CHAPTER 2

THEORETICAL FOUNDATION

2.1 Strategy

Strategy is an action that the company plan and do to achieve all the company's vision through their mission. As for the strategy implementation, it is more important for the company to be able to execute the strategy efficiently rather than the quality of the strategy itself.

Based on the definition, strategy is the planning of what an organization should do by coordinating with the activities of the organization; deciding what, if any, action should be taken, and influencing people to change their behavior (Anthony & Govindarajan, 2001).

Yet it is easy to define the meaning of strategy, but it's very difficult to implement the strategy in a real practice. As Kaplan & Norton mention that:

"In the majority of cases – we estimate 70 percent – the real problem isn't [bad strategy but]… bad execution"

There are others factors that cause the failure in implementing the strategy, such as (Luis & Bimoro, 2011):

a) Barriers to the vision

Barriers to the vision occur because there is lack of understanding to the meaning of the company's vision. It creates a barriers that prevent the employees to work well and practicing the strategy, this may occur because the employees felt that the mission and vision of the company is too high expected, or the company's vision are too long or many, and difficult to understand.

b) Barriers to the actors

The actors that need to play the role in implementing the strategy include all level of organizational structure. Thus they must first understand and realize the vision, mission and strategies that have been made.

c) Barriers to the management

Another barrier in implementing the strategy is the management of the strategy, usually managers spend most of the time on operational activities but they missed out the strategy discussion.

d) Constraints on resources

The final barrier to the strategy is the resources, which is the capital. As an organization need a strategic effort to link budgets to the strategy. While the survey show that 60% of organization haven't applied that.

2.1.1 Different Level of Strategy

There is several important level of strategy, namely: enterprise strategy, corporate strategy, and business strategy (Hofer, Schendel, & Higgins, 1978):

a) Enterprise strategy

Every organization need a relationship with the community, as the community themselves is the key success of the organization. Thus this strategy is closely related with the community, and revealed that the organization are actually working and trying to give good services to all the community.

b) Corporate strategy

This strategy is related to the mission of the organization, how they run the company, how they planned for the future, and it also includes all field that was involved by the organization.

c) Business strategy

The business strategy describes how the organizations seized the community, how to put the organization into the mind and hearts of the customers, shareholder, and so forth. The purpose of this strategy is to support the development of the organization to a higher level. Some example of business strategy is differentiation, include differentiation of products as well as the company itself compare to the competitors.

2.1.2 Organization Need Strategy

Most of the organizations already realize that they need competitive advantage to win the competition in the market, and this competitive advantage come more from the intangible knowledge, capabilities, and relationship created by the employees than from the investments in physical assets and capital. Therefore for the implementation of the strategy, the organization must link and aligned all the business units to the strategy (Kaplan & Norton, 2001).

In this competitive world, especially in the business world with advanced technology and a lot of competitors, organizations need a tool to explain and give feedback or solution about their current strategy. As the strategy must be implemented continuously and actively participated by all parties in an organization.

Management strategy is usually associated with manager's work, but the most effective strategy is to spread them throughout the organization's culture. Many companies have done organizational performance measurement to check the effectiveness strategy implementation in a company, but they only use them only for short-term operations.

Balanced scorecard emphasizes all the financial and non-financial measures driven by the mission and strategic business unit. Thus the balanced scorecard puts together all the elements such as planning, implementing, and controlling a business strategy (Lynch & Cross, 1993)

2.1.3 Strategic Themes

Each company must have their own strategy, and this strategy is separated into different themes. Basically, a strategic theme was defined as the belief that the management team hold to achieve the success. This themes act as a pillar for the company's strategy, as in each of the themes, there are an objective to support the themes to be successfully done.

Based on the study, strategic themes have several categories (Kaplan & Norton, 2001):

a) Build the franchise: corporate could build a new franchise for them to capture a new market and customer as well as new product.

b) Increase customer value: increase the relationship with the customers for continues buying.

c) Achieve operational excellent: this is also a value creation but it occurs in the corporate, include zero defect product, on-time production, on-time delivery and also good services to the customers.

d) Be a good corporate citizen: each company has a responsibility in taking care of the environment they working on, thus they need to manage the relationship with the stakeholder as well as the community around them, and not to harm any parties.

