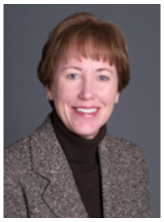
The Urgent Need for Pervasive Performance Management in 2009: Linking Strategy and Execution



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TowerGroup Take-Aways

- 2009 promises to be a difficult year for financial services institutions (FSIs), which will remain under pressure to shore up profits through revenue generation and increased operational efficiency.
- The real-time or near real-time reporting of a performance management solution provides insights that enable an FSI to modify business plans rapidly to respond to the economic volatility of today's markets.
- Too many FSIs have neglected to adopt performance management solutions and have suffered the consequences: plummeting profits and institutional failures.
- Pervasive performance management is not a panacea; FSIs must constantly examine their corporate strategies and business plans to ensure that the key performance indicators they use are appropriate.
- Failure to adopt performance management solutions in 2009 is an invitation to continued mediocrity, if not failure.

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Report Coverage

"However beautiful the strategy, you should occasionally look at the results." –Winston Churchill

All too often in financial institutions (and nonfinancial institutions) the linkage between strategy and execution is broken, missing, or misconceived. As the tumultuous events in the financial markets of the past two years have demonstrated, the results delivered to shareholders seldom bear any correlation to the grandeur of the corporate strategy. This TowerGroup ViewPoint looks at the use of performance management solutions in banking today and advocates for its expanded use. For more information on performance management in the banking industry, refer to TowerGroup Research Note V45:24RW, *Corporate Performance Management (CPM): Key Trends in the Banking Industry*, and V52:01R, *Be Global and Act Local: Performance Management Solutions Ensure Success in Cross-Border Operations*.

Background

Whether it is called corporate performance management (CPM) or enterprise performance management (EPM) or simply performance management, this is a category of solutions whose time has come. Regardless of how it is labeled by any single software provider, the challenge to be addressed remains the same: to provide greater transparency into daily operations and thus to facilitate improved decision making across the enterprise in real time or near real time. Performance management, when deployed in a pervasive manner throughout an organization, equips management with the "headlights" needed to detect dangerous situations earlier, make timely course corrections, and scope out the competitive terrain. Although performance management does not yet allow a management team to see around corners, it does provide the tools necessary to avoid bumps in the road ahead.

As has been all too evident in recent months, organizations continue to struggle with forming the appropriate linkages between corporate strategy and daily activities. While avoiding bumps in the road is important, correctly correlating strategy and everyday activities is perhaps the more pressing concern. Although the development of balanced scorecards and key performance indicators (KPIs) has greatly improved the capacity for linking strategy and actions, there is no guarantee that the KPIs deployed are the "right" ones. In financial services institutions, it is still common to hear that customer experience and customer service are critical aspects of an FSI's strategy and then find that the KPIs deployed in that institution's call centers and branches are focused on efficiency to the exclusion of service performance. In these instances, the linkage between strategy and execution is clearly misconceived and a pay-for-performance strategy is counterproductive.

Elements of Performance Management

Ideally, performance management in an FSI is an architected solution that covers a broad range of key functionalities. It is possible to integrate disparate software applications into a performance management solution, but the challenge of fully integrating so many distinct capabilities is considerable. At its most basic, a performance management solution is constructed from a trinity of software components: data management, financial management, and business intelligence:

- **Data management** is data consolidation, integration, and management to facilitate the consolidation of various data types, in various formats, from across an organization into a repository that facilitates creation, execution, and monitoring of strategies.
- **Financial management** is focused on the budgeting and planning components of forecasting. A pervasive performance management solution also includes modeling and scenario planning so that organizations can anticipate the effects of possible midcourse corrections to their annual plans and budgets.
- **Business intelligence** includes balanced scorecards and key performance indicators along with information-reporting capabilities such as dashboards.

In concert, these software components allow FSIs to structure their annual business plans, determine the key metrics for evaluating success, report on those metrics, revise plans as necessary, and provide a solid basis for a pay-for-performance strategy. Quite simply, they are the most practical possible link between strategy and successful execution.

