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International Conference on Accounting Studies (ICAS) 2016
15-18 August 2016, Langkawi, Kedah, Malaysia

Performance Management for Effective Governance: The Case of a State Owned Enterprise

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Abstract

The purpose of this study is to demonstrate how a state owned enterprise (SOE) responded towards governmental regulations for better governance. Given the pressure to fulfil both economic and social objectives, the case SOE had adopted and implemented the balanced scorecard (BSC). Data was collected through interviews with the relevant organisational members and documentary reviews. The findings of this study show that all social related activities of the SOE were being centralized under the responsibility of one particular business unit i.e. the Community Development Centre. This study demonstrated how social objectives are integrated in the BSC model and how the case organisation addresses social objectives without hindering its main function as a profit-making organization.

Keywords: Social indicators, BSC, non-financial information

1. INTRODUCTION

Development in the public sector, particularly concerning good governance practices, indicate the need for the use of performance management into the structures and processes of the various public sector organizations, including state owned enterprises given that they are regulated and partly funded by the government. An effective performance management system would improve accountability and results as it supports good governance practices. The existence of a performance management system ensures that there is a system in place that directs and controls the structure, processes and activities of the organization to achieve its intended performance and fulfilling the requirements of the stakeholders (Fourie, 2012). In essence, governance is about ensuring performance and conformance, while performance management drives effective governance by warranting that the strategies and activities are implemented to attain goals and produce outcomes (Hawke, 2012). This case study of a state owned enterprise (SOE) in Indonesia was undertaken to understand the design of its performance management system i.e. the balanced scorecard (BSC), as it was put in place and adopted by the SOE, in response toward the governmental push for better governance. Furthermore, this study investigates how the SOE integrates its social perspective into the BSC.

2. LITERATURE REVIEW

In Indonesia, the government normally holds at least fifty percent of the SOEs' ownership and plays an active role in major decisions such as the appointment of CEO and board of directors, mergers and acquisitions,

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consolidation, liquidation and awarding of contracts. Starting from year 2002, several regulations have been issued by the Ministry of SOE, reflecting the government's seriousness in demanding for the SOEs to concentrate on profit making as well as fulfilling their social objective which is to enhance the welfare of the community living around the SOEs location. In year 2011, the Indonesian government, in its effort to combat problems such as individual exploitation, corruption, collusion and fraud among SOEs (ADB Annual Report, 2007), had also issued a new regulation which requires SOEs to have good governance practices by implementing good governance principles such as accountability, transparency, integrity, stewardship, leadership and efficiency (Minister of SOE, 2011; Fourie, 2012).

Considering the challenge faced by the Indonesian SOEs in order to meet both economic and social objectives, as well as the pressure from the government for them to put in place a good governance system, a study on how a high performing SOE managed its organizational performance via the implementation of the performance management system BSC is deemed timely as not much has been discussed in the literature regarding the BSC model for organization of such hybrid nature (Hoque, 2014). Furthermore, given the reality that a large number of SOEs are still underperforming, the findings of this study may provide some guidelines for policy makers and other SOEs in terms of lessons learned, particularly regarding the adoption and implementation of the performance management system.

Performance management system (PMS) is a driver towards good governance as it emphasize on accountability and transparency, thus paving ways for successful organizational performance (Phusavat, Anussornnitisarn, Helo & Dwight, 2009). The type and nature of PMS of organizations varies according to its institutional environmental conditions (Munir, Baird & Perera, 2013). Among the factors that influence the design and use of performance management systems are organizational size and ownership types, stakeholders' focus, employees' understanding and learning, and information and technological advancement (San-Ong & Heng-Teh, 2008). There are two common key factors contributing to the success of PMS i.e. the commitment of staff, and the suitable measurement tool for the identified managerial requirements (Jaaskelainen & Sillanpaa, 2013). On the other hand, the key challenges in designing performance measures in public organizations are due to the difficulties in resolving the conflicts between the needs of various stakeholders and the translation of performance measures into a coherent set of targets (Rantanen, Kulmala, Lonnqvist & Kujansivu, 2007; Giovannoni & Maraghini, 2013).

The BSC enhances the traditional management planning and control system by looking beyond financial measures and considering nonfinancial measures. The BSC reflected the balance between short-term and long-term objective, between financial and nonfinancial measures, between lagging and leading indicators, and between external and internal performance perspectives (Kaplan & Norton, 1996). The combined perspectives will result as a comprehensive system for performance evaluation and the companies should determine quantitative targets for the each of these measures and finally should plan and implement necessary actions and initiatives to achieve their goals (Kaplan & Norton, 2001).

