

Prospects of using Balanced Scorecard
in banks operating in Egypt

إمكانية تطبيق بطاقة الأداء المتوازن
في البنوك العاملة بمصر

By

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Abstract

The objective of this study is to investigate prospects of Balanced Scorecard application in banks operating in Egypt & whether it is affected by bank size, ownership or management level. The sample was from the banking sector & focus of this study was on branch managers & top managers. Questionnaire was used in data collection; composed of four sections: Financial perspective, Customer perspective, Internal processes perspective & Learning and growth perspective. Five likert scale was used whereby scale 1 “Currently Applied” & scale 5 “Not Feasible”. Results indicated that there is no statistical significance in responses of publicly-held banks & privately-owned banks. However, large sized banks perceive higher significance for all four perspectives under balanced scorecard measures relative to small sized banks. Finally, branch managers are fully aware of significance of both financial & non-financial measure & even place higher significance with respect to customer perspective relative to top management.

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Chapter One

Introduction

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1-1 Background

1-2 Problem Definition

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1-4 Egyptian Banking Sector

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Introduction

1-1 Background

A major concern of business organization has always been how to manage the business efficiently and effectively in an environment which has been increasingly turbulent. Resources are limited which requires its efficient management i.e. maximizing the output/input ratio. On the other hand business firms need to achieve its multiple objectives that serve its stakeholders. In the face of increasing global competition and the rising demands for these firms to be socially responsible these tasks have proven to be increasingly difficult. Banks belong to the main stream of business organizations and they are under the same pressures. In fact their role is more critical because they are the main vehicle for gathering financial resources and making them available for investors to pursue their projects. In this sense they are also required to maintain the same requirements of efficiency and effectiveness.

Efficient management requires proper planning and follow up on performance. While this may seem simple at first sight but it has been proven very difficult to achieve .This has been largely due to the increasing internal complexity of business firms in addition to the increasing complexity of the environment. Performance measurement (PM) plays a key role in organizations' decision making in both stages of planning and control. Whatever strategies or objectives are determined in the planning stage need to be followed up in execution through specific measurements(Chan, 2004). If these measurements are not consistent with the plan the company in question will drift away and loose sight of its mission. These measurements can give feedback on performance so that management can take the necessary changes.

Given the rapid development of financial markets, along with intense competition in banking industry; traditional performance management

techniques, which were developed during a simpler environment situation system proved to be inadequate with respect to all-round performance measurement which is deemed necessary to meet the banking needs of strategic development in a turbulent environment. In current times, effective management of banking performance requires establishment of a comprehensive performance evaluation system that deals with banks as an open system continuously interacting with its environment.

Traditional performance management system tended to focus on financial indicators and ignored the non-financial indicators. This automatically meant putting more emphasis on tangible assets and ignoring intangible assets which are of utmost importance. Furthermore, traditional PM put emphasis on internal evaluation of operating conditions, while neglecting external factors.

Balanced Scorecard(BSC) resolved these shortcomings in traditional performance evaluation techniques. It is a strategic performance management tool that combines financial and non-financial measures of performance in one single scorecard in addition to giving enough weight to the external environment.

Balanced Scorecard PM system framework includes performance measures for four perspectives: financial, customer, internal business processes, learning & growth (innovation) and more perspectives could be added if need arises (e.g external environment). Given the need to have a close link between planning and control BSC is a tool that guides strategy formulation, implementation & communication, coupled with tracking performance and providing feedback for control & evaluation.

1-2 Problem Definition

Balanced Scorecard (BSC) approach was first introduced early 1990's by Robert S. Kaplan and David P. Norton when they jointly published the

article titled “The Balanced Scorecard: Measures that drive performance” (1992), along with a book titled “The Balanced Scorecard: Translating Strategy into action” (1996).

