



## ROLE OF EMPLOYEES IN THE CORPORATE GOVERNANCE A STUDY ON BALANCED SCORECARD APPROACH

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***“Our core corporate assets walk out every evening. It is our duty to make Sure that these assets return the next morning, mentally and physically enthusiastic and energetic.” –***

*N. R. Narayana Murthy,  
Chairman and Chief Mentor. Infosys technologies ltd.*

### **Abstract**

*All employees of the organization play an important role in the corporate governance for the strategic growth and competitive advantage in addition to the role of the top management. A study is carried in the organizations based on the balanced score card approach with the human resource perspective. Through this study the importance of the role of the employees in the corporate governance is brought with the balanced score card approach. Different perspectives of the balance scorecard are discussed. The importance of balanced scorecard is emphasized to establish a linkage between the human resources pertaining to the corporate governance. A research question is formulated, study is carried out and importance is discussed in the scenario of Indian business industry.*

### **1 Introduction**

The importance of the corporate governance need not be emphasized for the success and growth of the organizations in the present competitive world. In these, human resources of the organizations play a crucial role. As there is no methodology, the role of employees in the corporate governance is studied with the balance scorecard approach.

A number of research scholars and corporate giants have accepted the significance of recognizing the role of employees in corporate governance. The involvement of employees in corporate governance has shown an effective appearance for the corporation because it increases the labor motivation and strengthens the system of human resource management within the organization.

After the study of several annual reports of Indian companies one can infer that very few firms treat their employees as the most important stakeholders; however it is heartening to note that the trend is changing. In Indian Companies, where employees are typically denied any governance role, there should be a clear trend towards making employees shareholders of their firms, and simultaneously letting them be more involved in autonomous practices at workplaces.

The principal objective focus of this paper is to highlight the fact that in any firm, employees can play a vital role in Corporate Governance simultaneously uplifting the firm's performance. In this process employees also can improve upon the “strategic management system” incorporating all quantitative and abstract measures of true importance to the enterprise.

#### **1.1 Corporate Governance**

There is no universal definition of corporate governance. Corporate Governance is explained as the conduct of business in accordance with shareholders desires to maximize their wealth.

Monks & Minow have defined corporate governance as “relationships among various participants in determining the direction and performance of a corporation”.

CII- Desirable corporate governance code defines corporate governance as: “Corporate governance deals with laws, procedures, practices and implicit rules that determine a company’s ability to take informed managerial decisions vis-à-vis its claimants – in particular, its shareholders, creditors, customers, the state and employees. There is a global consensus about the objective of “good” corporate governance: maximizing long-term shareholder value.”

The Institute of Company Secretaries of India has also defined the term corporate governance as under: “Corporate governance is the application of best management practices, compliance of law in true letter and spirit and adherence to ethical standards for effective management and distribution of wealth and discharge of social responsibility for sustainable development of all stakeholders.”

The fundamental concern of corporate governance is to ensure that the firm’s directors and managers act ethically in the interests of the firm and its shareholders and that the managers are held accountable to capital providers for the use of assets<sup>12</sup>. Corporate governance is about making the right judgment in a given situation even if it involves risks. Corporate Governance also points out to what extent the complaints of the stakeholders including shareholders are being resolved within the specified time. Companies also have to disclose in front of the shareholders how efficiently they have resolved the complaints.

Corporate Governance also includes other aspects like Corporate Social responsibility etc. In addition to economic performance, modern business must demonstrate social awareness or sensitivity and social performance. So while expanding and managing large corporates, whether executives are balancing the value of stakeholders or not is an important aspect of corporate Governance.

Corporate Governance also emphasis that.” Transparency is the core aspect of corporate governance” Each and every stakeholder expects transparency from the management, because stakeholders cannot get total idea of inside management practices, by just referring to the financial statements of the firm. They must be aware of the essential aspects like how much remuneration is drawn by directors, what criteria are used by company for director's appointment and reappointment and thus corporate governance is considered as one of the most important and integral part of the organization.

## 1.2 Balanced Score Card

The balance scorecard is a modern tool for performance measurement and management that is being used by many companies across the corporate world, globally. It provides managers with the information needed to make “value creating” decisions. It provides a decision framework for performance measures and strategy implementations which motivates the management and employees to create value for the corporation. It recognizes the need to identify and track a number of financial and non-financial measures to provide a broader view of the business.

The balanced scorecard approach is understood from the following figure-1:



### Fig-1: Balanced Score Card Approach

The Balanced Scorecard was created by Robert Kaplan and David Norton to translate vision and strategy into objectives. It is meant to help managers keep their finger on the pulse of the business. Each organization will emphasize different measures depending on their strategy.

