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Third Quarter 2013 Volume 5 Issue 3

TKG Perspective

The Kafafian Group mourns the loss of David M. Ciolli, son of TKG Senior Vice President Richard G. Ciolli, who unexpectedly passed away on October 2, 2013. We extend our deepest sympathy to the Ciolli family. Please keep them in your thoughts and prayers.

Events

Teaching & Speaking Engagements

New Jersey Bankers Association CFO Meeting
Woodbridge Hilton
Woodbridge, NJ **November 4**
Things I wish community banks would do or at least consider

Independent Bankers of Maryland
Bluestone Restaurant
Timonium, MD **November 21**
Financial Industry Trends Effecting Community Banks

SNL Knowledge Center
Topics in Bank Valuation
Downtown Conference Center
New York, NY **December 4**
Advanced Topics in Bank Valuation is a comprehensive two-day course that builds on the foundation established in Fundamentals of Bank Valuations

Conferences, Conventions & Other Events

Financial Managers Society
Philadelphia Chapter
Dinner Meeting
Radnor Hotel
St. Davids, PA **November 13**

Financial Mangers Society
New York/New Jersey Chapter
Christmas Party
The Fiesta
Wood-Ridge, NJ **December 3**

Financial Managers Society
Philadelphia Chapter
Four Seasons Hotel
Philadelphia, PA **December 10**

Implementing Management Reporting in Community Banks

By George W. Millward, Managing Director

The pressure is on for Community Banks to raise their skill in the development, delivery, analysis, and utilization of information. Think about what Enterprise Risk Management, Capital Planning, Compliance Management, Credit Oversight and/or any of the other myriad of recent initiatives have in common? They require thoughtful, well-organized, relevant information that enables management to:

- Assess the current status
- Visualize future trends
- Enable the asking of good questions to drive action

In other words, an organized, focused Management Information System ("MIS").

Even without these current pressures, executive management of growing institutions eventually realize that the traditionally-produced financial and management reports from the core banking system do not help analyze the health of their various lines-of-business, products and customers. Often such reports are too detailed and difficult to summarize, and too focused on one set of users, such as the financial reporting staff. Executives will find that, without a formal, consistent, reliable set of management reports to provide the appropriate level of insights, their business unit managers will create this reporting on their own. If allowed to grow unchecked, this ad-hoc form of management reporting will result in:

- Disputes regarding the validity of the various reports and their content (Frankly, this debate is easier to conduct than the real debate regarding "What are these numbers telling us?").
- Less than optimal level of reliability and integrity in the information.
- Growth without end in the number of ad-hoc reports (and the underlying Excel spreadsheets) which requires staff time for maintenance and support (and thus cost).
- Inundation of the accounting and IT staff by requests for information and analyses.
- Ultimately, less clarity than before of the Bank's performance but at much greater expense.

The result is increasing frustration and concern that the important stories are not being told. But resistance by executive management to this spreadsheet explosion will not stop it from occurring. "Just say no" does not work. However, bringing order to this chaos requires far more than just acquiring and installing some vendor's "dashboard" management reporting software. Nor does mandating "better" or "more complete" use of core banking system's reporting features work. If these features were as comprehensive, flexible and easy to implement as spreadsheets, we would not be having this discussion.

Implementing an effective MIS truly requires a top-down commitment to the following five critical considerations:

1. Identify the desired impact on the Bank's culture. An effective MIS requires not only the right information delivered timely in accessible formats within the appropriate security framework, it also requires a management team willing and able to engage in meaningful conversations about the significance of the information. For example, much has been written on the impact of performance measurement on behavior. On the positive side, what gets measured gets done. But culture in which "making the numbers" is the only way to succeed can encourage actions which create exceptional risk to the Bank.

2. <u>Develop a consistent set of "rules of the game."</u> Even within community banking, each business unit will proclaim its uniqueness. To be able to discuss the meaning of the MIS, a standard set of principals regarding the purpose of the MIS, the definition and summarization of data, the structure of reports, and the access to information have to be developed. For example, what is the value of a new loan: The amount committed, the amount booked, the amount outstanding? The answer depends upon the purpose of the information, which drives the MIS.

