A Closer Look at Strategic Planning and Financial Performance in the Banking Institutions

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ABSTRACT

In today’s business environment, the banking industry is under tremendous pressure from many different parties to remain financially sound and exercise good judgment when making decisions that can affect the general well-being of our economy. Federal regulators are particularly interested in the actions that banks take as well as their future actions. Strategic planning has been used in the banking industry for many years now, but its importance has been seriously reevaluated since the financial meltdown of 2008. Many banks are now required to submit strategic plans to the U.S. Department of Treasury in order to receive any federal assistance (Lyons, 2012). In contrast, strategic planning has also been criticized for the banking industry because it is believed that many banks create strategic plans as simply a formality and make decisions based on what is in their best interest financially at the time instead of following the guidelines of their plan. As with any business industry, planning is an important step in the financial success of banks. Famed businessman and columnist Harvey Mackay said it best when he wrote “Failures don’t plan to fail; they fail to plan.” (Goodreads Inc., 2013) History tells us that business is more efficient and profitable when they plan and the banking industry is no exception to this rule.

STRATEGIC PLANNING AND PERFORMANCE

Strategic planning is a process of using systematic criteria to analyze external and internal environment of the organization, formulate, implement, and control strategy, and formally document organizational expectations (Higgins and Vincze, 1993; Mintzberg, 1994; Pearce and Robinson, 1994; Piffs and Lei, 2003).

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Source: Adapted from Piffs and Lei (2003)

Previous research (Ansoff et al., 1971; Herold, 1972; Thune and House, 1970) of manufacturing have indicates that strategic planning results in better financial performance based on ROI, ROE, profit and increase in market share. In the financial institution industry also we have to have comprehensive strategic planning in place in order to measure the profitability and financial performance of the institution. Once a financial institution has completed all the pertinent analysis such as the SWOT, Five Forces, and benchmarking, it then delineates it strategic issues; the basic and fundamental issues that have
to be addressed in order to achieve its vision toward its desired future (Thompson et al., 2016). In order to address the strategic issues which have been identified, the financial institution will undertake strategic planning which involves setting strategic goals, action plans, and tactics. The strategic goals should follow the acronym SMART (Specific, Measureable, Agreed upon, Realistic, and Time/cost bound) (Thomson et al, 2016). The strategic goals define the milestone that institution plan to achieve; the action plan sets forth how the financial institution will go about achieving its strategic goals, and the tactics define the specific actions used to implement and achieve the strategic goals (Dess, et al. 2015). Some researches for past 20 years indicated that the intensity with which the financial institution involve in the strategic planning process has had a direct and positive effect on the financial institution’s performance. That is, strategic planning intensity causes better financial performance and in turn, better performance causes greater strategic planning intensity (Hopkins and Hopkins, 2014).

**“Strategic Planning Process”**

**SOURCES OF PRESSURE ON BANKING AND FINANCIAL INSTITUTIONS**

With the banking industry today facing increased pressure, it is important to know the sources of that pressure and how to plan around that pressure to ensure success. There are four key pressures that banks must deal with. The first area of pressure that banks face comes from a stricter global economic and regulatory environment. As economic growth has slowed in more mature economies, emerging markets are expected to pick up the pace instead. China and Russia are two countries that banks are particularly interested in for investment as they show large growth potential. In the past, banks in developed countries
have been able to take advantage of acceptable risk/reward situations in their own countries so there hasn’t been any pressure to expand internationally. Today however, this isn’t the case. With increased scrutiny of our financial industry, banks are looking to reexamine their business models and make adjustments such as investing and expanding operations internationally. Strategic planning plays a key role in a bank’s decisions as it must seek a balance between acceptable risk in new investments and return on equity (ROE) (Management Centre of Europe, n.d.).