According to Kaplan & Norton,

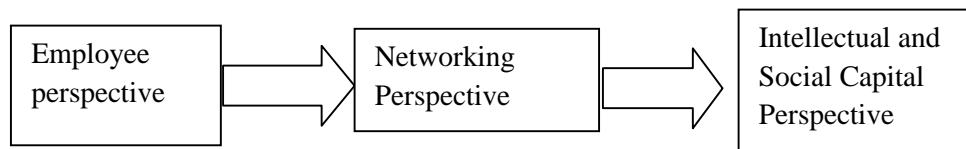
- The BSC is a strategic control tool intended to articulate a company's mid-term strategy (from three to five years) with its operational control.
- The BSC helps to correlate lagging and leading metrics so that a link could be established between the strategic management and the management control<sup>3</sup>. So the purpose of the BSC is to establish a causal chain between indicators and strategic objectives.

#### A Balanced Scorecard Provides the Following Benefits

- Defines the strategic contributions of the management
- Provides a tool to manage the composition and performance of the management and its committees
- Clarifies the strategic information required by the management.

The study finds that the implementation of the Balanced Scorecard as a performance management tool has led to the identification of cost reduction opportunities in the organization, which in turn, has resulted in the improvement of the bottom line of the company, while paying due attention to the regulatory compliances<sup>4</sup>.

This balanced score card approach is modified as extended balanced scorecard and is given in Fig-2 below:



### Fig-2: Extended Balanced Scorecard Approach

The workforce perspective, networking perspective and Social capital perspective of the balanced scorecard is studied in the Indian organizations in this paper. The larger Indian corporate has not yet fully appreciated the relationship between the Balanced Scorecard adoption and financial Performance. The change in the work culture for the successful implementation of the Balanced Scorecard is required. This needs a paradigm shift in dealing with some potential issues, which can play a vital role in the betterment of firm's performance. For this following factors need to be taken into consideration:

- Chartering firm specific training and development programs
- Excellent career planning and development processes
- Constant and effective communication processes
- Maintenance of proper documentation
- Conducting appropriate climate surveys and
- Developing metrics aligning strategy

Thus BSC acts as a catalyst in terms of several corporate reactions, which take place within the organization. So it is like an important ingredient, which decides the ultimate result of various steps taken within the organization<sup>5</sup>. (VALUELABS, NASSCOM survey, Press Release 2007).

The Balanced Scorecard has been implemented in reasonably good number of organizations in India, particularly the technology-based companies (CMM Level-5). Based on the simple premise that "measurement motivates," the BSC puts strategy at the centre of the management process, allowing organizations to implement strategies rapidly and reliably. It has been cited by Harvard Business Review as one of the most important management ideas of the past 75 years. Based on the simple premise that "what gets measured is what gets done," the BSC puts

strategy at the center of the management process, allowing organizations to implement strategies rapidly and effectively.

## **2 Linkages among Corporate Governance, Employees and Balanced Score Card**

A relation among the corporate governance, employees and balance scorecard is developed in this study. To achieve more clarity relation is developed as: (i) linkage between corporate governance and employees; (ii) linkage between employees and balanced score card; (iii) linkage between balanced scorecard and corporate governance, and is discussed below.

### **2.1 Linkage between Corporate Governance and Employees**

There are various evidences to show that employee's participation in corporate governance enhances the wealth creation of the organization. The excellence in the performance of employees leads to corporate excellence, which lies in a good corporate governance. So, evidently employees play a vital role in improving the status of the firm and increasing its profitability besides satisfying stakeholders like, customers, shareholders and generating revenue, profit growth and growth in market value (stock market capitalization) as well. A new perspective towards excellence in an organization given by "Peters T and Waterman R" (1982) highlights the seven "S" approach—structure, strategy, system, style, skills, staff and super-ordinate goalsMckinsey-7s.

According to this perspective the organizational excellence of a company depends upon these seven factors. Further study shows that in companies which operate with super-ordinate goals and strong culture, people at all levels have clear guiding values. Many Indian corporate like TATA group, ITC, some companies of BIRLA Group, Gujarat Ambuja etc., have realized the importance of the role of employees in corporate governance and have taken up the challenges. The employees of the organization have been highlighted as a significant ingredient of the corporate governance process of the organization.

### **2.2 Linkage between Employees and Balanced Score Card**

The Balanced Scorecard provides a simple, clear message about organizational strategy that all employees can understand and internalize in their everyday operations. With such understanding, employees can link improvements in their daily processes to achievement of high-level strategic objectives<sup>15</sup>. It instructs employees to work with energy, creativity, and initiatives, searching to find new and better ways by which they can help the organization succeed. It articulates the critical elements for a company's growth strategy:

- Objectives for growth in shareholder value
- Targeted customers through whom profitable growth would occur
- Value propositions that lead customers to do more business and at higher margins with the company
- Innovation and excellence in products, services, and processes
- The capabilities and alignment of employees and systems that enhance important internal processes and customer relationships to generate and sustain growth.

