Actions Settings				View: All Items
Title	Likelihood	Impact	Heat	
Almost Certain / Serious	Almost Certain	Serious	Extreme	
Almost Certain / Significant	Almost Certain	Significant	Extreme	
Almost Certain / Medium	Almost Certain	Medium	High	
Almost Certain / Minor	Almost Certain	Minor	High	
Likely / Serious	Likely	Serious	Extreme	

Risk-based performance

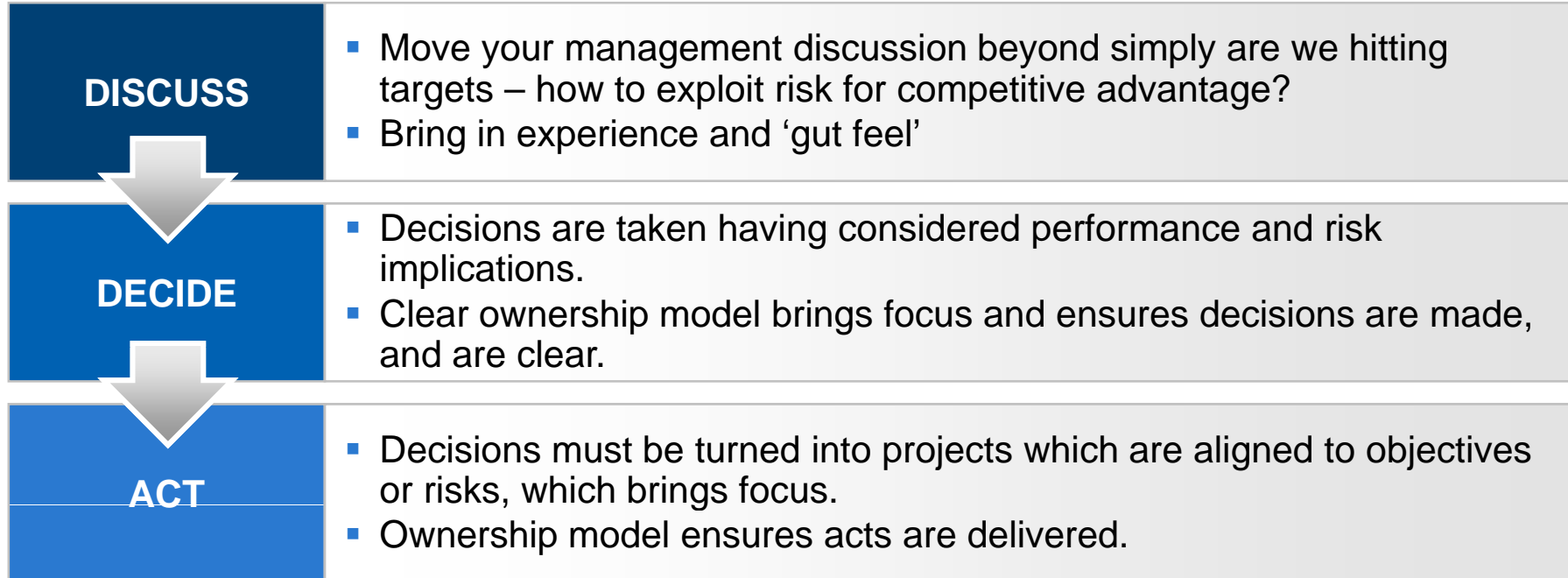
Integrate your Strategy Map and Risk Map



- Strategy map communicates strategy.
- It also indicates levels of performance, risk and control.
- Risk Map enables management to understand their risk profile.
- These two tools enable a more complete management discussion.

