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Adapting Financial Institution Directors' Roles in the Management Process to Achieve a Competitive Advantage: A Challenge for 2000 and Beyond

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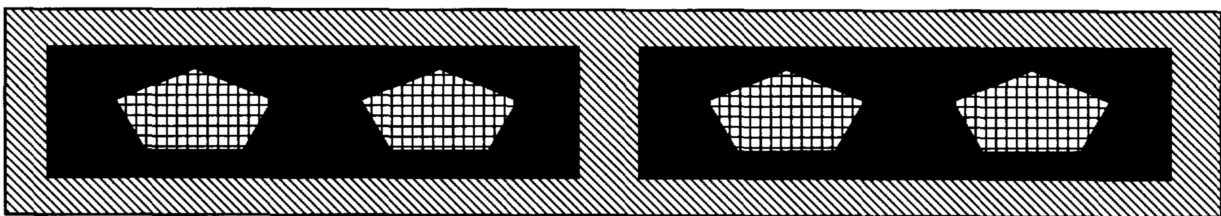

Introduction

During the 20th century managers thought a company could gain a competitive edge by assembling an array of resources that outclassed the rivals. This philosophy, evident in the popular SWOT analysis used by strategic planners, encouraged planners to note a company's strengths and weaknesses. Strengths were tangible or intangible company resources of capabilities: e.g., a strong marketing department, good reputation, successful product lines. Weaknesses were a lack of resources or capabilities or inefficient deployment of resources: e.g., lack of production capacity or financial resources, ineffectual advertising campaign. This perspective will not suffice in the next millennium.

Successful firms in the 21st century will need to establish a sustainable competitive advantage: the ability not only to adapt but also to anticipate and shape the future direction of the industry. A company that has a sustainable competitive advantage has a set of core competencies that endure over time. Core competencies are those that create value for a firm, are not shared by rivals, are difficult to imitate, and have no substitutes. Ultimately, the only truly enduring core competencies are knowledge based.

Purpose

A specific source of sustainable distinctive competency for a financial institution is a synergistic relationship between directors and the financial institution's executives engaged in strategic management. Directors' primary responsibility is to protect the owners' interest by monitoring and controlling the actions of the company's top-level executives. The heightened insights that can be gained in the dialogue between executives and directors may be the type of rare knowledge-based competency that will separate the industry's above-average performers from the average or below-average performers. (It should be noted that our focus on the financial services industry does not preclude the likelihood that this source of sustainable competitive advantage is appropriate for other industries).

This paper will first outline the traditional relationship of the board of directors to the strategic management process, and how that relationship can be enhanced. Next, a value-added role that directors can assume *vis a vis* the strategic management process will be described. Finally, a superordinate role for directors will be suggested that prevents the strategic management process from crystallizing and signating.

Traditional Role of the Board in the Strategic Management Process

Strategic plans are critical to financial institutions for the same reasons they are important in other industries:

- They provide a means of setting goals and measuring results.

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- They offer a vehicle for exchanging ideas and putting them in writing.
- They establish a direction for the institution.

An added reason for having a strategic plan is to meet regulatory requirements. Regulators demand that financial institutions have a strategic plan because they have found that serious problems result when there is none. Institutions lose focus in the same way that travelers lose their way if they set forth on a cross-country trip without a road map. A good strategic plan enables regulators to determine if the financial institution is on the right course or if adjustments are needed before it is too late.

The components of the strategic management process include formulation, implementation, and control. It is the board's duty to insure that the financial institution has a strategic plan and that the plan is carried out. Traditionally, the role of the company's directors has been to evaluate the strategic plan implemented by top management. The board should monitor implementation at least monthly by reviewing the financial results, comparing actual results to budget, and also determining if the new products, technology, etc. are being implemented as planned. This role is only possible when the board contains a balance of insiders (top-level managers) and outsiders. Since monitoring the plan's success is a role common to all boards, it is not rare and therefore, not classified as a distinctive competency. However, directors who have the ability to anticipate when the assumptions used to formulate the strategic plan are no longer appropriate can give top management a valuable head start in redirecting the company's strategic thrust. Directors who have broadened the definition of monitoring to include examining the validity of the plan's premises as well as judging the executives' implement on efforts, have the capacity to enhance the knowledge base used in strategic decision making.

New Role for Directors in the Strategic Management Process

While the board, as a practical matter, normally delegates the preparation of the actual plan to management, it can also participate in a dialogue with management to establish the definition of target markets, as well as long-range goals and objectives. Directors add value to the strategic decision-making process when they are involved in strategy. In this case, the director moves from being an outsider evaluator to a cooperative, supportive role in which informational input is provided. The idea of the board collaborating with top management to improve strategy rather than the board standing in judgment of top management may seem radical. However, it is not outside the scope of the board's responsibilities if that responsibility is ultimately to protect stockholders' interests. The synergy of the directors and corporate executives working collaboratively can result in a distinctive competency.

Historically, strategy formulation has been considered the domain of top management. However, in the cooperative model proposed here directors become important participants, particularly in the early stages. From their independent, outsider perspective, directors can help the company find unique ways to leverage its resources and competencies. These directors, who are not enmeshed in the organizational culture and ongoing problems, may be better able to see how the company should stretch itself to win competitive battles in the future. The articulation of this "company's stretch of its resources and competencies" represents a strategic intent. Strategic intent provides an energizing and directive force within the company (Hamel & Prahalad, 1989).

Input from the directors in the formulation of strategic intent also helps in defining the company's mission, since the mission evolves directly from the company's strategic intent (Rajagopalan, 1992). In companies with boards chosen to represent the major stakeholders, it is possible to use directors to evaluate a proposed mission statement. If the directors representing the capital market, product market, or organization (Donaldson & Lorsch, 1983) do not find the mission "inspiring or relevant," it is unlikely other stakeholders will.