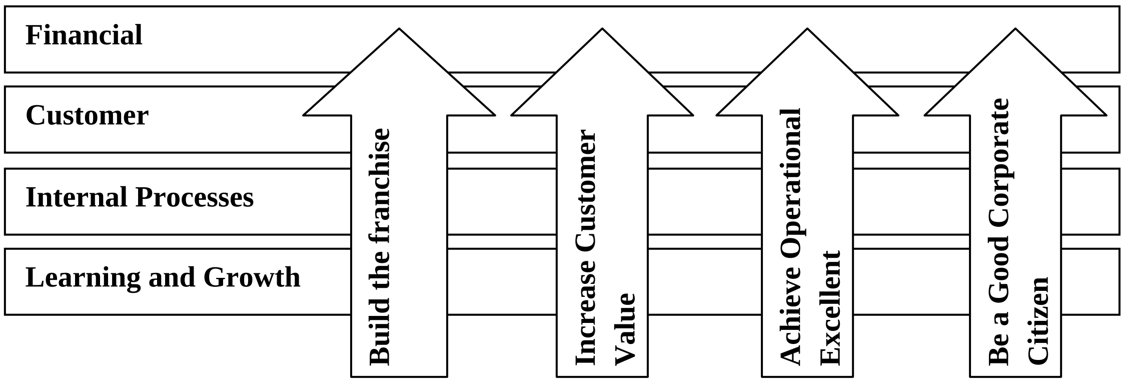

Figure 2.1 Architecture of a Strategy Map

Source: Kaplan & Norton, 2001, pg. 79

2.2 Balanced Scorecard (BSC)

Balanced Scorecard defined as a tool of performance management that can be used to help the organization to translate their vision and strategy into action by using set of financial and non-financial measures which linked in a cause and effect relationship. Company needs a balanced scorecard, especially for a large organization.

"It's nearly impossible for an organization to perform in concert at a very high level unless all the employees are responding to the same feedback from a single digital dashboard. Many organizations are introducing a balanced scorecard to guide performance" (LaChance, 2006)

The implementation of balanced scorecard concept does not stop when the strategy and measurement was completed; it must continuously monitor and controlled to make sure that the strategy is perfectly done.

According to the word balanced in balanced scorecard, balanced means equally divided. Thus, BSC is used as a tool to maintain the balance between:

a.) Financial and non-financial indicators

It includes all the aspects that include the factors of growth, profit, and productivity of the company.

b.) Past, present, and future performance indicators

This indicator means financial statement that shows the performance of the organization in the past, current as well as to predict for the future.

c.) Internal and external indicators

The internal and external indicators include all the activities and strategy that need to be done by all of the units in organizational structure, inside and outside of the company.

d.) Lead and lag indicators

Lead means the “cause”, that causes something to happen, while the lag is the “effect”, resulting from the cause, it could be good or bad.

The advantage of BSC compared to other strategic planning concept is that it can maintain the balanced between these indicators.

2.2.1 Balanced Scorecard Perspective

There are four different perspective of balanced scorecard; these four perspectives are used to provide a framework to be easier to look at the strategy, namely:

1. Financial

This is the strategy to increase profit as well as the growth of the company, from the shareholder’s perspective.

2. Customer

This is the strategy to create a value in customer’s mind about the products as well as the corporate itself.

3. Internal business process

These include the strategy that involved in the action inside the company or business process, which will create the customer and shareholder value.

4. Learning and growth

This strategy shows the innovation, technologies, skills and knowledge that are needed to practice the internal business process effectively.