Risk-based performance

Better management discussions, decision-making and action-taking

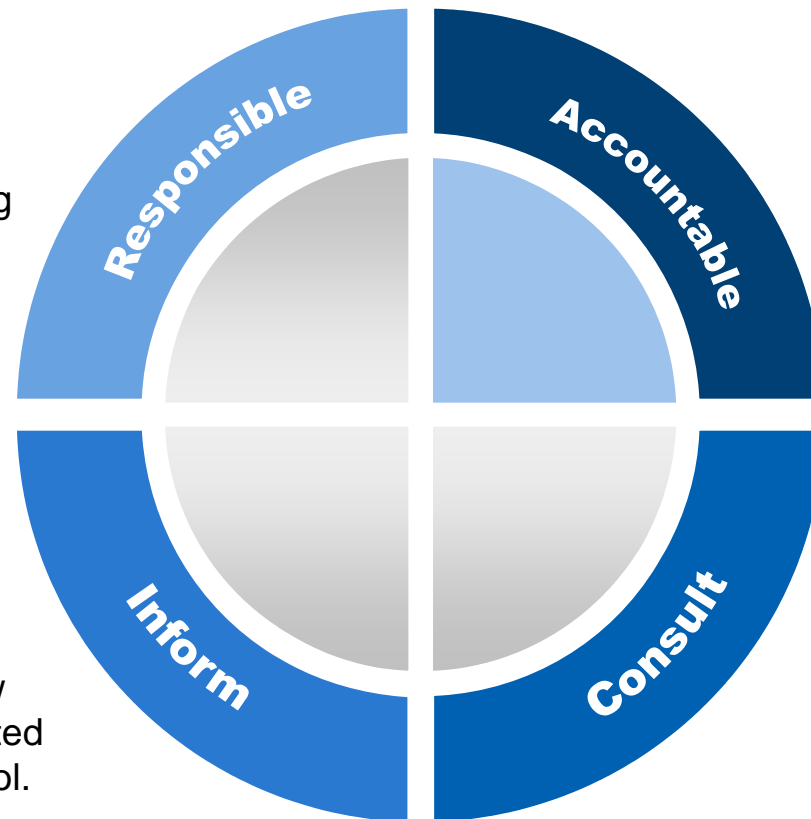


Risk-based performance

Embed Ownership & Governance

“The doers”

Those people working on delivering the objective, managing the risk or applying the control.



“The buck stops here”

Those with Yes/No authority related to the objective, risk or control.

“Keep in the picture”

Position(s) that need to know about decision or action related to the objective, risk or control.