### **2.3 Linkage between Balanced Scorecard and Corporate Governance**

The implementation of balanced scorecard needs changes in corporate governance mechanisms by defining its primary outcomes, board processes, and skills, information, and employee engagement dynamics for more effectiveness. Added to this the economic reforms addresses issues such as the definition of director independence, the responsibility, composition and relationships of the audit committee, internal control and financial disclosure requirements and other governance processes such as exclusive sessions, director nominations and executive compensation.

The Balanced Scorecard program starts with an Enterprise Scorecard that describes the strategy of the organization, including strategic objectives, performance measures, targets, and initiatives. The enterprise scorecard has a dual role. First, and primarily, it is a powerful internal communication and alignment tool that helps the CEO implement the corporate strategy throughout the organization. Secondly it provides a succinct and

yet a comprehensive representation of the strategy and a powerful summary of the organization's success in implementing it.

#### **2.4 Detailing Human Relations Perspective: Focus On Stakeholders and Employees Perspective**

The primary participants in a corporation are the Triad: Shareholders, management-led by the CEO & the board of Directors. There are other participants as well such as employees, customers, suppliers, creditors and community. The conduct of the corporation is a three-way process among the board of directors, top management and the employees. Unfortunately, because of the dawn of capitalism in the Indian corporate world, the role of employees as the key participants in this process has never been adequately recognized. The employees have always been the responsibility of management, and the conduct of the corporation is a "table for two" between the board of directors & top management (Manuel A Tipgos & Thomas J Keefe, 2006). Post liberalization, economic reforms have transpired both the social & economic status of the employees.

#### **Shareholder's Perspective: Employees Treated as Factors of Production**

##### **Stakeholder's Perspective: Role Of Employees as Capital Providers**

First, with the advent of empowered or reengineered organizations and the concept of employee empowerment, employees have become a force to reckon with in making significant decisions affecting the success of the corporation. Secondly the employees are a group of new owners of the corporation as participants of other savings & retirement programs. Being "new owners", they are connected with the corporation in three significant ways: (1) By direct interest in the corporate enterprise as a source of gainful employment; (2) As a source of security in retirement years through other retirement programs; & (3) As a source of "collateral benefit", being a stakeholder (as members of society) of the corporate entrepreneurship.

Essentially, the two pillar concept in the conduct of the corporation needs be transformed into a tripod, which will become the foundation of corporate governance in the 21<sup>st</sup> century, Corporate India.

Pursued to its fullest, the three-way relationship among the board, the management, and the employees will balance the power within the corporation to:

1. Promote transparent, proper disclosures and substance over form based financial reporting to get really a true and fair view of the enterprise.
2. Prevent management fraud
3. To foster the confidence and trust in the financial markets with minimum interference from the government.

### **3 Research Question**

#### **This Study Provokes a Debate Regarding the Following important and Pertinent Questions**

1. If better corporate governance is related to better firm performance, should better-governed firms perform better than not well-governed firms?
2. Is corporate governance a bottom up process or top down process?
3. Can the employees play a critical role in the better governance of a firm?
4. Whether tools like balanced scorecard etc., can be useful in better governance process, if yes, then how?

#### **4 Alignment of Balanced Scorecard with Other Factors**

A study is carried out to align the linkages among the factors: balanced scorecard, business strategy, CMM and PCMM processes within the organizations in Indian scenario. The details are discussed below:

##### **4.1 Alignment of Balanced Scorecard with Organizational Strategy**

The strategy map of BSC is supported with a Balanced Scorecard of measures, targets and initiatives. The company uses the scorecard to align the strategies of business units and support groups, to Communicate strategy to all employees, to align employees' personal objectives and incentive plans, and to screen and fund strategic



projects. The governance committee uses these scorecards as a strategic job description that provides the basis for executive succession plans and for identifying succession candidates. This enables them to select executives whose experience, knowledge, and temperaments are most aligned with the job's strategic responsibilities. A more advanced use of such scorecard is to be included as a development component so that rising stars in the organization are developed and groomed for succession<sup>13</sup>.

#### **4.2 Alignment of Balanced Scorecard with CMM & PCMM**

The Capability Maturity Model (CMM), People Capability Maturity Model (PCMM) and the BSC framework helps organizations in developing their workforce maturity and in addressing their critical people issues. Based on the best current practices in fields such as human resources, knowledge management, and organizational development, P-CMM guides organizations in improving their processes for managing and developing their workforces. CMM helps organizations characterize the maturity of their workforce practices, establish a program of continuous workforce development, set priorities for improvement actions, integrate workforce development with process improvement, and establish a culture of excellence. BSC improves the firm's condition with a proper implementation of required tools after the analysis from different perspectives. It is heartening to note majority of the software firms have acquired this capability, may be because they provide services to foreign clients. Our concern is for the other sectors as well .where many lag far behind .This erodes our global competitiveness, which is reflected in persistent current account deficit coupled with our continued dependency on oil, the price trend of it always points towards north.