The second pressure that banks are facing is simply increased competition from other banks and financial institutions. For many years, the banking industry has been flooded with banks all competing on every front. Since the financial crisis, many smaller banks failed and have been bought up by larger institutions. This gives the larger banks a stronger foothold in the market. It is very clear that each bank must develop and implement a competitive strategy to survive in this global economy. Banks basically have two strategies that can be implemented: Offer premium products and services that make their customers feel prominent, or become low-cost providers offering scale and convenience. Banks that fail to plan a strategy will lose ground to other banks that distinguish themselves as offering value to their customers (Management Centre of Europe, n.d.).

The third pressure being put on banks is from customers demanding more from their banks and having their expectations met, even if it is from a competing bank. The global image of financial institutions from the public eye has been greatly diminished over the past few years as banks have been demonized in the press and from various governments around the world. This demonization has left the banking industry heavily scrutinized by consumers and has empowered them in finding the best options for banking. As banking fees increase and services offered decline, customers are able to go out and find new banks that will gladly accommodate their demands whereas traditionally they might have been more loyal to a particular bank. It is crucial for banks to develop strategic plans of action to retain customers and establish trust with their institution. Often times, banks focus too much on profits from individual transactions instead of the overall value of each customer. Here is a key example of why banks need to implement their strategic plans instead of dismissing them as simply a formality: When banks dismiss their strategy and attempt to “micro-manage” their transactions to maximize profits, they hurt customer relations and can possibly lose those customers and their revenues for years to come. On the other hand, when a bank properly implements its strategy and focuses on the big picture, customers are retained and profits normalized for years to come instead of facing uncontrollable ups and downs. Banks must remember that many of their main customers are business owners as well and understand the importance of customer relations. Having a strategic plan in place to set guidelines for bank’s customer relations is extremely important for a bank’s ability to do business (Management Centre of Europe, n.d.).

The fourth pressure on the banking industry comes from within its own ranks. A bank’s ability to retain employees and develop new employees into talented workers is crucial to a banks success. According to a CNBC article from fourth-quarter 2012, the number of recent graduates pursuing careers in investment banking is in a steady decline. From a prominent business school in Pennsylvania where many investment bankers have previously come from, there has been an 8% decline in students entering that field since 2008. The article goes on to say that the main reason students are shying away from the banking industry is the cutting of big bonuses and job insecurity in an industry struggling to adapt to federal regulatory changes (Braithwaite, 2012). Overall, the banking industry has lost some of its appeal to graduates in recent years and banks must adopt a strategy to deal with this issue. The number one way to combat a lack of a skilled labor force is to reduce the employee turnover rate at your bank. According to Nobscot (2013), a human resource company specializing in employee retention rates, the average
employee turnover cost a company around 25% of that employee’s annual salary. Although not measurable, the tangible costs to a company are quite high as well (Nobscot Corporation, 2013). As banks expand internationally, the need for more management professionals in the industry will grow. One strategy a bank could use would be to implement a low-cost approach that developed and engaged valuable employees while putting into place a more personalized, high-investment approach for the most talented employees that will be needed to fill senior leadership positions one day. Even the bank tellers need to be involved with employee retention programs and their job satisfaction is the first thing customers see when they walk through the door. Throughout the industry, it is vital that banks create and implement these strategic plans before they lose their valuable employment assets (Management Centre of Europe, n.d.).

The fifth, and last pressure being put on banks is from technology. Especially in small banks, they are optimistic and excited about new technologies but due to drastic and sudden changes it will be difficult to implement new offerings. By the time that the institution starts seeing it, working it, training it and implementing it, new technologies are coming. Some banks use offensive and others apply defensive strategies to adopt the technology, if you do not provide services on line then customer will go to the competitors that provide better service. It depends on banks to implement the new technology in the future. Successful innovations have focused on improving the customer experience but that they have significant secondary benefits in bank efficiencies (Kiselev, et al, 2016). Based on several studies they found out that impact of technology have a positive impact on bank’s financial performance. Based on several studies indicated that technology had positive impact on (1) increased labor productivity, (2) decreased payroll expenses and increased operating and total administrative expenses, (3) increased market share, and (4) increased revenue and profit and (5) increased customer satisfaction, if financial institutions effectively use technology then they can improve competitive advantage (Kaur, 2012).