A more contemporary framework for BSC integrates sustainability elements into the scorecard (Figgie, Hahn, Schaltegger & Wagner, 2002; Schaltegger & Lukede-Freund, 2011; Hansen & Schaltegger, 2012). The financial indicators no longer serve as the only leading indicator of organizational performance, as non-financial dimensions (e.g. social dimension) are also being integrated into the performance measurement systems (Schaltegger & Lukede-Freund, 2011). Previous literature had suggested several ways to integrate social and environmental aspects into the BSC, which are (1) integration into four basic perspectives, (2) formulation of a fifth perspective, (3) development of an extra sustainability scorecard (Schaltegger & Lukede-Freund, 2011). Such expansion of the traditional BSC model with ecological (environmental) and social components represents a significant step in practical implementation of socially responsible business (Krstic & Uvanovic, 2012).

3. DATA AND METHODOLOGY

This is a case study of a successful Indonesian SOE referred as Gamma. Gamma was chosen based on its suitability in relation to the study's research objectives as it is one of the most profitable SOE in Indonesia. To date, Gamma's economic and social achievement had been recognized by the Indonesian government and a business press. Given the push by the Indonesian government for SOEs to have good governance practices, Gamma had responded by adopting and implementing a performance management system tool i.e. BSC in order to achieve both its financial and social objectives, and demonstrating improvements in terms of accountability towards its stakeholders and community. The Indonesian government is Gamma's majority shareholder (53.9%), while the remainder of Gamma's common stock is owned by the public (46.1%). Thus, a study on Gamma, to a certain extent, would provide some platform for other SOEs to benchmark for performance advancement.

A single case study approach is suitable to meet the objective of the study as it allows an in depth understanding as to how the SOE via its performance management system had translated its objectives into strategies, key programs and actions, in order to allow for better accountability. The data for this study was gathered from interviews with the relevant organizational members from various business units at the company's group and subsidiary level (such as Community Development Centre, Performance Measurement Group, Human Capital Management, Human Capital Policy, Corporate Communication and Affairs, Risk and Process Management, Enterprise and Business Service, Accounting and Finance). The interviewees are those holding top management and middle management position in Gamma (i.e. senior general manager, general manager, manager, senior officer, assistant vice president). Additionally, several internal documents (from Gamma's annual report, KPI document, website and magazine) and external documents (such as Ministry of SOE's report, website and magazine) were also reviewed. The study had used the qualitative interpretive analysis to answer the research question. Interview data was transcribed and clustered to identify the main issues. The thematic network approach was applied to explore the understanding of the case findings.

4. FINDINGS

The adoption and implementation of performance management as a tool for better governance happened gradually in Gamma, where changes are heavily influenced by the pressure from the government. As early as the mid-1990s, Gamma had used the Malcolm Baldridge assessment, together with ISO in order to measure its performance. Here, the focus of performance is on operational excellence where the emphasis is on 55% evaluation of process 45% on achievement of results, and the key performance indicators (KPIs) used are basically measuring financial achievement (100%) such as revenues, earnings before interests and taxes.

4.1 Development in Regulation

In year 2002, the Ministry of SOE introduced a new regulation which demanded that the performance of SOEs should be more holistic and comprehensive, focusing on both financial (55%) and non-financial performances (operational (35%) and administration aspects (15%)). The abovementioned regulation sets the starting point for Gamma to seriously measure and meet their non-financial targets and objectives, through the adoption and implementation of the BSC. Table 1 summarizes the KPIs set by the Ministry of SOEs in year 2002.

Table 1. The KPIs for Financial and Non-Financial Performance.

Type of Indicator	Examples
Financial indicator	Return on equity; return on investment; cash ratio/quick ratio; current ratio; collection periods; inventory turnover; total asset turnover, equity to total assets ratio.
Operational indicator	Key activities to support the operational success.
Administrative indicator	Submission of audit report; delivery of the program and budgeting plan; delivery of periodic report; effectiveness of the partnership and community development program; collectability rate on loan of partnership program.

Source: Regulation Number KEP-100/MBU/2002, Gamma's Document

The Indonesian government, through Decree number: KEP-59/MBU/2004, further emphasized their seriousness on the importance of SOEs to meet both financial and non-financial objectives by requiring that there is a management contract between the appointed SOEs' Chief Executive Officer (CEO) with the SOE Minister. The 2004 regulation which targeted on the leadership factor as the driver for organizational commitment, explicitly stated that the CEOs are responsible to achieve the suggested targets, as proposed by the 2002 decree. Consequently, the year 2004 regulation had led to the need for a performance management system that provides a clear measurement of performance and linkage between performance and reward of the CEO, as well as the employees.

A more specific requirement on the transparency of activities related to social objectives was then highlighted by the government through regulation 06/MBU/2007 issued in year 2007 where partnership program and community development program, were explicitly stated as activities for social objectives. The abovementioned had to be made by the Indonesian government considering that the effectiveness of the partnership program and community development program among SOEs was below expectation. In response to this regulatory development, Gamma had decided to centralize the administration and delivery of its social related activities under the responsibility of its Community Development Centre (CDC).

4.2 The Adoption and Implementation of BSC

The adoption and implementation of Gamma's performance management system was heavily influenced by the abovementioned governmental regulation issued between year 2002 and 2007. In 2002, Balanced Scorecard was first introduced in Gamma by a consultant through some trainings and workshops.

