# HADHARI SCORECARD: AN APPROACH TO CO-OPERATIVE SOCIETY PERFORMANCE MANAGEMENT SYSTEM

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## *ABSTRACT*

*This paper offers a solution to the agency problems by improving the perspectives of the traditional financial statement and conventional Balanced Scorecard. It borrows the meaning of Islam Hadhari or Civilisational Islam, which is a theory of governing based on the Quran. It promotes the balancing between the material and the non-material civilisation in deriving a holistic system of managing organisational performance: Hadhari Scorecard. It adds to the perspective of principle value, being proxy by organisational integrity to the presently famous four perspectives of BSC: the financial, customer, internal process and learning and growth.*

## INTRODUCTION

Islam Hadhari or Civilisational Islam is a theory of governing derived from the Quran that consist of 10 principles: Faith and piety in Allah, Just and trustworthy government, Freedom and independence to the people, Master of knowledge, Balanced and comprehensive economic development, Good quality of life for all, Protection of the rights of minority groups and women, Cultural and moral integrity, Protection of the environment and A strong defense policy. According to Wikipedia (http://en.wikipedia.org/wiki/Islam_Hadhari), the theory was originally founded by Tunku Abdul Rahman, the first Prime Minister of Malaysia in 1957. It was later re-introduced and labeled as Islam Hadhari by the current Malaysian Prime Minister in 2004.

Taking Hadhari as a balanced civilisation that promotes both the material and the non-material (humane and spiritual) aspects of improvement, this paper improvise the Balanced Scorecard (BSC) approach in managing strategy of an organisation earlier developed by Kaplan & Norton (1992). In 1996, they pointed out that more than 90% organisation failed to execute its strategy. They later improvised in 2004, that what was missing then was the ability to communicate the strategy formulated to a larger workforce in an organisation. Strategy map was introduced as an important element in any BSC initiatives. The map is a tool to address the understanding of the multiple causal relationships among various strategies formulated. The real cause has not been single out.

As a solution, the author anticipated that the clue lies within everyone in the organisation. It is argued that balancing between the financial and the non-financial measures alone is not enough in assuring high organisational performance. There is a need to look and balance between the material and the non-material richness of an organisation. The author hypothesised that the inner spiritual strength of an organisation that sits within the workforce is the differentiating factor. Measuring that strength would prepare organisation to anticipate whether what it had planned shall be successfully executed or otherwise. As then Hadhari Scorecard © 2004, was born.

## THE MEANING OF HADHARI

Islam Hadhari was introduced by Malaysian Prime Minister Dato' Seri Abdullah Badawi in early 2004. The concept of Islam Hadhari was introduced by the Prime Minister as a "shock" to the society so that they will not be submerged in the routine of daily chores. His wish is for everybody to focus on both lives at present and the hereafter, and the true teaching of Islam is propagated and practised. The concept of Islam Hadhari has since then been spread out not just within Malaysia, but also to other countries including some Muslim nations and some European countries.

Islam Hadhari was never mentioned in the Quran or in the *'Hadith'*, nor was it mentioned by any reknown *'ulamaks'*. It is only recently being derived as a contemporary concept of civilisational Islam. Its' understanding is not yet propagated in a large scale. In one of the discourse organised by Jabatan Kemajuan Islam Malaysia (JAKIM) which was held on 19-20th May 2004, Islam Hadhari was conceptualised as; *"an approach that emphasises development, consistent with the tenets of Islam, and focuses on enhancing the quality of life. It aims to achieve this via the mastery of knowledge, the development of the individual and the nation, the implementation of a dynamic economic, trading and financial systems, and the pursuit of integrated and balanced development to develop pious and capable people, with care for the environment and protection of the weak and disadvantaged."*

The Prime Minister in his speech on the 21st December 2004, at Jamia Millia Islamia, Delhi, India, re-emphasised that Islam Hadhari is not a new religion, it is not a new teaching, nor is it a new *'mahzab'* or denomination. Islam Hadhari is an effort to bring the *'ummah'* back to basics, to return to the primacy of values and principles, as prescribed in the Quran and the *'hadith'* that form the foundation of Islamic civilisation. It posits ten fundamental principles that Muslim must demonstrate. Hence Islam Hadhari means civilisational Islam.