With the new regulatory environment that has formed since the financial crisis of 2008, strategic planning has become more important than ever in the banking industry. New regulations combined with widespread public scrutiny of the industry have forced banks to rely more heavily on their board of directors to carry out execution of the institution’s strategic plan. Traditionally, bank boards have focused primarily on current strategy execution and its effects on the business on a month-to-month basis, but now the boards are exploring a more overhead approach and planning for the future. Boards are now examining SWOT analysis and other useful tools to give themselves a frame of reference on how effective their strategic plan will be going forward. This allows the board to be involved with discussing the strategic goals of the bank instead of only relying on information they are told by management. By having the board involved with the planning process, there is an additional level of valuable input that might be overlooked by management for the wellbeing of the company. Good strategic planning will set goals and objectives not only for the bank itself, but also its employees, including the board members themselves. One of the issues that happen with every strategic plan is execution of the plan. In the banks, the managers and directors are responsible for making sure the plan is followed. The board provides oversight to those responsible for following the plan and can take corrective action if it is not adhered to (McAlpin & Moeling IV, 2012). The negatives of strategic planning are few and far between, however there is one that seems to plague the banking industry in particular because of the nature of their business. When it comes down to making financial decisions that will make the bank money in the short run, managers and directors always choose to go with short-term gains and tend to overlook the banks strategic planning when doing so. According to the ABA Banking Journal, there are three components to a successful strategic plan when dealing with the banking industry: 1. “To start, good strategic planning
does not yield a plan: It yields capabilities.” 2. “Its objective is not to make decisions, but to enable better decision-making.” 3. “Precisely because the banking environment is so dynamic and fast-changing, strategic planning’s real benefit is to establish the most important issues, goals, gaps, and opportunities that banks must address in any key business decision, whether those decisions are known or yet unknown.” These three components of a strategy plan for banks emphasize the importance of good decision making. The ABA Banking Journal goes on to say, “In order for strategic planning to work effectively, it must be elevated from a once-a-year “event” to a day-to-day “habit,” and made a regular and accountable part of every staff member’s awareness, activities, and goals.” (Kidder, 2012) This provides some insight into some of the flaws of strategic planning as a whole as any plan is only as good as the people executing it. Strategic planning is not an easy task for the banking industry and it requires accountability for the plan to work. However, if strategic planning is conducted and implemented properly, it can assure the viability of a bank for years to come (Pierce, 2012). The unique thing about strategic planning is there is no cookie-cutter answer to planning. Each organization has its own unique circumstances that it must address to meet their needs. For banks performing capital assessment and strategic planning, there are four questions that must be answered: 1. “Who are our target customers?” 2. “What is our unique value proposition?” 3. “How will we make money?” 4. “How will we sustain our advantage?” (CCG Catalyst Consulting Group, 2012) If a bank is able to answer all of these questions with their strategy, they should be in a good position to be successful and sustainable in today’s economy.

CONCLUSION

Strategic planning for the banking industry is unique in the sense that it doesn’t exactly follow the same rules as other industries because so many financials decisions which directly affect the institutions income are made on a day-to-day basis and many times left up to the manager on duty at the time. This allows for deviation from the plan if proper oversights are not put into place. In a manager’s eye, he might think he is making the best decision for the bank by closing a deal for extra short-term profits, but it could hurt the bank in the long-term by not following the strategic plan that has been laid out for sustainable grow of the institution. With new regulations and public criticism, the banking industry must adopt more stable strategic plans to prove themselves as a rational industry that’s not just trying to make a quick profit at any chance they get. As with any business, strategic planning is a necessity for banks if they are going to be able to keep up with the fast-moving economy. With proper execution of a strategic plan, the banking industry can achieve success in this new economy just as it has in the past. There is a great need for financial institutions like banks to think strategically about what is going on (Schmenner, 1995). In response to increasing complexity and change in the financial services industry most of the banks begun to review their strategic planning on regular basis and revised them due to forces that government and regulatory agencies impose on them.

REFERENCES