> "Balanced scorecard is still the best tool for performance management system….We translated all the key programmes into four perspectives of balanced scorecard in 2002 until now."
>
> (Senior officer, Gamma).

> "In the beginning, we invite balanced scorecard experts from Yogyakarta. He wrote a book about the balanced scorecard and the book was a bestseller. He provides training on strategy formulation and then cascaded the strategy into the scorecard according to four perspectives in the scorecard."
>
> (Senior officer, Gamma).

Subsequently, in year 2004, Gamma began to set up its five year long term strategy together with its annual short term strategy as part of its effort to ensure that there is a linkage between each targets and strategies. Also, the imposition of the management contract between Gamma's chief executive officer (CEO) and the SOE's minister had triggered a more serious undertaking of the BSC in Gamma encompassing actions of translating grand strategy into strategies, work plan and budget programme. There are targets agreement cascaded down throughout Gamma i.e. from CEO level to directorate and subsidiary.

Through balanced scorecard, Gamma had intensified its performance based culture as it implements the stretch target approach which was enabled through the creation of synergy among its various units and subsidiaries. By year 2012, the achievement of target is explicitly linked to the employees' bonus. The performance management system also supports teamwork culture through its shared KPI weightage. Tight monitoring on performance is done using online application of the BSC where evaluation of performance indicator are conducted regularly for daily, weekly, monthly, quarterly and annually.

4.2.1 Gamma's BSC

In response towards the various developments in governmental legislations which requires the SOEs to be held more responsible for their activities, Gamma had adopted and implemented the BSC to assist them in translating their objectives into strategies, key programs and actions. The measures provided by the indicators as per reflected on the scorecard allows for better accountability as it will drive for effective and efficient implementation of activities. Table 2 summarizes the four perspectives of Gamma's BSC.

Table 2. Gamma's BSC- A Summary

Perspective	**Indicators**
Financial perspective	Indicators related to productivity and growth strategies.
Customer perspective	Indicators related to customer value proposition, product/service attributes, relationship and image.
Internal business process perspective	Indicators related to operations i.e. process management, customer management, innovation, regulatory and social.
Learning and Growth perspective	Indicators related to human capital development, information and organizational capital.

Source: Gamma's Document

It is interesting to note that social performance are being specifically reflected in Gamma's BSC, thus to a certain extent indicating a more open communication regarding its activities pertaining to social objectives (as shown in Table 3).

Table 3. Social Indicators, Measurements and Targets.

Social Indicators	**Measurement**	**Target**
The effectiveness of fostering funds for the partnership programs	The percentage of total funds disbursed compared to the amount of funds available	Deliver a minimum of 90% of the amount of funds available to the partners
The collectability rate on the loan for the partnership program	The weighted average of the collectability of loans compared to the total amount of loan disbursed	The rate of return on loans at least 70% of the loan amount disbursed

Source: Gamma's Document

Nevertheless, the centralization of the administration and delivery of Gamma's social related activities under the Community Development Centre (CDC) are obvious as the company's social indicator is not considered as shared KPIs for other departmental or heads of subsidiaries in Gamma (as stated in Table 4). However, to emphasize the importance of social performance, these indicators are still included in the Gamma's BSC at a certain weight. This clearly displayed that the social objective is included only in the KPI of CDC and head of Gamma. Managers in other business units are not required to carry the responsibility for social performance and their focus are mainly on the core function of the business.

Table 4. The KPIs of CDC- Internal business Process Perspective.

Perspective of BSC	**Responsibility**	**The Weight of KPIs (in Percentage)**		
		Shared	**Common**	**Specific**
Internal Business Process (IBP)	Key Program	10		
	Deployment of product	5		
	Operational excellence:			
	-Effectiveness on managing social activities			10
	-Synergy (Gamma and SOE) Index		5	
	Business excellence system	5		
Total weight of KPI- IBP		20	5	10

Source: Gamma's Document

5. CONCLUSION

The Indonesian government, in their attempt for better governance of the SOEs had introduced the following changes i.e. non-financial key performance indicators, CEO's management contract, partnership program and community development program. In response to the abovementioned developments, the BSC had been institutionalized in Gamma as its performance management tool. Furthermore, Gamma had also established a Community Development Center (CDC) and starting year 2008, all social activities in Gamma are centralized solely under the responsibility of the CDC. The experience of Gamma may assist other organizations in managing their performances, particularly when faced with the challenge of efficiency while at the same time fulfilling their societal legitimacy. Nevertheless, this is a case study hence may not be generalized to all SOEs in Indonesia. Future research may want to consider the existing system prior to the introduction of BSC in the company in order to capture a more wholesome picture and discuss the pathway for integrating performance management system through the BSC.

ACKNOWLEDGEMENTS

The authors would like to express gratitude and appreciation to Universiti Sains Malaysia for its short term grant no. 304/PMGT/6313240.

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