Initiation of BSC approach was mainly driven by shortcomings associated with exclusive reliance on financial measures in a performance management system (Kaplan & Norton 2001). Relying only on financial measures assumes the company assets are only financial which is not true. For example human resources ,distinct customer service as well as knowledge accumulated over the years are all neglected. Even though these nonfinancial and intangible assets could be the main resources the company has and are usually difficult to imitate by competitors. Significance of proper management for intangible assets was further confirmed by Smith (2006): “By the end of the 20th century, the book value of tangible assets accounted for less than 20 percent of companies’ market values.” Intangible assets which account for the rest include: customer relationships, innovation products & services, high-quality and responsive operating processes, skills and knowledge of the workforce, the information technology that supports the work force and links the firm to its customers & suppliers, and the organizational climate that encourages innovation, problem-solving and improvement.

Neglecting to measure the contribution of these intangible assets makes it difficult to follow up on their performance and improve it if needed. This is why BSC adopts a comprehensive measurement system that combines both financial and nonfinancial indicators, along with placing special emphasizes on the significance of linking these measurements to strategy in a way that ensures its proper implementation (Kaplan & Norton 1996).

To sum up, the challenge faced is primarily identifying whether or not non-financial measures are given importance in assessing bank’s performance & then how to quantify them comes next. Taking into consideration that these measures are diversified being related to different departments, makes

organizing them in a homogeneous manner that directly reflects strategy in a corporate sense extremely important. In this sense adopting measurements that are closely linked to strategies by implementing BSC; will help reduce the tendency towards fragmentation whereby each department is working in its own direction without being closely tied to the whole organization.

1-3 Scope of work

Egyptian banking sector plays a significant role in the development of the country and it is now closely linked with the global economy in terms of global agreements and protocols such as the Basel agreement and the World Trade Organization (WTO). Like similar banks in other countries this sector has been exposed to many external and internal forces, along with encountering financial difficulties of its own. Moreover, these banks are currently operating in an extremely competitive challenging environment, especially with the arrival of foreign banks into Egypt, which intensifies the need for adopting effective comprehensive PM scheme such as BSC.

This thesis aims at exploring the potential of BSC application by banks operating in Egypt and the extent to which its application can enhance performance management. Evaluating the possibility of applying BSC tool to the banking environment in Egypt will help in upgrading performance evaluation process of these banks which will enable them to use resources efficiently and achieve their objectives in satisfying all concerned parties .This will eventually help these banks become more competitive in performing their role in the development process .

Specifically, this research aims at studying the experience of Egyptian banks in applying the BSC tool and identifying success requirements and constraints .If the BSC is not applied entirely the research will examine the current stage of its application

1-4 Egyptian Banking Sector

1-4-1 Liberalization Trend of Egyptian Banking Sector:

“ Since the implementation of the Economic reform program in Egypt early 1990’s, Egypt has paid great attention to the reform of the banking system to face banking competition within the framework of financial globalization, expanding the capital base of corporate banks and restructuring banks to keep up with international developments” (Kenawy, 2009)

Prior to 1990 the Egyptian banking sector faced serious problems. Originally and until recently the banking sector was controlled mainly by state-owned banks. During this stage no foreign banks were allowed to operate within Egypt. Banks’ financial statements, like public sector companies were an integrative part of the State budget. State banks were actually forced to lend state-owned companies even if these loans were not potentially feasible. Non-profitable banks were supported by the government. In the case of these banks they were not allowed to restructure or to merge in order to improve their performance. During this period there was an absence of applying proper business management (Qian, 2009). As a result and during the mid nineties non-performing loans (NPL) accumulated and reached its peak. The absence of good governance structure of banks and real supervision by the Central Bank of Egypt (CBE) contributed to this problem.

The first stage of the financial sector reform program in 2004 focused on four pillars (Farrag, 2012):

1-The privatization of state owned banks and foreign banks started to operate in Egypt. Eighty percent of Bank of Alexandria’s stake - the fourth largest state-owned bank, was sold to Italy’s Sanpaolo IMI Group for USD 1.61 billion (Economic Research, 2011).

2- Raising the minimum capital requirement for banks. Egyptian parliament passed a new banking sector law (Law No. 88/2003) requiring a minimum capital requirement of EGP 500 million for domestic banks and USD 50 million for branches of foreign banks. This forced many banks into mergers and acquisitions to meet the new capital requirements.