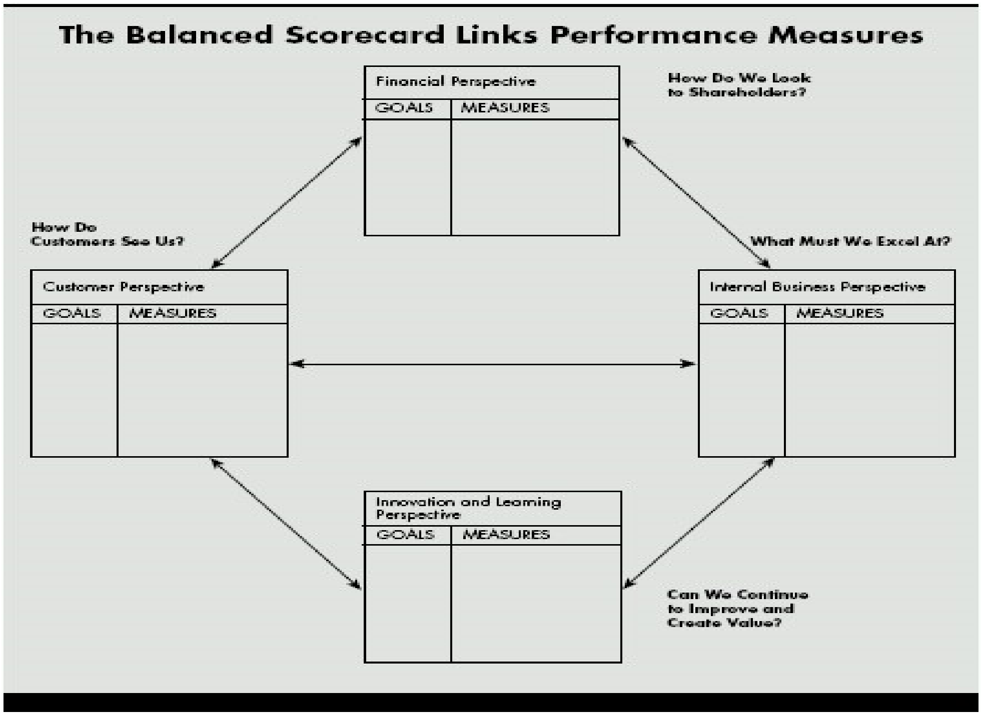

Figure 2.2 The Balanced Scorecard Links Performance Measures

Source: Kaplan & Norton, Harvard Business Review

The figure above shows the cause-and-effect relationship of the strategy with the four perspective of the balanced scorecard.

The process begins with the definition of the company's strategy in the of the shareholder and customer. Then it moves to the financial objective, what are the objective for financial growth and how to increased financial performance, and etc. The process continues to specify and select the target market that could generate and increase revenue growth.

The next step comes to the action need to be done by the company such as product design, brand and market development, service, and operation. These activities are needed to create the customers value and differentiation. And the last perspective was the ability, skill and knowledge or technology that the employees need to execute the internal business processes effectively (Kaplan & Norton, 2001).

2.3 Strategy Maps

After analyzing the four perspectives in a balanced scorecard, the data are then mapped into a framework named strategy map. In general, strategy map is a design of an architecture used to describe a strategy in accordance to the concept of the four perspective of balanced scorecard. Each perspective elements in the balanced scorecard are linked together in a causal relationship that will lead to the strategic outcomes. As Kaplan and Norton stated that:

"The balanced scorecard tool and strategy map offer a framework to measure intangible assets and to describe strategies as a series of cause-and-effect linkages among objectives. They provide a language that executive teams can use to discuss the direction and priorities of their enterprises" (Kaplan & Norton, Strategy & Leadership, 2004)

