BankNews

Strategic long-range planning with a management

Into the future:

The application of strategic long-range planning/mbo for the banking industry

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Banks are faced with an ever-changing environment as they make their way toward the new millennium. As stated recently in *Fortune* magazine, "The uncertain depth of the Russian and Asian debacles ... leaves U.S. banks and Wall Street grappling with questions that they haven't faced since the savings and loan collapse: how much danger is still out there? And which banks are ready to bounce back?"

Using a strategic long-range plan (SLRP) with a management by objectives (MBO) approach can help a bank move with confidence into the future.

Peter Drucker first coined the phrase "management by objectives" in 1954. Many others contributed to the philosophy of MBO and in the mid-60's George Odiorne and Dale McConkey, along with others, boosted MBO into widespread use. Ordiorne gave us a clear definition of MBO as "a process whereby the superior and subordinate managers of an organization jointly identify its (the organization's) common goals, define each person's major area of responsibility in terms of the results expected of him, and use these measures as guides for operating the unit and assessing the contribution of each of its members."

The concept presented here for the banking industry builds on Odiorne's definition and encompasses an analysis of the firm's purpose, the environment in which it operates, its strengths and weaknesses, and even takes into consideration assumptions that should be made before setting objectives.

Nine-step process

A nine-step process gives the banking industry a dependable, results-oriented management system for the year 2000 and beyond.

A more comprehensive SLRP/MBO philosophy is to identify an organization's purpose, objectives and desired results; establish a realistic program for obtainingthese results; and evaluate performance in achieving them. This requires the following:

1. Defining the bank's purpose and mission;
2. Monitoring the environment in which it operates;
3. Assessing realistically strengths and weaknesses;
4. Making assumptions about unpredictable future events;
5. Articulating written, specific, and measurable objectives in principal result areas contributing to the organization's purpose:
   a. Negotiating and bargaining at every level from top management to lower -staff positions; and
   b. Executing a performance contract embracing the agreed-upon objectives.
6. Developing strategies on the utilization of available resources to meet theobjectives;
7. Making long-range and short-range plans to meet the objectives;
8. Appraising performance continually to determine whether it is keeping pace with the attainment of objectives and is consistent with the defined purpose:
   a. Demonstrating a willingness to modify objectives, strategies, and plans when conditions change;
   b. Evaluating progress at every stage so that needed changes can be made smoothly; and
   c. Ensuring that rewards are thoughtfully considered and are appropriate for various accomplishments (recognizing the effectiveness of extrinsic and intrinsic rewards).
9. Re-evaluating purpose, environment, strengths and weaknesses, and assumptions before setting objectives for the next performance period.

The following discussion will address each of these nine points in detail focusing, with respect to each, on (1) its importance, (2) the mechanics of using it, and finally (3) examples of it within the environment of the banking industry.

Purpose or mission

The first, and arguably most important, consideration of developing a long-range plan incorporating this nine-step analysis of SLRP/MBO is to define the purpose or the "reason for being" for the bank or any of its specific departments or areas of responsibility. Peter Drucker, in discussing the importance of identifying an organization's purpose says, "It is defined by the want the customer satisfies when he buys a product or a service. To satisfy the customer is the mission and purpose of every business." He continues, "Business enterprise, however, requires that the theory of the business be thought through and spelled out. It demands a clear definition of business purpose and business mission. It demands the question, 'What is our business and what should it be?'"

Drucker also states, "Only a clear definition of the mission and purpose of the business makes possible clear and realistic business objectives. It is the foundation for priorities, strategies, plans and work assignments. It is the starting point for the design of managerial structures.

Clearly, if purpose is defined casually or introspectively, or the list of key result areas neglects some of the less-obvious threats and opportunities, the fabric of organization objectives and resources is loosely woven." As Calvin Coolidge put it, "No enterprise (including banks) can exist for itself alone. It ministers to some great need, it performs some great service not for itself but for others; or failing therein, it ceases to be profitable and ceases to exist."

Banks are not exempt from the necessity of defining their purpose or reason for being. Although such purpose may be difficult to ascertain in the rapidly changing economic environment of today, the following purpose statement might be generally appropriate:

Our goal is to achieve an enhanced level of earnings through managed and diversified growth. Inherent in this goal is our commitment to provide:

1. Relevant and comprehensive fairly priced financial services to our customers;
2. A challenging work environment for employees with rewards and career opportunities linked to productivity and creativity;
3. A strong equity position which allows for meeting continued needs of borrowers and which provides stability and safety for depositors;
4. Profit level which produces an acceptable return for shareholders; and
5. Support for the charitable, cultural and economic needs of the community. Such a purpose/mission statement is vitally important for the new millennium as banks begin to redefine their roles in an ever-changing and expanding financial services climate.

