STRATEGY & YOUR HUMAN CAPITAL – PART 2

Last month we began a two part series related to building a "successfully strategy." We think the timing is appropriate since around this time of the year, groups of bankers huddle around a conference table at some offsite hotel and start talking "strategy". While it may feel very productive while you are there, and you may love that you can think strategically, statistically you are likely to fail in achieving this strategy.

According to a 2005 article in the *Harvard Business Review*, the average strategic plan only delivers 63% of its potential financial returns, and more then 1/3rd of the executives interviewed placed the figure below 50%. The performance loss of 37% was attributed to everything from inadequate resources (7.5%), to a poorly communicated strategy (5.2%), to unclear accountabilities (4.1%), and to eight other reasons. The article shows the importance of strategy execution, as only 5% of the performance loss was attributed to poor strategic design, while 32% was linked with failed strategic execution.

At Human Capital Banking, we believe there are 5 reasons that strategies fail.

1) **The Market Barrier** – 9 out of 10 business strategies fail due to an inability to translate market conditions into real strategic actions. Some business leaders are like horses with blinders on, just running forward as fast as possible without knowing what is going on around them, while other leaders get into analysis paralysis, and cannot take nimble actions to address a changing market. Success means being quick enough to respond to market changes, while simultaneously not taking action without seeing the whole picture.

2) **The Resource Barrier** - 60% of organizations don't link their budgets and resources to long term strategy. The budgets and resource plans are just rolled over from the previous year, and no thought is given to the assets that are needed to execute the strategy.

3) **The People Barrier** - Only 25% of managers have incentives linked to the long term strategy. Most of the managers have short term incentives, and are focused only on yearly performance objectives. In fact, some researchers have claimed that less than 15% of companies make it a regular practice to compare the business's results with the performance forecast from the prior year's long term strategic plan. In the end, the average manager is not held accountable for the long term performance of the organization.

4) **The Management Barrier** – 85% of managers and the executive team spend less than one hour per month discussing strategy. In most organizations, a vision and a strategy are things that are discussed once per year at an offsite meeting. When the managers return to the office, they place the newly crafted strategy in a drawer, and there it sits.

5) **The Communication Barrier** - Since none of the managers are talking about the strategy on a regular basis, less than 5% of the employees actually understand the strategy. In the end, the strategy becomes corporate jargon, and either it is forgotten or soon replaced by another hollow strategy.

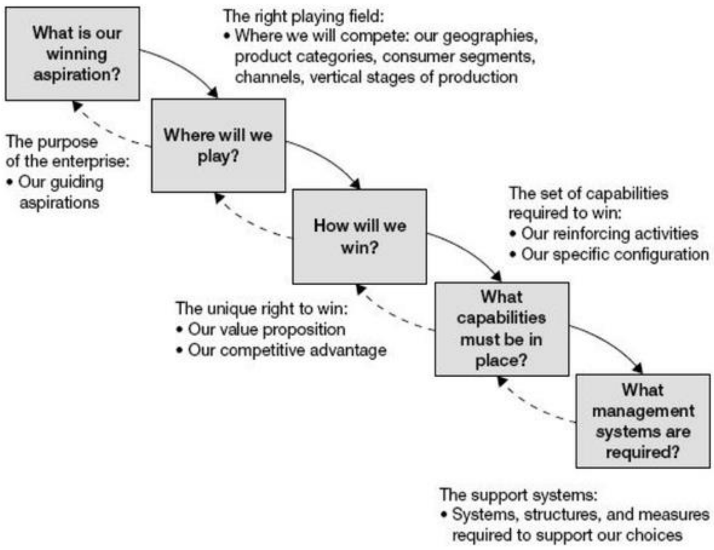
In order to deliver on a winning strategy, you need to address these five barriers. This two part series is designed to discuss your Bank's Strategic Plan and the process you go about ensure it is a success. Last month we started this discussion and began to present simple but strong ways to design your strategy, and highlighted the critical aspect your Human Capital fills when creating your strategy. To support this discussion, we have been using the book *Playing to Win: How Strategy Really Works* by A.G. Lafley (Former CEO of P&G) and Roger Martin (Dean of University Toronto School of Management).