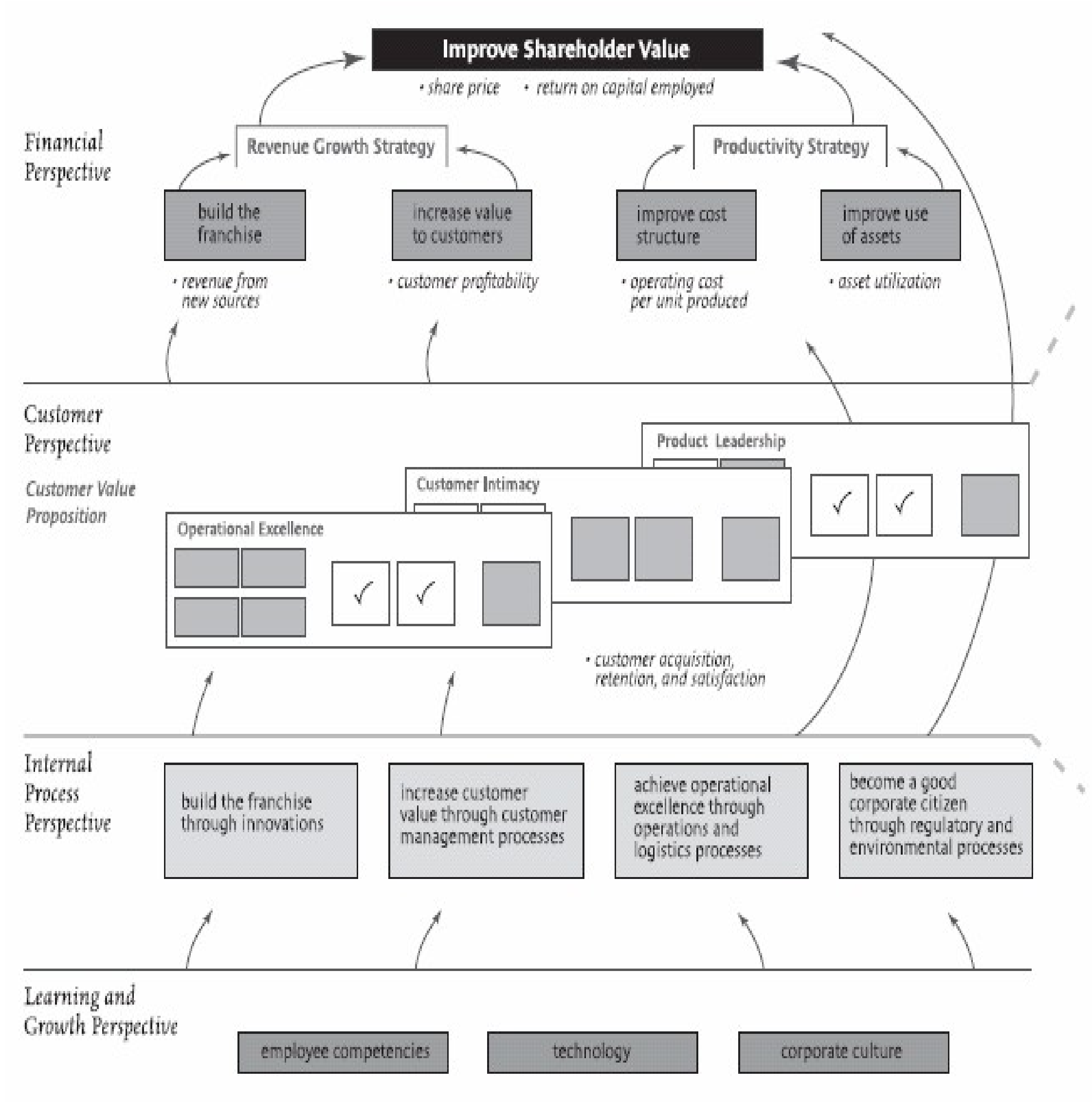

Figure 2.3 Strategy Map

Source: Kaplan & Norton, 2001

There are four level of architecture perspective in the strategy map; it allows people to read and understand the strategy of a company clearly. In the strategy map, it's not only tells what a company want to achieve but it also shows how to reach that outcomes. The architecture contains a linkage of four elements of objective from the financial perspective that a company want to achieve whether by using revenue growth strategy or by productivity strategy, or both. The financial perspective is then linked to the customer perspective and explains which type of customer does the company wants to focused on. Based on the outcomes that the company seeks, it comes to the internal business perspective and learning growth perspective that linked the objective on which strategy needs to be use and how to reach that result.

2.3.1 Financial Perspective

In the financial perspective of the balanced scorecard, there are two strategies to increase the financial performance, namely: growth and productivity.

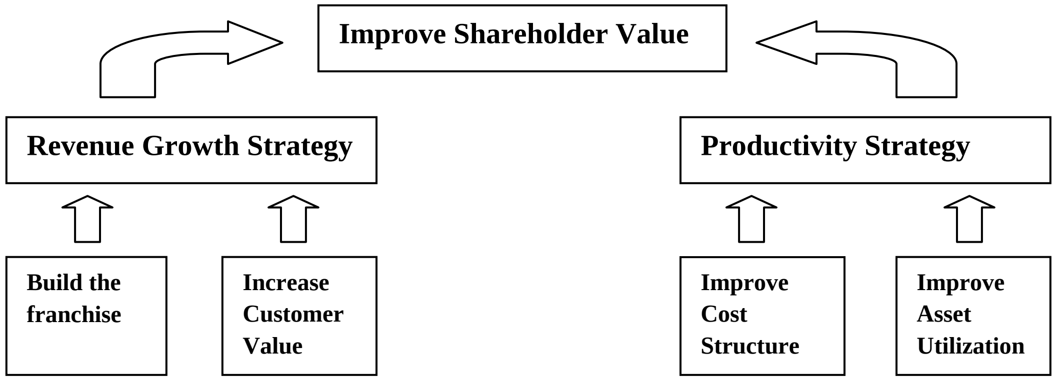

Figure 2.4 Building the Strategy Map: The Financial Perspective

Source: Kaplan & Norton, 2001, p. 84

Generally, there are two elements in revenue growth strategy:

1. Build the franchise: Expanding the sources of revenue either by creating new business or market, build new products or acquiring new customers.

2. Increase customer value: Increasing the relationship with the existing customers by cross selling, giving solution, etc.

For the productivity strategy, the elements are:

1. Improve cost structure: It could be done by decreasing direct and indirect cost of production or services, and sharing the resources with other entities to decrease the cost on resources.

2. Improve asset utilization: It includes better utilization of the assets, careful assets acquisition and the disposal parts of the current and fixed assets.

1.3.2 Customer-Value Perspective

Based on the study, there are many types of customers. Some customer prefers low prices, good quality, on-time delivery, and easy purchase. While other customers choose the newest innovation of the product’s offers, and some value the relationships with the seller.

With this strategy map, companies could identify and define their customers.

"It is important to identify clearly the company's targeted customers. They become the focus of the customer outcome measures in the company's Balanced Scorecard." (Kaplan & Norton, 2001, p. 89)

So, to get the correct outcomes that represents the strategy of the company, the customer outcomes should be a measured of targeted customers who was selected by the company.

Operational Excellence Strategy **"Smart Shopper"**

Product / Service Attribute				Relationship		Image
Price	Quality	Time	Selection	Basic Requirement	Basic Requirement	Brand

Customer Intimacy Strategy **"Trusted Brand"**

Product / Service Attribute				Relationship		Image
Requirement	Requirement	Requirement	Requirement	Service	Relationship	Brand

Product Leadership Strategy

Product / Service Attribute				Relationship		Image
Requirement	Requirement	Time	Functionality	Basic Requirement	Basic Requirement	Brand

Figure 2.5 Building the Strategy Map: The Customer-Value Proposition

Source: Kaplan & Norton, 2001, p. 88

Based on the figure above, there are 3 types of customer-value proposition:

1. Operational Excellence Strategy

This part shows that the company's customers are smart shopper; their customers tend to choose the lower price, better quality product, timely operation, as well as selective about the products.

2. Customer Intimacy Strategy

This strategy shows that the customers value more on relationship and service given by the company, seller or supplier. They prefer nice welcome or greeting and long term relationship, although the prices are high as they think it is worth it.

3. Product Leadership Strategy

This strategy focused on the customers that need product innovation, differentiation compared to the other competitor's products, as well as their function and used based on the customer's perspective.

The customer value perspective then linked upward to the financial perspectives to identify which one is the suitable strategy to work on and it also relate downward to the internal business processes perspective that enable the company to specify the correct business process to be delivered to the respective customers.

1.3.3 Internal Business Perspective

Come to the next perspective, aligning the strategy with the internal activities of the company to the value proposition. Strategy leads the company to achieve desire outcomes, but in the study of balanced scorecard said that:

"Strategy must not only specify the desire outcomes, it must also describe how they will be achieved" (Kaplan & Norton, 2001, p. 90)

Hence, the most important element in the strategy is the activities perform by each company, which will lead to the competitive advantage. To ensure the creation of the strategy to be successful, then we need to align the organization's internal activities to the customer value proposition.