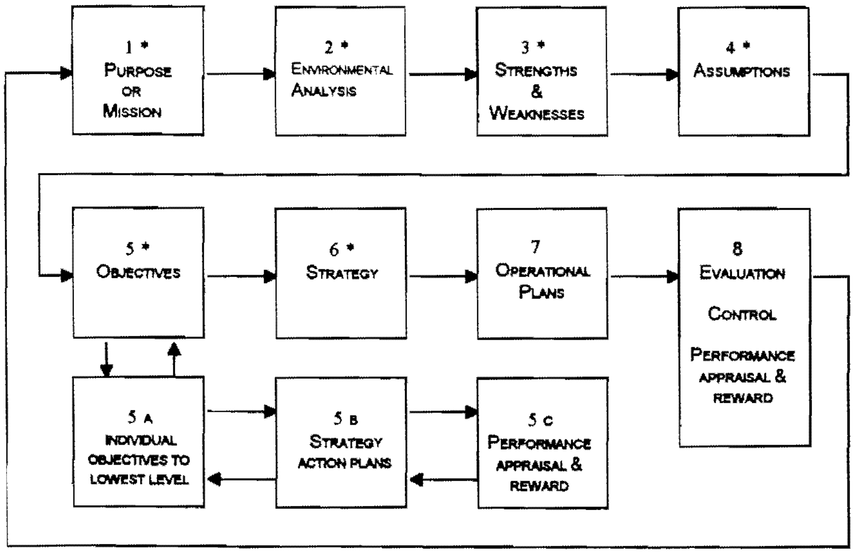

Figure 1: The strategic planning/MBO process.

Environmental analysis

For a bank to grow, or even survive in these perilous times, it is vital for it to gauge the environment within which it operates. At no time in the past has the political, social and economic environment had such a direct and persuasive impact on banking as it does today. Realizing that anything that can happen ultimately will happen must become a fundamental tenet in any modern approach to banking philosophy. Recognition of the inevitability of change promotes flexibility and the capability of making change work for an organization rather than against it. The only way to manage change is to set up a systematic process to constantly monitor the environment within which our company operates. Thus banks must vigilantly keep one eye on debates in Congress, proposals from the White House, pronouncements by regulators, while keeping the other eye on the *Wall Street Journal* and other business and trade publications. The successful bank of the new millennium must stay abreast of regulatory relief legislation, the staggering stock market in investment banking, downturns in global economic growth, megamerger consolidation, and a trend toward convenient banking locations for the customer. Needless to say, success in banking also requires a constant analysis of business trends, interest rate changes and other old established economic factors.

The complexity of the task facing banks as they monitor their environment is illustrated by the following facts concerning a few of the environmental factors banks must reckon with:

1. Prime rate. This integral part of a bank's structure of rates charged to its customers has evolved from a stable rate which changed, on average, once a year in the 60s, to a volatile rate which

during the 70s changed once a month and in the 80s once a week. The 90s have seen the lowest rates in years.

2. Legislative action. Proposals to enact regulatory relief legislation to "let banks pay interest on corporate checking accounts, authorize the Federal Reserve Board to pay interest on reserves, ease capital requirements for purchased mortgage servicing rights and allow insolvent banks to challenge their seizure in court."

It has never been so imperative for banks to know, monitor and manage their "environment."

Strengths and weaknesses

Following the identification of "purpose" and the consideration of "environment," attention must be turned to an assessment of the organization. Howard H. Stevenson states, "Business organizations have certain characteristics (strengths) which make them uniquely adapted to carry out their tasks. Conversely, they have other features (weaknesses) that inhibit their abilities to fulfill their purposes. Managers who hope to accomplish their tasks are forced to evaluate the strengths and weaknesses of the organization ..." Assessing an organization's strengths and weaknesses requires, in part, a review of its key resources: human, financial, facilities, equipment, natural resources, etc. Although identifying the strengths is somewhat simple, defining weaknesses is, if not more difficult, at least more painful. Often organizations resort to outside consultants to candidly pinpoint their limitations. Regardless of the difficulty of the task, weaknesses and limitations must be recognized before further analysis can proceed. Only with a realistic appraisal of strengths and weaknesses can realistic objectives be set.

Bankers face a doubly difficult task in assessing strengths and weaknesses in that, as a regulated industry, some weaknesses are superimposed by laws and rules outside the control of the individual bank. For example, the Treasury Department noted in its "Modernizing the Financial System... " report that "outdated laws prevent banks from responding to changed financial markets and achieving geographic diversification, while non-bank financial service providers chip away at the banking franchise." No bank can succeed without candidly assessing this intrinsic weakness.

Assumptions

The fourth step in the nine-step analysis of SLRP/MBO is the stating of major assumptions. These assumptions should be stated with respect to the range of action over which your organization has little or absolutely no control; for example the external environment.

Some assumptions essential to the interest of commercial bankers might include:

1. Important cost elements of the banking industry, such as reserve requirements on deposits, asset-to-capital ratios, and federal funds costs;
2. The continuance of commercial banks as financial intermediaries in the money market most often utilized by lenders and borrowers;
3. The equilibrium of the stock market stays within an acceptable level;
4. The emergence of stiff competition from super multi-state bank holding companies owned by industrial conglomerates;
5. The continued expansion of banking services.