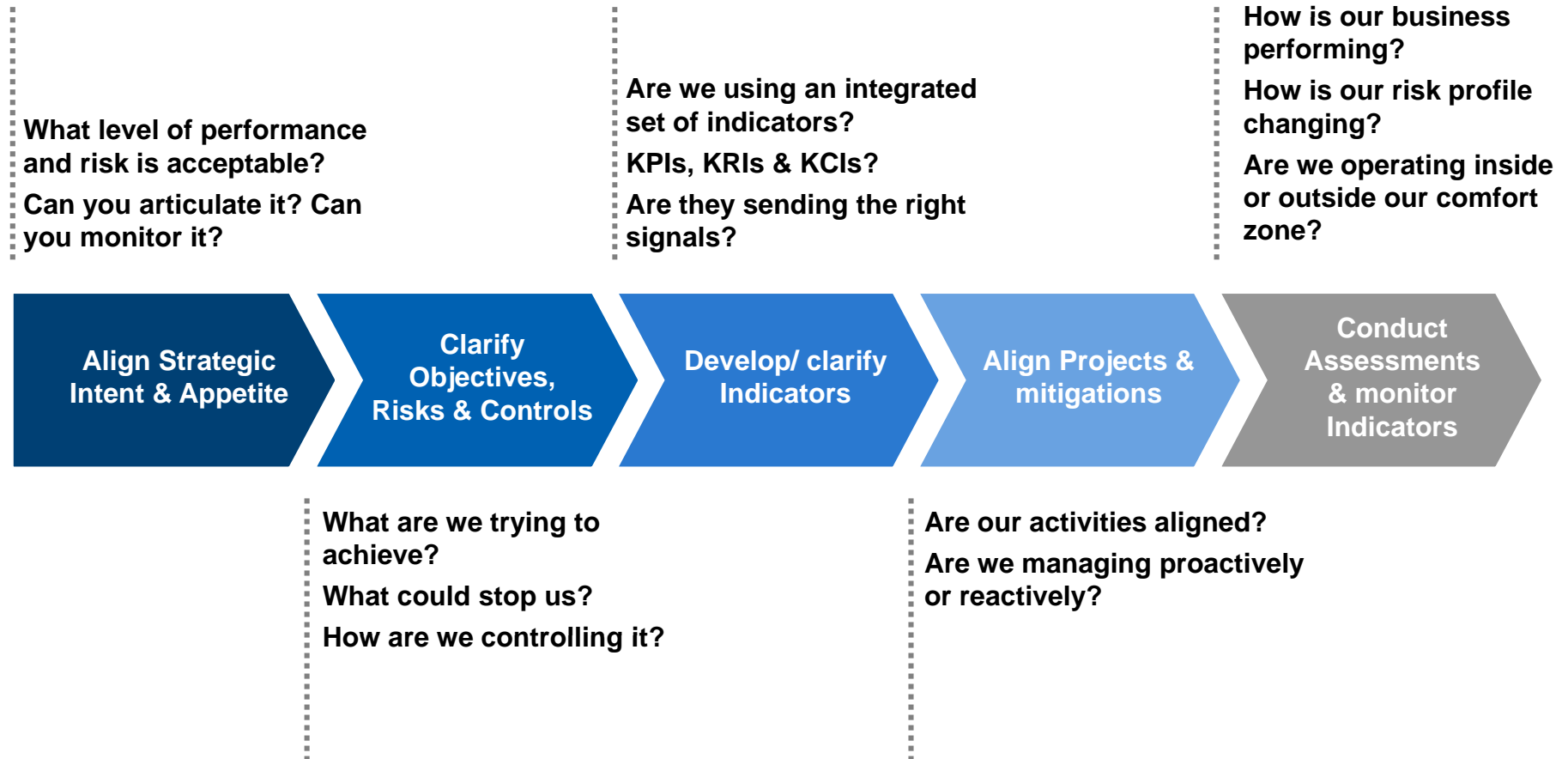
“Keep in the loop”

Those involved prior to decisions or action related to the objective, risk or control.



Risk-based performance

High-level implementation process – key questions



Risk-based performance

Delivers a comprehensive set of 'tools' to support performance and risk management

Performance	Risk	Controls	Activities
Objective definition & mapping	Risk Appetite & Tolerances	Controls definition & monitoring	Portfolio Management
Performance Scorecard & Dashboards	Risk Identification, assessment & mapping	Controls Scorecard & Dashboards	Portfolio/Project Alignment (Objective, Risk, Controls)
Key Performance Indicators	Risk Scorecard & Dashboards	Controls self-assessment	Performance Improvement projects
Human Capital Readiness Report	Risk Mitigation	Key Control Indicators	Remediation actions
IT Capital Readiness Report	Risk Reporting		Countermeasures
	Risk Events (Incident /Near Misses)		Project Performance Reporting
	Key Risk Indicators		Project Risk Reporting
			Benefits realisation
			Post project reviews



Risk-based performance

Key benefits our clients have gained



- Alignment of strategic intent and appetite
- Reduction in the number of indicators to the 'vital few'
- Development of a 'Risk-based performance' culture



- Improved strategic execution
- Reduced costs and operational errors – up to 50%
- Drove growth by building organisational capability



- Development of a comprehensive set of management information
- Combined 'hard' numbers with experience & gut feel
- Developed better management discussions

Conclusion

Balanced Scorecard: Necessary but not sufficient!

Necessary

- Clarification of strategic objectives
- Balanced set of performance indicators

But not sufficient

- Align strategic intent and risk appetite
- Clarification of risks and controls
- Integration and alignment of risks and controls to objectives
- Comprehensive set of 'levers' for the execution of strategy

Balanced Scorecard: Necessary but not sufficient!



Questions