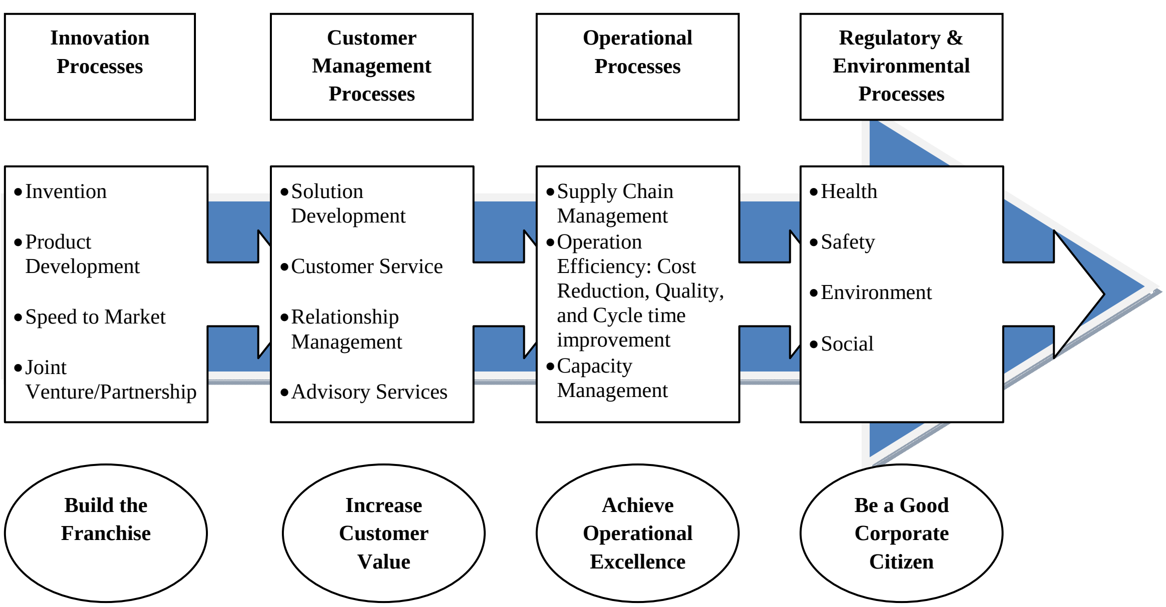

Figure 2.6 A Generic Organization's Value Chain

Source: Kaplan & Norton, 2001, p. 91

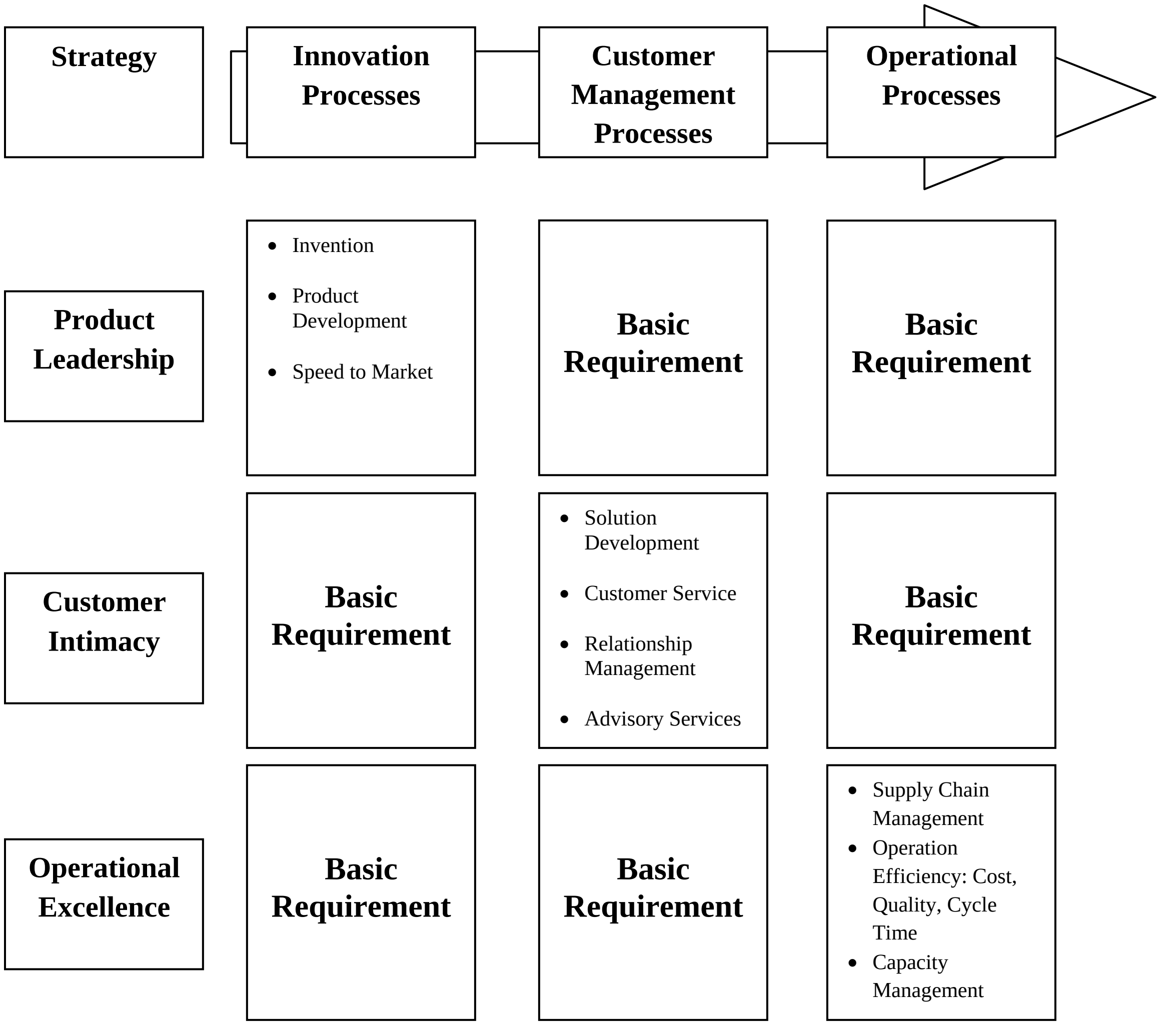

Figure 2.7 Identifying Strategic Internal Business Processes

Source: Kaplan & Norton, 2001, p. 91

Based on the figure above, all the basic requirement process are essential, and need to be done correctly by the company, but the most important thing to do is to master one of the process that have the most effective impact to customer value.

In product leadership, the main strategy is to make a new innovation of the product with excellent quality and useful functions that meet the market requirement and sell them rapidly into the market, as early mover company has competitive advantage in customer's perspective.

On the other hand, in customer intimacy, the strategy is to increase the customer value that is to improve relationship with the customer by receive inputs and feedback, that eventually contribute better innovation and development of the product or services.

And the last strategy is operational strategy, that includes all the operational process of the company, such as relationship to the supplier, accuracy and speed of inventory supply, as well as distribution, quality, cost, and the cycle time excellencies.