   The second issue involves the use of financial information. The CFO must be comfortable that any such information can be reconciled to financial reporting. What gets measured internally has to have a clear track to what gets reported externally to the Bank's investors and to the banking examiners.

   Executive management must agree to these "rules of the game." To do otherwise risks entering into the debate over which (or whose) numbers are the "right" numbers. This sets the "tone at the top" in building the culture of the use of MIS to guide decisions.

3. <u>Develop a clear protocol for access and delivery of the MIS.</u> Today's environment of constant communication, intranets, reporting databases and security breaches has exploded the issues regarding how MIS gets delivered. The historical concerns regarding how reports should be designed, when they get printed and delivered and who should have the ability to receive them now seem naïve. An important issue to be addressed is one of how information is presented. Some individuals are "rows and columns" readers while others want to see the trend lines. While some MIS is more suited to one form or the other, the underlying data needs to be flexible enough to support individual preferences.

4. <u>Establish the appropriate governance process to oversee the implementation and operation of the MIS activity.</u> The ongoing operation of the MIS function will not run itself. As we have seen, internal needs and external requirements for MIS constantly change. Organization structures, credit analysis requirements, product costing activities all evolve. Business changes and as change occurs, the MIS has to evolve with it. While the IT Steering Committee may be the right place for such discussion, it can only do so if (a) it includes the members of the executive team, and (b) room in the Committee's already extensive schedule can be made for this topic.

   MIS governance is not an IT issue; it is a corporate issue. For example, I once heard a CFO proclaim that he was the bank's "Chief Information Officer". While that statement did not endear him to the bank's head of IT, it did encapsulate the notion that managing a bank's MIS is not the sole responsibility of IT.

5. <u>Use a disciplined project management approach to implementation.</u> The number of approaches to implementing an MIS likely equals the number of community banks. Many of these will work, some more successfully than others. In our experience, adherence to the following guidelines increases the probability of success, where "success" is defined as achieving a usable MIS that supports the Bank's objectives within the time and cost parameters.

   - <u>Have a written plan.</u> While building an MIS will involve "trial and error," an overall plan will provide the description of the project's scope, significant goals and tasks, and expected products which comprise the guidance necessary to control the project. The plan needs to include both timing and a budget, and the regular status reports provide the appropriate updates to both.

   - <u>Likewise, have a project manager.</u> This doesn't need to be a full-time position, but a project like this does need a manager. It also needs an owner, which can be the governance group discussed above. The owner should receive the regular updates, and the entire Bank should be kept generally informed of progress.

   - <u>Start small and build.</u> The focus should be on assessing what information should be delivered and how. For example, the spreadsheets already in use can be a guide to what reporting is needed. A higher priority project, such as beginning an ERM assessment, can be the prototype for starting the broader MIS effort.

   - <u>Test and test again.</u> Testing the information delivery will build comfort not only in the technology, but in how the information can be used. A test environment can help the Bank's culture adapt to the MIS.

   - <u>Find and eliminate the "ad hoc" spreadsheets.</u> All the cost and effort to build structure, definition, control and security of the MIS can be wasted if these ad hoc reports continue to exist.

Executives struggle with the trade-off between the hard, direct costs of implementing an MIS implementation project verses the non-quantifiable prospect that better "early warning" information will result in improved decisions which, in turn, will result in economic value added to the Bank. However, if the use of an organized, standard MIS becomes integral in the Bank's approach to planning, risk management and decision-making, the benefits are and will be undeniable. Remember, if you can't measure something, you can't manage it!

TKG, as part of our consulting and advisory engagements, frequently evaluates our industry, its trends, successes, and challenges. We are pleased to share our thoughts with you, our valued clients and friends, in the form of this periodic newsletter. If you would like to discuss anything further, or learn more about our performance measurement, strategic planning, regulatory assistance, profit/process improvement or financial advisory services, please call us at (973) 299-0300 or visit us at <u>www.kafiangroup.com</u>.

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