3- Strengthening the banking supervision at CBE. The purpose of this reform is to assure that CBE's supervisory role is matching with the latest international standards. The supervisory method implemented by CBE focused on evaluation of risks and assessment of the Egyptian Bank's abilities to identify current and future risk.

4- Addressing the problem of Non-Performing Loans (NPLs). NPLs were reduced or eliminated (Campbell, 2007). This is done by swapping such loans for long-term government bonds to be repaid by debtor firms over up to 20 years. Along the same line, each banking institution was obliged to install an internal audit department to avoid future recurrences of NPLs.

After the completion of the *first stage* of the reform program which lasted until 2008, the government started second stage (2009-2011) of banking sector reform (Economic research, 2011), with following main targets:

- 1- Prepare and implement a comprehensive program for the financial and administrative restructuring of specialized state-owned banks (The Principal Bank for Development and Agricultural Credit, Egyptian Arab Land Bank, and Industrial Development and Workers Bank of Egypt).
- 2- Follow up the results of the first stage of the restructuring program for National Bank of Egypt (NBE), Banque Misr (BM) and Banque Du Caire, which revealed that the first stage of the reform plan (2004/2008) had already yielded fruit and positively affected their performance levels.

- 3- Apply Basel II standard in Egyptian banks to enhance their risk management practices. In this context a protocol was signed with the European Central Bank and seven European banks to provide a three-year technical assistance program launched on January 1st, 2009, to implement Basel II requirements in the Egyptian banking sector.

The connection of banking systems in different countries was a natural outcome of free trade and investment throughout the world which encourage the free flow of capital. While this, in theory at least, leads to higher prosperity in the world as a whole it also creates other sources of risk and more severe competition.

1-4-2 Egyptian Banks and Globalization Trends

Egypt is involved in many international agreements and protocols including Basel and WTO. It is in the self interest of the Egyptian banking system to follow the recommendations of these international bodies if the country wants to be an international player. This urgency is illustrated in the following quotation. “The new framework proposed by Basel Committee for capital adequacy aims at promoting safety, integrity of the international financial system, based on the composition of that capital that is sufficient to meet diverse financial risk and to stand for the intensified competition in the banking market after liberation of the banking services trade” (Kenawy, 2009). This is why since 2009 the Central Bank of Egypt (CBE) has followed a systematic plan to apply the different Basel requirements in the Egyptian banking system which involved the development of technical skills of CBE staff, development of the required data base in addition to exercising effective supervision on these banks. This according to Economic Research (2011) allows the banks to “continue to enhance the safety and soundness of the financial system, continue to support competitive standing and accordingly create a comprehensive way for coping with risks.” So, Egyptian banking system ,after being protected for so long, is faced with the

need to allow foreign competition in the local market as required by the WTO agreement and meanwhile to equip itself with the management system to be able to meet this competition. A further step along the road for local banks to extend its operations in the international markets and meet foreign competition head to head in the home countries of foreign banks. This requires developing proper strategies supported by a well integrated performance measurement scheme that serves these strategies; an approach that is well served by the BSC concept.

Experts agree that enhancing performance upon the formation of strong banks with strong capital base requires providing high quality of banking services to clients (both existing and potential clients) in order to strengthen its position in the market place and hence enhance profitability. Four main criteria were specified for assessing quality of banking services namely; banking service, customer service, physical and electronic resources and method of providing service to customers. Similar conclusions were highlighted by other researchers such as (Alber and Gayed, 2012), (Sadek, Youssef, Ghoneim, Tantawi, 2011).

The evolution of BSC as a comprehensive measurement system that combines both financial and nonfinancial performance indicators becomes essential; particularly that it moves in parallel with increasing significance of having a solid financial position as regulated by Basel framework, combined with a distinguished quality of banking service to keep up with severe competition within the framework of financial globalization.

Chapter Two

Theoretical Background and Literature Review