The Prime Minister proposed that in implementing the Islam Hadhari, it must be balanced and encompasses both: materialistic civilisation that is characterised by physical infrastructure and economic development; and non-materialistic civilisation that is characterised by inner strength, humane and soulful-ness of the people that make up the society. The balance is propagated in the Quran: Surah Al-Qasas Verses 77 that translates as:
*"But search out, with the (wealth) that Allah has given to you, the Home of the Hereafter, And do not forget your part in this world: But you do good, like Allah has been good to you, And do not search (to make) mischief in the land: because Allah loves not the Mufsidun (those who commit great crimes and sins, oppressors, tyrants, mischief makers, corrupters)."*

This balancing concept is adopted into the proposed Hadhari Scorecard, that is a scorecard of managing strategy that balances between both the material and spiritual (non-material) civilisation.

## SCORECARD

Scorecard is a report that can be used for various purposes. It can be used to describe performance, or to track the progress of achievements. In both cases, they fit as a system of performance management. The first, more of feeding to external party (in this case the stakeholder), and the second is more for individual performance, i.e. internal usage.

Traditionally, business organisation prepares scorecard (financial report) for the owners. The owners use the report as a mean to value the performance of their businesses. They also use it to monitor the manager's (agent's) behavior (Ramli, 2001). Financial report is prepared voluntarily by management (agent) for the owner (principal) due to conflict in the relationship between the two parties: the agency relationship/agency theory (Jensen and Meckling, 1976). In this situation, regular, audited financial statements may be prepared in order to minimise the costs of monitoring management performance, where such costs reduce management compensation or link compensation to company performance in bonus or profit-sharing schemes which management considers undesirable. According to Watts (1977) the purpose of financial reporting is to show that the terms of bond covenants have been adhered to.

Ross (1979) however suggests that financial reporting arises from the desire of management to signal its superior performance. Since good performance enhances management's reputation and position in the market for management services, and good reporting may be one aspect of good performance.

Akerlof (1970) suggests that information is disclosed voluntarily to prevent market failure. However, Choi (1973) argues that in the competition for scare risk capital, disclosure of relevant company information to the capital market would enhance a company's competitive position. This assumption however contradicts agency theory to some extent.

Even though this paper is not regarding disclosure, it is elaborated in detail for us to understand why financial report or the term used in this paper 'scorecard' is prepared. Hundreds of years financial report is being prepared by business organisation voluntarily to the users (shareholders/principal) however, in the early 90s Kaplan and Norton argued that the information in the financial report is not sufficient both for internal and external users. They in turn innovated to the 'Balanced Scorecard (BSC)' that balances between financial and non-financial performance measures.

## BALANCED SCORECARD (BSC)

According to Kaplan and Norton (1992):
*"The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation."*

BSC is a management system (not only a measurement system) that manages strategy. Through the strategy maps, organisation can describe the vision and their strategies that shall be translated to actions and deliverables. The basic BSC by Kaplan and Norton (1992) proposed that organisation should be viewed from four perspectives, i.e. Financial Perspective, Customer Perspective, Internal Process perspective, and Learning and Growth Perspective. Kaplan and Norton (1992) argued that if an organisation just focused on one indicator (for example financial indicator) it would not guarantee their success. Kaplan and Norton (1992) suggest organisation should balances between financial and non-financial measures.

Since then many organisations small or large, national or multinational adopts the BSC methodology. To name a few, DUPONT, Mobil, GE, Motorola, Volvo, Hilton, TATA and many more (Kaplan, 2005). According to a survey, almost 50% of 'Fortune 1000' companies used BCS or its adaptation (Niven, 2002). Lately the public sectors have also started showing interest in using this methodology (Niven, 2003).

But the issue was, if BSC guarantees success then why were there a lot of corporate scandals like Enron, WorldCom, Parmalat, Tyco International, etc. Was it due to the inefficiency of the managers in managing their financial resources, human resources or their customers? In the author's opinion, their competency was not an issue, but what were lacking in their conduct were the spiritual strength (humanistic and soulful-ness) and their opportunistic behavior that geared towards maximising their wealth that does not belong to them i.e. the agency problem.

## AGENCY PROBLEM

The agency problem or the conflict between the principal and the agent is not new. This conflict was first highlighted by Adam Smith way back in 1776. After about 200 years this issue was given a fresh impetus by Berle and Means (1932) and popularised by Jensen and Meckling in 1976 in their paper "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure" (Ramli, 2001). They described that agency relationships exist when there is a contract under which one party (the principal) engages another party (the agent) to perform some service on the principal's behalf. Under the said contract some power is bestowed upon the agent to make decision.