In the assumption area, bank management must make judgments based on the external environment and any assumptions made concerning banking in the 90s and beyond must take into consideration these proposals and strategies to assure their profitability.

Objectives and goals

The next step in the nine-step analysis of SLRP/MBO is the development of overall organizational objectives. These objectives must be developed for the entire company utilizing input from all levels of corporate structure, including, but not limited to, top management. Objectives must be clear, concise, written statements outlining proposed accomplishment in key priority areas, within specific time periods and in measurable terms. Objectives may be classified as routine, problem-solving, innovative, team, personal and budget performance. Drucker feels that "Objectives are not fate, they are direction. They are not commands; they are commitments. They do not determine the future; they are means to mobilize the resources and energies of the business for the making of the future."

Objectives can be set at upper organization levels in:

1. Profitability;
2. Market size, position, growth, and penetration;
3. Productivity;
4. Product leadership;
5. Employee morale, development, and attitudes;
6. Physical and financial resources;
7. Public responsibility; and
8. Personal.

Every bank executive should set an objective in each of these areas in his or her company long-range plan.

Performance contract

Lower-level management and staff also should contribute to the setting forth of objectives. Their statements of objectives become a performance contract following the completion of the following process:

1. Properly written objectives are submitted to the supervisor;
2. The objectives are then discussed and negotiated with the supervisor;
3. They are re-submitted to the supervisor;
4. They are approved by both parties, and (optionally)
5. Some organizations have both

parties sign the objective sheet.

Periodic review

Objectives, once operational, must be continually monitored and reviewed. One practical, easy way to record, communicate, measure and update objectives is through a "Performance Plan Book." All objectives for the organization should be stated in this book. The objectives should then be reviewed periodically and updated.

Strategies

After the objectives and goals have been set, strategies must be developed to achieve the goals and objectives. A good way to formulate strategy is to ask how is my organization going to commit its resources? The answer will become your strategy. You might describe strategy as your "game plan." Some examples of marketing strategies are:

1. Changes in services the bank offers;
2. Changes in price policy; and
3. Changes in promotional strategy.

It is during the strategy phase of the nine-step analysis that organizational structure should be reviewed. Drucker says, "The best structure will not guarantee results and performance. But the wrong structure is a guarantee of non-performance." Thus, the strategy phase of the analysis must include an organizational structure decision.

Strategy also involves timing. For example, timing of the introduction of a new product or service can be very important. Strategy is the "thinking" stage of the long-range plans.

Strategies a bank might adopt for the purpose of attracting new customers might include such steps as:

1. Initiating a promotional campaign advertising free checking services offered by the bank; with free overdraft protection if you deposit some money in a new savings account;
2. Cutting the cost of checking account monthly charges;
3. Removing the annual fee on bank credit cards (Visa, MasterCard);
4. Acquiring or establishing branches for the convenience of customers in various locations, including remote banking and supermarket branch banking;
5. Offering initial reductions on loan rates to encourage installment borrowing; and
6. Using the proper type and amount of advertising and promotion.

Operational plans: long-range and short-range

After all the foregoing steps have been completed and strategies have been developed to meet defined objectives and goals, an organization must develop both long-range and short-range plans. Examples of long-range plans are building for future expansion, equipment acquisition or hiring to meet organizational needs. At this stage of the analysis, it is important not to confuse objectives and strategy. This is the "action" or "doing" stage. Here you hire, fire, build, advertise and so on. It is appropriate at this point to develop proforma income and balance sheets for some stated period such as five years. Also helpful is the development of contribution analysis by product line for five years. These efforts afford an organization the opportunity to review periodically the outcome of implemented plans in measurable terms.

Appraisal

An appraisal of the organization and each of its entities is the next step. This is to determine if all objectives have been met. The questions to be asked include:

1. Have measurable objectives and goals been accomplished?
2. How far did actual performance miss the mark?
3. Did the attainment of the objectives and goals support the overall purpose?
4. Has the environment changed enough to change the objectives and goals?
5. Have additional weaknesses been revealed that will influence changing the objectives of the organization?
6. Have additional strengths been added or your position improved sufficiently to influence the changing of your objectives?

Re-evaluation

At the end of the bank's performance year and as part of the thinking for the new year, the purpose, environment, strengths and weaknesses and assumptions must be re-evaluated. This assures that the plan is working and allows for any needed. corrections.

Conclusion

In the Oct. 1,1998 issue of the *Washington Post*, author Paul Blustein reported that, "the International Monetary Fund warned yesterday that the sharp slowdown in global economic growth this year could become even more dire in coming months." Having a dependable, results-oriented management system in place, such as the strategic long-range planning/MBO process presented here, is imperative to the survival of banks. Smart management in banking for the new millennium requires careful consideration of the adoption and implementation of the nine-step analysis of SLRP/MBO.

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