Linking Accountability to Strategy

When building accountability within their organizations, banks need to link their metrics to strategy in order to incent the appropriate behaviors.

By Jeffrey Marsico
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Accountability need not be a dirty word, but it has become one. To many people, accountability means unrealistic goals, recriminations from the boss and invitations to the exit. Few organizations, including those in the financial services industry, would want that culture. To avoid it, we hold no one accountable.

But creating an accountability culture need not involve a negative environment that points fingers at those who put forth the effort yet fell short and praises the non-participants for flying below the radar. Banking organizations are naturally structured to align accountability and performance. For example, there are profit centers, such as branches, lending functions and wealth management. And then there are support centers, such as finance and operations. We commonly give profit center managers, and at times, rank and file employees, goals and hold them accountable.

Support centers are a different story. Since they lack a departmental income statement (no revenues, just expenses), it's not easy to find something relevant to measure. So we often don't. Why do you think branch staff frequently transfer to support centers, but we rarely hear of support center staff transferring into branches?

Strategy First

Accountability should always start with your strategy. If your strategy is to grow large commercial real estate loans with easy terms and thin pricing to get deals done, then make lenders accountable for generating dollar volume and the size of their portfolio. If you want branches to add checking accounts, no matter the customer profile, then hold them accountable for generating growth in the number of checking accounts.

How often do I hear of banks pursuing those strategies? Rarely. Yet, I often hear of lenders being held accountable for loan dollar volume and branches being held accountable for new account growth. In such cases, we can safely assume that accountability is *not* aligned with strategy and an organization's overall financial performance. Why do you think the state of California is accusing Wells Fargo of opening accounts without customer permission? My guess: incentives to grow the number of accounts or products per-customer. I doubt you would find the unintended consequences of Wells Fargo's accountability scheme in their strategic plan.

In addition to my bank consulting duties, I am actively involved in local lacrosse organizations. When I pursued a US Lacrosse coaching certification, I completed a coaching course called the Positive Coaching Alliance (PCA), which taught a different style of coaching than I was used to. One thing I learned was how to fill the player's emotional tank by highlighting the things they do right, rather than focusing on what they do wrong. Research proves that this is more effective at maximizing player performance and creating a positive environment. Why can't this concept apply to accountability at your bank?

How would this work in practice? Let's suppose a hypothetical bank, Schmidlap National Bank, aspired to be the number one business bank in the Portland, Maine region. Two strategic objectives on its journey to this aspirational future are to maintain a top quartile net interest margin, as being the best implies the ability to price for it, and to achieve a 10% market share in professional practice firms in the region. So, how could a positive accountability culture work at Schmidlap?

Branches. Instead of gross deposit balances growth, or number-of-accounts growth, Schmidlap could implement an incentive system for its branches based on branch revenue growth and profitability. Revenue growth includes branch-originated loan spread less provision, deposit spread and fee income growth. Imagine the change in branch personnel behavior if they were now accountable for growing revenues. Would they pursue low balance account relationships to grow number of accounts? Would they call up for a certificate of deposit (CD) price exception to "keep the money at the bank"? Or would they call on the local accounting firm to try to gain their confidence to refer customers and win their operating accounts? If these branch staffers are held accountable for revenue growth, the answer would be clear.

Continuous improvement, described above, can be part of the equation. This pegs the branch up against its past performance. To continue building our accountability culture, how about a little competitive spirit at Schmidlap? Rank branches based on revenue growth, deposit spread percent, pre-tax profit as a percent of branch deposits, etc. Track trends in each category and compare each branch to the Schmidlap average and top quartile performance. Publish success stories of top quartile branches, and how they do it, so others can emulate their tactics. Hold an awards ceremony with the necessary fanfare to highlight a job exceptionally done.

Lenders. Based on my firm's profitability peer database, commercial lending is currently the most profitable department in most banks, when calculating pre-tax profit as a percent of the portfolio. The reason is the relatively low funds charge from historically low funding costs. Yes, loan yields are down too, but rate floors on loans are supporting greater spreads. Commercial real estate loans lead the profit charge, as these portfolios are experiencing similar spreads as commercial business loans, but are larger and therefore generate greater revenues and feature lower expense ratios per-loan.

This environment has contributed to aggressive pricing on high quality, larger commercial real estate loans. Where does that leave Schmidlap, which aspires to be the best business bank in Portland? Doing large commercial real estate deals at competitive, commodity-like pricing is not likely to ring the bell.

What if, Schmidlap develops lender profitability reports, as it did with its branches, tracking the net loan spread less provision and pre-tax profit per-lender? Hold lenders accountable for continuous improvement. Additionally, if Schmidlap allocates capital to loan products based on perceived risk, it now can measure return on equity per-lender. Create ranking reports for various metrics. Reward your top quartile performers with top tier incentives. And call them on stage during your awards ceremony to celebrate their accomplishments.

Support/operations. I spoke at a recent industry chief financial officer conference about this very subject. In my experience, CFOs bang the drum loudest for accountability at their banks. But supporting accountability in the branch network and among lenders without holding yourself accountable hurts the credibility of the culture you want to create.

True, it is difficult to hold the finance function accountable for driving profits. But if we turn to strategy and risk management, could we not hold finance accountable for maintaining interest rate risk and liquidity positions within policy? How about comparing finance staff to benchmarks and tracking continuous improvement in realizing economies of scale? So often we take note of banks that grow, yet their expense ratios (operating expense to average assets) and efficiency ratios don't decline. If the bank is growing, the relative size of the finance department's budget should decline. Trend it. And reward a job well done! Look to other, similar metrics for other support functions, such as accounts managed per-loan servicing staff in that department, etc.

There is no brass ring for measuring accountability. So, don't let perfect be the enemy of very good. If your accountability measurement scheme is consistent with strategy, transparent to those who are measured and elevates and highlights the performance of your rock stars, then very good should build an environment of continuous improvement. And, more importantly, create a bank where top performers want to work.

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