The 5 Questions of a Successful Strategy

At the heart of any good strategy, there are critical questions that you need to answer. When you are building your strategy, each question you have should build off your previous answers, until you have gone from your high level goals to a practical plan of action. In *Playing to Win*, there are 5 strategic questions, that, when properly answered, will give you a clear plan for sustainable advantage.

1) What is our winning aspiration? – What is the purpose for our bank? What are our guiding principles?
2) Where will we play? – What is the market in which we want to be dominant? In which geographies, product categories, consumer segments, and channels will we compete?
3) How will we win? – What is our bank's value proposition to our desired customers? What is our competitive advantage in our desired market?
4) What core capabilities must we have? – What are the activities and core competencies that critically underpin our "Where to Play" and "How to Win" strategic choices? What do we have to be great at?
5) What management systems are required – What systems, structures, KPIs and tools are required to support our choices?

An integrated cascade of choices



The 5 strategic questions logically flow from one to the next, but at the same time there is a strong feedback loop that influences the earlier questions. For example, it is important to know your existing core capabilities when deciding the winning aspiration. These are the kinds of things you should be talking about at your strategic retreats, and using these questions to determine what the critical focus areas are for your bank. Last month we dealt with Strategic Question #1 -"What is our winning aspiration?" and Strategic Question #2 – 'Where will we play?" This months the discussion continues with the final three questions.

Strategic Question #3 – How Will We Win?

Once you know where you want to play in terms of markets and customer segments, then you can start building your value proposition for that specific market and those specific customers. A successful strategy does not try to be everything to everyone. Instead, a successful strategy focuses on a specific set of customers, and this narrowed focus actually makes it a much easier to create a strong value proposition. Imagine your bank trying to serve pay day loan customers, your common home loan applicants, real estate developers, and local manufacturing businesses all at the same time. By focusing on just a segment of your potential customers, you can align your bank to deliver exceptional value. Otherwise you will be just diluting yourself in order to hit all customers.

When it comes to deciding how you will provide exceptional value, you really only have two choices. You can be the Cost Leader in the market or you can Differentiate yourself from your competitors. Now most of you might already be thinking you are pursuing a low cost strategy in your banks, but there is a big difference between having low costs and truly being the Cost Leader. Delta and United are both trying to minimize their costs as much as possible, but Southwest is the true Cost Leader. If this is the way your bank wants to capture your customers, then you need to align your entire bank to driving the lowest possible costs possible.

But from our experience, most banks try to maintain a low cost while ultimately pursuing the Differentiation strategy. In this way of winning, your bank needs to set itself apart from its competitors. You need to create/identify specific areas of value that you can provide to your desired customers, that your competitors cannot. While the Cost Leadership strategy is all about the costs, the Differentiation strategy is all about your customers. You need to be able to answer a simple question in a Differentiation strategy: What can we provide that increases our customers' willingness to pay and is something that our competitors cannot easily replicate? When you answer that question you will know how you are going to win in your desired market and customer segments.

In terms of Human Capital, deciding how you will win (Cost vs Differentiation) will have serious impact on your people, your leaders and your culture. A bank with a Cost strategy has to have a relentless, almost maniacal, pursuit of cost reductions. The managers' in the low cost bank know all the drivers of cost, and gear all their attention to cost reduction. For the employees, standardization becomes the most critical aspect of their jobs. There are no unique solutions or going above expectations for the customer. There is only the pursuit of efficiency.

On the other side, banks with a Differentiation strategy require a completely different set of employees, managers and culture. The Differentiation strategy is all about the customer, and that means that all the employees need to be driven by customer service. They need to be going above and beyond the standards in order to help that customer. The managers need to be pushing this customer understanding and rewarding employees who deliver exceptional value to the customers. There are many different ways to differentiate your bank (innovation, customer service, upstream / downstream integrated service, etc…), and whichever way you choose, your people need to be living that strategy in their daily lives.