Within the given scenario, where both principal and agent are utility maximisers, there is no guarantee that the agent shall act upon to maximise the wealth of the principal. In normal circumstances, where agent as manager will be inclined to acquire more benefits for their own, like company car, bigger office space with state of the art equipments, paid holidays and other expenses bore by the organisation (principal). The agent sometimes avoids giving full commitment to their work like absenteeism, play golf during office hours, taking longer break, doing side business in the office premises, etc. Agent is capable of doing this because they are given the power to make decision. This unhealthy imbalance in decision-making process is known as the agency problem, and can be rectified by the principal's intervention.

This agency problem will result in agency costs. Agency costs are the dollar equivalent of the reduction in welfare experience by the principal due to the divergence of the principal's and the agent's interests (Godfrey et al, 2003). Jensen & Meckling (1976) divide agency costs into:

i) Monitoring Costs
ii) Bonding Costs
iii) Residual Loss

According to Godfrey et al (2003), monitoring costs are costs to monitor the agent's behavior. These costs, which include observing; measuring; and controlling agents' behaviors, are borne by the principal. Some examples of monitoring costs are costs of auditing, costs to establish management compensation plans, budget restrictions, operating rules. Since the principal incurs the monitoring costs, he or she will protect against ultimately bearing the costs by adjusting the remuneration paid to the agent so that the agent bears the costs. For example, a manager (agent) with a good reputation would be expected to behave in the interests of shareholders (principals). As such, shareholders would probably monitor the manager's performance very little and remunerate the manager well. If the manager had a poor or uncertain reputation, shareholders would probably monitor his or her performance much more. Also, shareholders would not be prepared to pay the managers as much as one who had a good reputation and acted in shareholders' interests. That is, shareholders (principals) pay managers (agents) less as the cost of monitoring increases. The way the principal protects against bearing agency costs by paying according to the level of costs expected is known as price protection.

Because of price protection, agents ultimately bear the monitoring costs associated with contracts. Therefore, agents are likely to establish mechanisms (e.g. financial reports) to guarantee they will behave in the interest of the principal, or to guarantee they will compensate the principal if they act in a manner contrary to the principal's interest. The costs of establishing and complying with these mechanisms are known as bonding costs since they are the costs of bonding the agent's interest to those of the principal. Bonding costs are borne by the agent. The costs incurred by managers in relation to these bonding activities include:

i). the time and effort involved in producing financial reports
ii). the constraints on the manager's activities because the quarterly reports
will reveal opportunistic behavior
iii). the income foregone by being prohibited from selling firm's secret to an opposing firm.

Despite monitoring and bonding, it is likely that the agent's interest still will not correspond exactly with those of the principal. Furthermore, the agent is likely to make some decisions that are not entirely in the principal's interests. For example, a manager might take home stationery from work or put in less work effort than shareholders expected. As such, the net value of the agent's output is less than if the agent's interests were completely aligned to the principal's. This deadweight loss is known as the residual loss and is borne by the principal.

## HADHARI SCORECARD

Looking at the weaknesses of the BSC and traditional financial report, the author introduced a Scorecard known as the Hadhari Scorecard © 2004. Hadhari Scorecard is based on Surah Al-Qasas Verses 77 of the Quran and the concept of Islam Hadhari proposed by the Malaysian Prime Minister in 2004. Hadhari Scorecard is also a modification of Kaplan and Norton's BSC. In the BSC, Kaplan & Norton balance the financial and non-financial measures, while Hadhari Scorecard balances between the financial, and non-financial measures (performance on material aspects); and measures relating to humanistic and spiritual strength (performance on non-material aspects).

## Co-operative Society Hadhari Scorecard

Before discussing Co-operative Society Hadhari Scorecard, this paper will discuss briefly the definition, values and principles of co-operative society. According to the International Co-operative Alliance (1996), co-operative society is an autonomous association of persons united voluntarily to meet their common economic, social, and cultural needs and aspirations through a jointly-owned and democratically-controlled enterprise.

Co-operative societies are based on the values of self-help, self-responsibility, democracy, equality, equity, and solidarity. In the tradition of their founders, co-operative society members believe in the ethical values of honesty, openness, social responsibility, and caring for others (International Co-operative Alliance, 1996).