1.3.4 Learning and Growth Perspective

This is the bottom line of the perspective in balanced scorecard that encourages and supports the effectiveness of internal business processes that leads to better customer's relationship and intimacy.

In learning and growth perspective, the things that the company needs to focus are categorized into three:

1. Strategic competencies

2. Strategic technologies

3. Climate for action

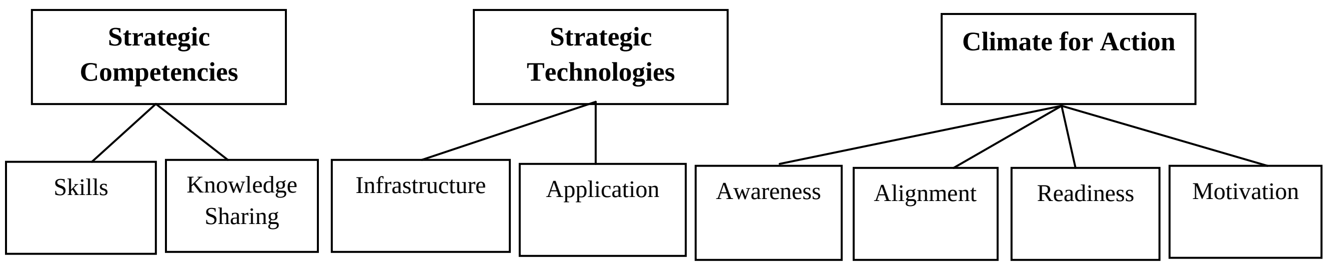

Figure 2.8 The Learning and Growth Perspective

Source: Kaplan & Norton, 2001, p. 93

This figure shows the elements of learning and growth perspective strategy, which has three categories. The first is the strategic competencies that include all the skills and knowledge needs by the workers to work on the strategy.

Second element is the strategic technologies, it consists of all tools, technologies, information and data required to support the strategy. And the last is the climate for action, define as the action to teach and give practices to all the workers in-line with the company's strategy.