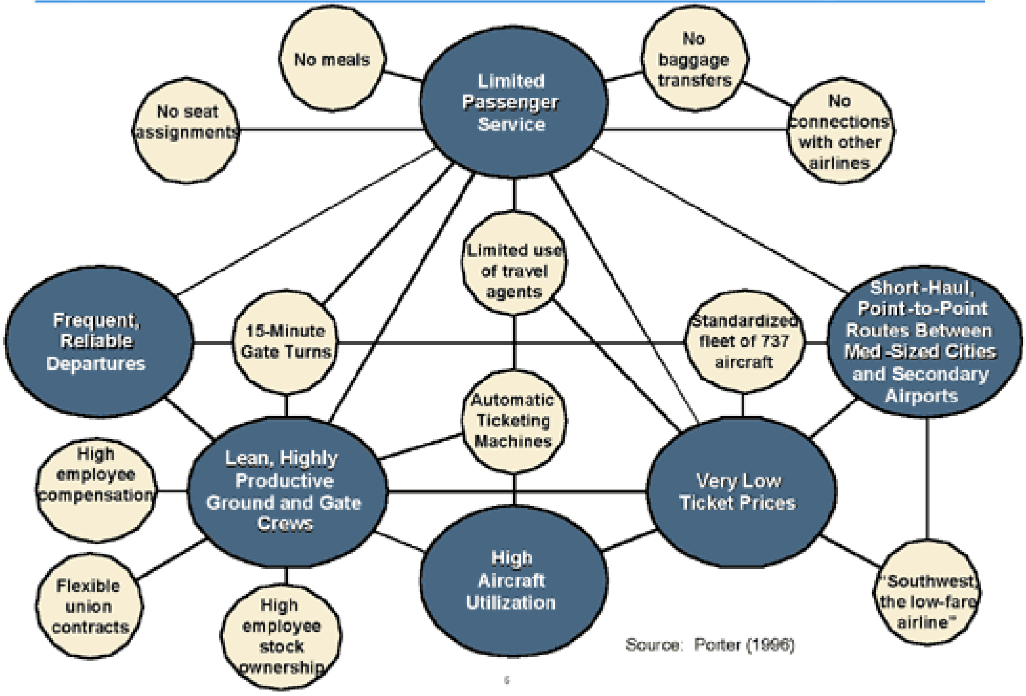
But before we move on to the 4th Strategy Question, it is important to realize that identifying how to win in a specific market may not always be possible. You may want to enter a specific market / customer segment but it is already saturated with banks that are better at Cost Leadership and better at Differentiation. If this is the case, you may need to go back to the 2nd Strategic Question and pick a new market / customer segment. The easiest way to fail is to be in the middle of the pack, where you cannot provide any extra value to your customers. When you are in the middle of the pack, you are basically a commodity. Play to win, and find your niche market where you actually have something of value that you can deliver.

Strategic Question #4 – What Core Capabilities Must We Have?

Knowing where you want to play and how you want to win is all about identifying the destination which you want your bank to arrive, but those questions will not help you plot the course to get there. This is where the next two strategic questions add value. In order to achieve your strategic goals, you need to identify the core capabilities that are required. At Human Capital Banking, we define core capabilities as the critical activities that your bank needs to perform at the highest level in order to achieve your strategic goals. Your core capabilities are not a list of generic strengths, or mandatory actions required from the regulators. Your core capabilities need to be the critical few things that you can do to differentiate your bank from the rest of the market.

One of the easiest ways to identify and map your core capabilities is by building an Activity System. Originally designed by the strategic guru Michael Porter (Harvard Business School), the Activity System is a visual representation of the core capabilities required to win, the relationship between those capabilities, and the activities required to support those core capabilities. Below is Porter's Activity System of Southwest Airlines, and even though this was written in 1996, it is still matching the main strategy of Southwest today.

Figure 1: Southwest Airlines: Low Cost Advantage



When creating your Activity System, Lafley and Martin have identified some key points you will need to discuss:

1. Feasibility – Are these realistic actions we can take? How much of it is currently in place, and how much would you have to create? For the capabilities you would need to build, is it affordable to do so? If upon reflection you find your required core capabilities impossible to attain, then you need to reassess your where to play and how to win choices.