Co-operative societies are governed by guidelines known as co-operative principles by which co-operative societies put their values into practise. The seven principles of co-operative societies are:

1$^{st}$ Principle: Voluntary and Open Membership
2$^{nd}$ Principle: Democratic Member Control
3$^{rd}$ Principle: Member Economic Participation
4$^{th}$ Principle: Autonomy and Independence
5$^{th}$ Principle: Education, Training and Information
6$^{th}$ Principle: Co-operation Among Co-operatives
7$^{th}$ Principle: Concern for Community

The united co-operative society members discussed above will vote to elect co-operative board members and internal audit committee among themselves in the annual general meeting. The voting system is different from public company because in co-operative society one member is eligible to one vote, regardless of the amount of their shareholdings. Co-operative board members managed the co-operative and appoint a chairman, secretary, and treasurer among them. The board is also responsible to implement the policies decided in the co-operative society general meeting (http://www.jpk.gov.my).

From the above explanation it can be deduced that co-operative societies are facing the agency problems, i.e., when the members (principal) delegate the task of running the co-operative society to the co-operative board members (agent). Since individuals are utility maximisers (the assumption in agency theory), there is no reason to belief that the co-operative board members shall act upon to maximise the wealth of the co-operative members. The conflict of interest between co-operative board members and co-operative members have resulted in scandals involving co-operative societies, not only in Malaysia but worldwide. The case of criminal breach of trust on the Chief Executive of Central Co-operative Bank and his Assistant General Manager amounting to RM20 millions is an example of scandals related with agency problem in co-operative societies. In this situation, the management, as agent, failed to safeguard the welfare and to maximise the wealth of the members (principals).

The scandal of deposit-taking co-operatives is another agency problem involving co-operative. In this case the governments through the Bank Negara investigated under the Essential Regulation (Depositors Protection) 1986 and made a conclusion that deposit-taking co-operative financial situations were in bad shape (Md. Salleh, 2005). These co-operative societies were facing bad management practises either because of lack of expertise and professionalism or the corrupt practise of the management. Misuse of co-operative funds is the main crime committed by co-operative management (agent). Most co-operative management team failed to maximise the wealth of the members; instead they maximised their own wealth. For example, a director of a co-operative society purchased a property for RM380, 000 and sell to a co-operative society where he is a director for RM3.8 millions (http://www.iiu.edu.my/qqu/agency-theory.pdf).

Above are a few examples of agency problems involving co-operative societies. There are many more cases similar to the above in Malaysia and worldwide. This is supported when Md Salleh (2005) argues that co-operative societies are usually associated with poor performance, scandals and poor management control.

Since Malaysian government intends to promote co-operative sector to be the third sector after public and private sector in the development of the national economy (Berita Minggu, 31st July, 2005), there is a need to find mechanisms to overcome agency problems in co-operative society.

There are various controlling mechanisms in placed in co-operative society to overcome the above problems, such as, the 'co-operative values' and 'co-operative principles'. However, these externally imposed rules do not necessarily ensure that the are being practiced by the co-operative society. In other words, you can take a horse to water but you can't make it drink, even though the horse might be pretending to do so (Dallas and Patel, 2004). Apart from this many more controlling mechanisms, such as, board of directors, proxy fights, large number of shareholders, hostile takeovers, financial structure, statutory regulations and corporate governance guidelines, are said to be able to overcome the agency problems (Hart, 1995). However, if these controlling mechanisms are able to overcome the problems, why are there so many failures in companies and co-operative societies all over the world?

Because of the failure of the above controlling mechanisms, the author would like to propose Hadhari Scorecard as an approach to co-operative society performance management system. This approach, as explained above, does not only measure material civilisation but also spiritual civilisation that is hoped can solve agency problems in co-operative society.

In the co-operative Hadhari Scorecard the following perspectives are translated for implementation:

Material civilisation
- Financial
- Customer satisfactions
- Internal processes
- Learning and Growth

Spiritual civilisation
- Humanistic and spiritual strength

The indicators for each perspective vary from co-operative to co-operative and depend on the vision and mission of the co-operative.

## Conclusion

The Malaysian Prime Minister introduced Islam Hadhari in 2004, which means civilisation. Civilisation is divided into material and spiritual. Hadhari Scorecard balances these two civilisations. Scorecard for material civilisation has popularised by Kaplan and Norton in their Balanced Scorecard, but is unable to solve the agency problems. Hadhari Scorecard that balances between the two civilisations is hoped to be able to solve the agency problems that has brought about problems and scandals involving companies and co-operative societies.

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