#### **4.3 Alignment of Balanced Scorecard with the Organizations**

Many of the Indian companies, have realized the importance of balanced scorecard and have incorporated it in their process for improving the operating performance and consequently in the corporate governance of the organization. Stakeholder theory, often thought not to take account of the interest of shareholders, in fact does so by seeking to ensure the long-term sustainability of the company. The stakeholder theory approach may be more conducive to balancing a wide variety of corporate interests and thereby discouraging impropriety. (H. Jeff Smith, 2003).

##### **4.3.1 Methodology**

In the process of developing an index for corporate governance, we have identified two sectors 1) Emerging technology sector, mostly new generation entrepreneurial firms and 2) Traditional manufacturing sector such as cement few of which are operating for more than 50 years. These manufacturing companies have a legacy reflected in their operating and governing practices.

We have listed annual reports of 30 software companies 30 companies from the traditional sector such as manufacturing, mainly cement.

Observations show that barring few, many companies in the software sector have adopted the PCMM route. In the traditional sector lot needs to be done. However few leaders like –ACC/Ambuja /Shree cements Ultratech etc., have adopted the modified form, but they are few in number.

##### **4.3.2 Indian Pioneers**

###### **i) Tata Motors**

Tata Motors is one of the few Indian companies to be inducted in the Balance Scorecard Hall of Fame. The Commercial Vehicle Business Unit (CVBU) of Tata Motors, India's largest automobile manufacturer, has been inducted in the exclusive club of organizations and corporate houses recognized by the prestigious Balanced Scorecard Collaborative, Inc for achieving excellence in overall company performance. This has played a vital role in making the company's governance policy more significant.

Tata Motors-CVBU has been recognized for having achieved a significant turnaround in its overall performance. The implementation of the Balanced Scorecard has enabled greater focus on different elements of operational



performance. Defining, cascading and communicating strategies across the organization have brought about transparency and alignment. The scorecard incorporates SQDCM (safety, quality, delivery, cost and morale) and VMCDR (volume, market share, customer satisfaction, dealer satisfaction and receivables). Ravi Kant, executive director, CVBU, Tata Motors, said, "While we were conscious of the benefits of the Balanced Scorecard when we began implementing it three years back, we are extremely pleased that it has helped us achieve significant improvements in our overall performance. I am quite positive that the BSC will play an important part in our objective to become a world-class organization.

It is no wonder that Acquisition of Rovers by TATA's was very smooth, not to mention the acquisition of TETTLY and CORUS.

### ii) Trent Ltd

Trent Ltd was inducted into the Balanced Scorecard Hall of Fame in 2005. Trent is only the 2nd Indian company after Tata Motors to receive this prestigious honor. The BSC implementation at Trent, championed by the managing director, Noel Tata, and co-owned by the senior management team has been instrumental in driving significant growth in its profitability, turnover, and number of stores, customer satisfaction levels and HR strategy of the company.

### iii) Infosys Ltd

Infosys Received 2007 Balanced Scorecard Hall of Fame Award for Executing Strategy. The award was based on five key principles: (1) Mobilizing change through executive leadership; (2) Translating strategy into operational terms; (3) Aligning the organization around its strategy. (4) Motivating to make strategy everyone's job, and (5) Governing to make strategy a continual process. The Balanced Scorecard has been implemented in reasonably good number of organizations in India, particularly the technology-based companies (CMM LEVEL 5). Based on the simple concept that "measurement motivates," the BSC puts strategy at the center of the management process, allowing organizations to implement strategies rapidly and reliably. It has been cited by Harvard Business Review as one of the most important management ideas of the past 75 years. Based on the simple fact that "what gets measured is what gets done," the BSC puts strategy at the center of the management process, allowing organizations to implement strategies rapidly and effectively.

## 5 Conclusions

In this study we have analyzed the role of employees in corporate governance and the current practices of the organizational performance management system with a focus on the HR perspectives of Balanced Scorecard. Our inference is that the listed companies like Infosys which communicate in the public domain and which are noted for good governance are using BSC. They have a good reputation in the capital market and the community as well for involving people.

We studied annual reports of 30 software companies who have adopted such practices. We also have selected 30 companies from the traditional sector like cement manufacturing and it is noted that only few like –ACC/Ambuja /Shree cements etc., have adopted it in the modified form. After exploring whether BSC can be applied to small and medium enterprises we reached an affirmative answer.

We discussed with managers of some private limited companies which have the potential to become public and which are registered, but not listed, during our interaction process and we find that they are in consonance with respect to the applicability of BSC.

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