
At the Intersection

An investigation into the integration and alignment of the Balanced Scorecard with operational risk management frameworks to enhance strategic execution in the UK Financial services industry.

Discussion and interpretation

General discussion and interpretation

- ❑ Considerable knowledge exists related to the individual areas of PM and ORM however when focusing specifically on the integration and alignment of these two disciplines, there was relative little knowledge or information available.
- ❑ There is support for the integrating and aligning of these two disciplines however the challenge is how to achieve this.
- ❑ The UK financial services industry is largely regulated by a single UK regulator that takes a principles-based approach to regulation, which was generally viewed as positive by study participants. Complexity is added when organisations have to address other extra-national regulatory demands, such as those from the United States (Sarbanes-Oxley) and the European Union (Basel II, CRD, MiFID etc).

General discussion and interpretation (2)

- ❑ The research highlighted competition in terms of products (developing and offering the right products and managing their commoditisation), customer/client (winning and retaining), and opportunities (spotting, winning the right to, and taking advantage of, opportunities), particularly important to private equity.
- ❑ It appears that industry's response from a PM and ORM perspective has been reactive and lagging behind environmental changes.
- ❑ Performance and Risk matrix results imply that whilst the industry is becoming more competitive and regulatory pressures are increasing, the industry is struggling to develop the required frameworks and approaches to meet these changing demands.

General discussion and interpretation (3)

- With three risk management-focused organisations and a further six demonstrating increased levels of risk management sophistication, the implication is that participating organisations are responding to regulatory pressure more readily than competitive pressures.
 - Does this mean that the level of regulation of the financial services industry is negatively impacting on the industry's ability to effectively react to competition and deliver on their strategies?
 - This would be in line with anecdotal comments from industry participants.

- There is a lack of correlation between a sector positioning on the environment matrix and its positioning on the performance and risk matrix.
 - This may indicate that the industry is not developing, sharing and implementing best practice approaches.

Performance management - discussion and interpretation

- Perhaps one of the most surprising findings to emerge was the apparent lack of adoption of the Balanced Scorecard within the UK financial services industry.
 - Kaplan and Norton, along with a number of other authors, point to many financial services companies where the Balanced Scorecard is used.
 - However 10 interviewees stated that their organisations did not use it, three suggested they might use it and only two interviewees stated that they used the Balanced Scorecard. Interesting, both started implementation of the Balanced Scorecard around three years ago and are categorised as execution-focused organisations.
 - This point is probably best summarised by one of the interviewees who stated; *“It is interesting, you read in Harvard Business Review about the widespread adoption of the Balanced Scorecard, however when you talk to colleagues in the industry you get a very different view”*.

Performance management - discussion and interpretation (2)

- Perhaps one of the most surprising findings to emerge was the apparent lack of adoption of the Balanced Scorecard within the UK financial services industry.
 - One explanation could be that companies have attempted to implement the Balanced Scorecard in the past, found it difficult and retreated to a more tactical, indicator or dashboard-focused approach.
 - This is the experience of the bank in the case study and one of the participant companies that are now positioned in the execution-focused quadrant. The executive representing the latter organisation hinted at the challenges in implementing the balanced scorecard. *“To be honest, we made a complete pig’s ear of it [the Balanced Scorecard] to start with, we went BSC mad, but we’ve got better as we’ve gone on. Now, after a period of four years, I think I could say we’re pretty damned good”. The interviewee went on to state that “we’re now very aligned; everything is incredibly aligned... For us it [the Balanced Scorecard] is about raising the bar; there’s no place for anyone to hide”.*

Risk management - discussion and interpretation

- ❑ Literature is voluminous and diverse, characterised by a rich history and varying views on how to define, assess and measure risk and particularly, the relatively new area of operational risk.
- ❑ Questions around definition were addressed with the Basel II accord - “the risk of loss from inadequate or failed internal processes, people and system or from external events” This definition was found to be well supported in the literature and during the interview process.
- ❑ However there does seem to be a continued emphasis on the downside related to risk, with upside opportunities given less attention, highlighted by Garrison (2001) and in the interviews.

Risk management - discussion and interpretation (2)

- ❑ Operational risk is a relatively new area of risk; however it is receiving considerable management attention driven primarily by regulatory demands.
- ❑ With only three organisations stating that they have appointed a Chief Risk Officer, this supports the position that this area is still evolving as a management discipline.
- ❑ One of the most significant challenges to emerge from the field research related to culture. Questions centred on what the right culture is, how it can be developed and how to embed operational risk into daily culture and decision-making. This concern is echoed in both the literature and the case study.

Performance management and Risk management - common issues emerge.

- ❑ There is a lack of maturity, both within individual organisations and industry wide around these processes.
- ❑ There are a number of areas where this lack of maturity becomes apparent;
 1. There is a lack of strategic approaches being deployed that will not only enable current requirements to be met, but also position organisations for future challenges.
 2. The quality and availability of PM and ORM IT systems. *“There’s no maturity level out there. Because there’s no maturity level, if you look at even a basic toolset that registers issues and actions, there aren’t many out there that are really good. They’re [IT vendors] not bothering so much to meet requirements because people [the industry] don’t really want to spend the money on it [PM and ORM systems]”.*

Integration and alignment - discussion and interpretation

3. Current best practice seem to reflect a silo approach whereby PM and ORM are implemented in relative isolation. This often leads to considerable duplication and potential confusion as there is significant overlap between the data sources, the processes and the ultimate end-users of PM and ORM information.
- ❑ Clear justification for integration and alignment is the elimination of duplication of effort and costs in both implementing and managing these processes.
 - ❑ There are some clear overlaps between the processes and dimensions of performance, operational risk and strategic execution. Thus, integrating and aligning these processes is likely to significantly enhance the capability of an organisation to execute its strategy, (see figure 28).

Figure 27 – Overlaps between Strategic execution, performance management and risk management

Strategic execution	Performance Management	Operational Risk Management
Strategy processes		External events
	Financial perspective Customer perspective	
Operational processes	Internal processes perspective	Internal processes
People processes	Learning & growth perspective	People Systems

There is considerable overlap between the processes and dimensions of strategic execution, performance management and operational risk management.

Benefits of Integration and alignment

- ❑ Reduces the current rate of strategic execution failure – currently estimated to be between 40% - 70%.
- ❑ Reduces the losses related to operational risk events, with initial costs averaging US\$ 65m and tail costs US\$780m.
- ❑ Reduces by up to 25% the capital allocation for operational risk to enable it to be deployed more effectively.
- ❑ Takes out organisational cost by better management of the internal factors that create approximately half all operational loss events. Estimated to offer greater potential for cost saving than traditional cost cutting.

Emerging best practises related to how to integrate and align performance management and risk management.

1. The use of clearly defined, well structured reporting and review cycles and processes.
2. Linking and alignment of compensation schemes, particularly bonus payments to PM and/or ORM outcomes.
3. Use a gateway process to further reinforce the alignment of compensation to strategy.
4. Ensure clarify of the role of the operational risk and compliance functions. Focus operational risk on the corporate agenda whilst focusing the compliance function on the regulatory agenda.

Key points from the literature related to the integration and alignment of performance management and risk management.

1. Use risk adjusted performance indicators.
2. Incorporate risk related indicators into your overall balanced scorecard approach.
3. Use multiple scorecards

Further information

Please visit <http://www.riskbasedperformance.com/> for further information related to this study and the Risk-based performance approach to the integration and alignment of corporate performance management and operational risk management.

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