Compelling Use Cases for Performance Management in 2009

Without question, institutional performance in the financial markets in 2008 was the worst in generations. Banks failed, insurance companies required propping up, hedge funds liquidated, stand-alone investment banks disappeared in the United States and governments and regulators around the globe were forced to act decisively on an enormous scale. Market volatility was unprecedented. Given the velocity and direction of the market downturn, one could argue that nothing could have stemmed the tide since the intensity of market sentiment could not be abated.

Although performance management solutions may not have been able to prevent the disasters of September and October 2008, they clearly need to be a significant element in FSIs' efforts to rebound and rebuild in 2009. As we enter 2009, FSIs around the world are burdened with the heightened fears and expectations of their stakeholders. For some, the stakeholders now include sovereign governments. All will be operating in a new reality and the stakes — often, survival of the institution — are high. In this business environment, the case for performance management is compelling. Taking this imperative a step further, performance management infused throughout the enterprise will provide managers, regardless of their role, with the headlights needed to see the bumps in the road ahead.

As managers work to improve their financial results in 2009 and allay stakeholders' fears, insight into business performance will be invaluable. One of the most beneficial aspects of performance management solutions is that they provide value to managers throughout an organization. As an example, information on sales performance in a bank branch provides value to several levels of bank management: sales managers, branch managers, regional managers, product managers, segment managers, financial analysts, and heads of the bank's lines of business. Once consolidated into a single source, the data can be provided to a variety of end users in finance, marketing, sales, human resources, and executive management.

TowerGroup believes that the unrelenting pressure from stakeholders in the financial services industry militates in favor of the implementation of performance management solutions. Although a host of use cases might be cited that would benefit from the introduction of performance management, the four defined in the following paragraphs are particularly applicable to the financial services industry in 2009.

Consolidated Compliance and Regulatory Reporting. Regulatory reform is a sure bet for the financial services industry in 2009. FSIs are certain to face a slew of new regulations, laws, and business norms, some introducing new reporting requirements for their various stakeholders. Information on ongoing business performance will be mandated, and the latency associated with producing the reports will be condensed.

Risk Management. Operational and fraud risk are two types of risk that merit heightened awareness and get more attention in 2009. Societe Generale, Caisse d'Epargne, CITIC Pacific, ARACRUZ, and MF Global all sustained significant trading losses in 2008. Financial institutions of all types are sensitized to the potential losses associated with fraud, financial crime, and the failure of business oversight.

Operational Efficiency. Profitability will be a top concern for every FSI in 2009. Unfortunately, not all FSIs are as efficient as they should be. Business processes are frequently manual and even if automated, they are not necessarily streamlined. Some industries such as the mortgage and consumer lending business were particularly prone to inefficiencies in their originations operations and will be embroiled in 2009 in projects to prepare for a lending renaissance anticipated in 2010.

Revenue Generation and Sales Management. The flip side of the profitability coin is revenue generation. In recent years, sales management has been a fertile field for performance management in many types of financial institutions. As the profitability imperative intensifies in 2009, those banks, brokers, insurance carriers and investment managers that have not yet adopted performance management solutions will entertain the notion as they attempt to compete with their more successful brethren.

Performance management is not a panacea that guarantees profitability for financial institutions. The primary value of these solutions is that they provide greater transparency into daily operations. Managers and decision makers across an organization have improved visibility into performance, which translates into enhanced decision making. Performance management solutions cannot guarantee profits, but the solutions can explain the presence or absence of profits.

Summary

Financial services institutions have made great strides in adopting performance management solutions, but the practice of performance management is not yet pervasive across the industry or across institutions. There are still many pockets of "darkness and opacity" in financial services. Performance management solutions have the capacity to improve the efficiency of daily operations and the efficacy of decision making at all levels of the institution. A key feature of such solutions is that they enable a disciplined approach to business planning and reforecasting. In times of market volatility, the business plans that were coherent and cohesive in January may look disjointed in April. Performance management solutions allow FSIs to model the effects of midcourse corrections and implement change in a controlled way. Not adopting performance management solutions in 2009 is a grave miscalculation; financial services institutions that continue to manage using reporting mechanisms with high latency or that have not yet adopted key performance indicators run the risk of mediocrity and poor results, an outcome that will not be pleasing to stakeholders in 2009.