To avoid confusion and a lack of clear focus, the mission should define what sets the financial institution apart from the competition. For example, at one financial institution it was decided that the primary mission should be to give quality service and quick response to a limited number of market niches, such as medical professionals, attorneys, or small business owners. The theme to be used by the financial institution was: "We bring the financial institution to you!" If the bank decision-makers had not limited and defined the niches the firm was to serve, it could have used that theme.

A properly orchestrated plan begins with a

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planning session that puts into focus the general direction the financial institution should take over the next five years. In one financial institution, a planning retreat involving several members of the board and senior management reviewed issues such as the economy, competition, new products, technology, staffing, and budgets before formulating a strategic plan for board review. Removing the group, especially the management team, from the physical place of business was important: a change of scenery helped to stimulate creativity and encouraged the participants to look at the "big picture." After the planning session, a formal document was presented to the board for discussion and approval. Once the strategic plan and the incorporated budgets were approved, the necessary documents were in place to offer guidance to the employees and provide standards to use in judging the institution's ongoing performance.

Meta-Level Role for Directors

In some companies strategic planning becomes crystallized. Planning is so formalized that creative thinking is eliminated and the process rendered ineffective; it is separated from implementation rather than being intertwined. Board of director involvement in the strategic management process can insure that the financial institution's executives *think* strategically as well as *plan* strategically. Strategic thinking examines underlying operating principles. It recognizes the shortcomings of focusing on quantitative measures such as market share, since there is not necessarily a link with profitability. It avoids the myopic vision of a competitive playing field that focuses only on comparing a financial institution with other similar rival financial institutions. Generally, a bank is ill-advised to borrow another financial institution's plan and attempt to force-fit because each financial institution is different in terms of customer mix, strengths and weaknesses, resources, and management style. Imitation strategies confine the financial institution to those already in use by competitors. Imitation inhibits creative thinking about how to alter the playing rules or change the competitive playing field.

Altering the rules of the game or the competitive playing field implies changing the structure of the industry. Affecting the future shape of an industry is referred to as crafting strategic architecture (Hamel & Prahalad, 1994). This is what happened when financial institutions entered the home mortgage arena and began offering a variety of investment accounts. Strategic thinking broadens the decision maker's perception of competitive challenges to include competing for opportunity share in addition to competing for existing market share. In other words, it includes looking for ways to "expand" the market, not just divide it up. It may be easier for financial institution directors with diverse backgrounds and experience to engage in strategic thinking than it is for financial institution executives whose task environment is mainly constrained by the existing boundaries of the industry. Moreover, directors may be more able to see strategy as a *stretch* beyond what the financial institution is presently doing instead of as a good *fit* between the financial institution resources and its present business environment. Strategic thinkers seek ways to leverage rather than allocate corporate resources.

Often management in financial institutions and other organizations are fearful of introducing new products. They wait for some other organization to take the necessary market risks. This "follower" strategic approach is not adapted to the dynamic environment facing financial institutions in the 21st century. Rapid advances in technology and the demand for new services and products force financial institutions away from the *status quo* if they wish to remain competitive. New products are required that will be attractive to the customer and profitable to the financial institution. If the product does not benefit both the institution and the customer, it will not succeed. Generally, it is advantageous for a financial institution to stretch its product development and planning to incorporate state-of-the-art technology.

Another issue to be addressed is product packaging. Will the financial institution offer products/services on an individual basis or bundle them to make them more attractive to the customer? This issue may ultimately be decided by customer preference and competitive pressure, although through careful product/service packaging, the financial institution can set both the direction and pace for rivals to follow. Pricing of the financial institution's products/services is an important part of the packaging decision. By interrelating some of the services to obtain favorable volumes and profit margins, packaging can be a definite

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factor in pricing. As part of the plan, it is important for the pricing to allow the institution to make a reasonable profit. With the narrow interest rate spreads in financial institutions today, there is virtually no room for loss leaders. Pricing should be evaluated from a price versus benefit point of view. It should also be evaluated from a competitive standpoint to insure that the financial institution does not price itself out of the market or have a margin that is too narrow. Here again the insights of directors can benefit the institution's strategic decisions.

Strategic thinking fostered by directors frees the organization from the stereotype view of rivals as "those to be beaten." Instead, rivals can be seen as complements (Brandenburger & Nalebuff, 1996), a view that encourages coalitions and cooperative strategies. For example, two rival financial institutions in a small town may cooperate to give a new business the loan package it needs to built a plant in the town. The resulting economic boom benefits both financial institutions in the long term. In this instance, it is easier for outsiders to see the complementary aspects of rival financial institutions than for the managers, who are essentially locked in competition for the existing small town market.

SUMMARY

Directors traditionally monitor the implementation of strategic plans. In addition to their role as evaluators of strategy implementation, directors can assume a supportive, synergistic role in relation to top managers. This collaborative role can be achieved by adding another dimension to their contribution to the strategic management process. They can participate in a dialogue with management in the early stages of the strategic planning process. External directors are especially helpful in providing insights gained from their diverse perspectives. Finally, the synergistic combination of the director's focus on strategic thinking and the manager's formal planning focus can result in a thoughtful, knowledge-based competency. This distinctive competency is unique, difficult to imitate, and adds considerable value to the strategic decision-making process. This type of knowledge-based competency furnishes the financial institution with a sustainable competitive advantage in the next millennium.

In addition to holding the Smith-Hutson Endowed Chair of Banking at Sam Houston, Dr. Bexley is executive director of the school's graduate banking school for bank executives and consults with community banks on strategic planning. Dr. Duffy is associated with Sam Houston's Gibson D. Lewis Center for Business and Economic Development as a teacher and director.

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