2. Distinctiveness – Are the capabilities and activities similar to or different from our main competitors? Will they truly help you stand out within your market, or are they the standard capabilities of any bank. Distinctiveness is where you create competitive advantage, and if your capabilities are too generic, then you need to evaluate your previous strategic choices. Remember… the goal of every strategy is to win, not just exist.

3. Defensibility – How easy will it be for your competitors to adopt your core capabilities, and go after your desired market? If your core capabilities are be easily replicated or overcome, then your strategy will not provide any sustainable competitive advantage and you should rethink your previous strategic choices.

When answering these questions about Feasibility, Distinctiveness, and Defensibility, you need to think about how your Human Capital will impact these. For example, when looking at Feasibility you need to see whether or not you have the Human Capital needed to deliver these core capabilities, and, if not, you need to think how feasible it would be to hire them. Some banks we work with are located in an area with a limited pool of candidates. You may want to hire the best and the brightest when it comes to your C Level, but the harsh reality may be that they don't want to work for your bank or move to your city. When defining your strategy and core capabilities, you need to take into account the Feasibility, Distinctiveness, and Defensibility of the required Human Capital.

Strategic Question #5 – What Management Systems Are Required?

The final strategic question you need to answer focuses on the different management systems that you need to be successful in implementing strategy. Without a clear communication plan, supporting structures / systems, and clear measures to track your progress, your bank's strategy remains a worthless wish list.

1) Cascading the Strategy – Your strategy does little good if it only sits with the C level staff of your bank. For a strategy to be truly successful, it needs to be cascaded throughout all levels of the bank. Part of this cascading is accomplished by communicating the strategy clearly thought-out the entire organization. But the other part involves having all levels of employees identify the key actions and behaviors they can perform in order to deliver the strategy.

2) Investing in the areas that build your strategy – Core capabilities don't just appear overnight. They have to be nurtured, and grown over time. This requires your bank disproportionately invest in the areas (processes, systems, technology, Human Capital) that will reinforce your strategy. For everything else that is either non-strategic or mandatory regulation, spend the minimum possible.

3) Measuring progress – The old saying goes, "If you don't measure it… it won't get done." Without measures of success, how will you know if you are succeeding or not? How will you know if your strategy is working? Serious thought needs to go into your choice of measures, because what you choose may or may not reinforce your strategy. For example, was an increase in assets due to the strategy working or due to growth in the community you are serving? We suggest take focused / targeted measures for your strategy, and not use the traditional broad measures of success.

A strong Human Capital Plan is one of the best management systems you can build. Your plan starts with the strategy, and making sure that it is seamlessly embedded throughout all of your employees' responsibilities. Your Human Capital Plan will also help you identify the key people and roles that are required for your strategy, which then allows you to disproportionately invest in those people (developmental investments and compensation). Finally, a key step in your Human Capital Plan is to make sure that your employees' performance is measured against achieving the strategic actions. These are just three of the aspects of how your Human Capital Plan will deliver your strategy.

How Human Capital Banking Can Help Your Strategic Planning Process

Throughout our many years in the banking field, the Human Capital Banking team has seen many banks fail. Sometimes it is because they fail to create a strategy that creates sustainable advantage. Sometimes it is because they get too complacent and too focused on optimizing today instead of build tomorrow. Premier Performing Banks always have an eye on the long term success, and with that in mind they are always building their people towards achieving that future success. A clear strategy that incorporates their Human Capital is one of the critical ways Premier Performing Banks ensure they have the talent to outperform the market.

With the right mindset, Strategic Planning can help set your bank apart from the herd, and this is where Human Capital Banking wants to support you. Our partners have led countless strategic retreats over the past 30 years, and can help your bank differentiate itself. From there, our Human Capital services are designed to translate your bank's strategy into clear people actions. We will help you answer the 5 strategic questions. We will help you make sure your Human Capital is aligned to your strategy and driving towards its success.

We want to be your bank's partner in differentiating itself from every other bank. Whether it is Human Capital Banking, The Findley Group, or Young & Associates, we can help you build your strategy for success. If you would like to read any of the past Human Capital articles, especially the "Differentiator" series, you can find them all on www.HumanCapitalBanking.com

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