6th International Scientific Conference
May 13–14, 2010, Vilnius, Lithuania
BUSINESS AND MANAGEMENT 2010
Selected papers. Vilnius, 2010

ISSN 2029-4441 print / ISSN 2029-428X CD
doi:10.3846/bm.2010.035
http://www.vgtu.lt/en/editions/proceedings

PERFORMANCE MEASURES FOR A BUSINESS UNIT IN LATVIAN RETAIL BANKING

Jelena Titko[1], Natalja Lace[2]

Riga Technical University, Kaļķu 1, LV-1658 Riga, Latvia
E-mail: [1]jelena.titko@inbox.lv; [2]natalja.lace@rtu.lv

Abstract. The shareholders' value creation has become the primary goal of any company. The main challenge is to translate corporate objectives into the set of measures and to communicate high-level goals to the employees. The purpose of this paper is to determine the most appropriate operating objectives and target measures for the bank's customer service centre. The Balanced Scorecard approach was used as a theoretical basis. The middle range managers and front office employees of Latvian commercial banks were surveyed to model the objectives tree with the quantitative metrics, which can be used by the middle managers as a daily management tool. The authors focused only on the financial, customer and personal perspectives.

Keywords: balanced scorecard, bank, customer and financial perspectives, performance measures

1. Introduction

Already in past age the American economist, Irving Fisher proved that company's value maximization is the best way to solve conflict of interest (1930). Modern finance theorists and practitioners (Sinkey 2007; Helfert 2000; Lee 2009) assert that shareholders' value enhancing should be an integral goal of any company.

According to Copeland, Koller and Murrin (2002), the investors in shareholder–oriented economies will receive the higher return on capital, than in other countries. Thus, the latter will gradually fall into troubles with foreign investments and will lag behind in world competition.

As for Latvia, the statistical data indicates the problem of value creation in Latvian banking sector. Although the banking profitability ratio in 2007 (24.2%) was even higher than the average ROE throughout the Western, Central and Eastern Europe, the index in 2008 (3.63%) is the lowest in the European banking sector, including the neighbors (Estonia and Lithuania) with 17% and 14% respectively (BSCEE 2008; Vries, Groen 2009). The data point to the high volatility of revenues and riskiness of banking business in Latvia. Taking into account that the 80% of Latvian banks are foreign-owned, the risk of capital outflow increases. Thus, Latvian banks' top executives should start thinking of value enhancing for their shareholders.

The reason of failure of using some management approaches was performance targets that were not properly aligned with the ultimate goal of creating value. Besides, the corporate objectives should be translated into the set of measures appropriate to each particular business group (Copeland *et al.* 1995).

The object of the research is a system of qu titative indicators used to evaluate performance of a retail bank's business unit. The aim of the research is to collect data about the existing performance evaluation systems that are used in Latvian banks' retail departments and to take the opinions of bank employees about these systems. The goal of the paper is (i) to study the international experience in the area of banks' performance evaluation; (ii) to get an insight into the key performance indicators of a retail bank; (iii) to analyze the results obtained from the authors' conducted survey among Latvian banks' employees; and (iv) to construct a model of objectives tree with the quantitative metrics, which can be used by retail bank's middle managers as a daily management tool.

The survey conducted in 2006 among 143 performance management professionals found out that 46 % of respondents still did not have a formal strategy execution system. 73 % of them reported average or below-average performance of their strategies. In turn, 70 % of the respondents who had a formal process to manage their strategy execution outperformed their peer group of companies.

The survey conducted by Cranfield University in 2003 found that 75 % of organizations use a management system based on Balanced Scorecard (Kaplan, Norton 2008). According to the data of the research that has been conducted by Bain&Company since 1993, the Balanced Scorecard approach is still among the 10 most popular management tools in 2009 (Rigby 2009).

Balanced scorecard (BSC) is a performance measurement and strategic management system that translates an organization's mission and strategy into a balanced set of integrated performance measures. Strategic performance measures are the foundation of effective strategy management--the key to taking the Balanced Scorecard, or any performance system, from the theoretical to the applied (Kaplan, Norton 1993).

The Balanced Scorecard focuses on critical success factors of an organization and involves key performance indicators.

Key success factors are the critical fields for the company's effectiveness (Никонова, Шамгунов 2007). Key Performance Indicators, also known as KPI or Key Success Indicators (KSI), help an organization define and measure progress toward organizational goals (Reh 2009).

The main objective of the implementation of KPI system is to formulate the concrete tasks for all departments and their managers. From the survey data that Booz&Company has been collecting for almost five years from more than 125,000 employees of some 1,000 organizations in over 50 countries the researches have distilled the 17 fundamental traits of organizational effectiveness (Neilson *et al.* 2008). The most important attribute of effective companies is that their employees are clear about which decisions and actions they are responsible for.

Thus, the existence of intelligible performance evaluation system is obligatory success factor for any company, including financial institutions. Besides, the each department should have its own measures and targets. The middle managers and frontline employees of Latvian commercial banks were surveyed in order to evaluate the existing systems that are used to evaluate performance of bank retail department. Using the Balanced Scorecard approach and the data obtained from the survey, the authors constructed the scorecard model for a retail bank branch. The given scheme can be used as a template for the construction of business unit's scorecard in real commercial bank, or as an instrument for improving the existing evaluation system.

2. Balanced Scorecard in a Bank

Effective measurement system is an integral part of a process of business strategy execution. The balanced scorecard concept, developed in 1992 (Kaplan, Norton 1993) is a strategy-focused approach to performance management that includes performance measures derived from the organization's vision and strategy.

Intangible assets amount to about 75 % of company's value (Kaplan, Norton 2003). The creators of the BSC argue that in the information age, organizations require new capabilities for competitive success, such as customer relationships, product innovation, customized products, employee skills, motivation, and information technology. By including all critical success factors in the performance measurement system, the organization will have a better idea of how to achieve its goals.

Financial measures characterize a bank in the context of financial cycle (from the capital inflow until the receipt of income on active operations). This approach presents marketing researches, new products development, employee development etc. as only costly activities. These processes and related intangibles, such as customer loyalty or staff knowledge and skills, are characterized with non-financial indexes.

The balanced scorecard augments financial measures with objectives and metrics in three additional areas: customer relationships, internal processes, and learning and growth. Balanced scorecard system offers the answers to four main questions (Norton, Kaplan 1993):

− Financial perspective: To success financially, how should we appear to our shareholders?

− Customer perspective: To achieve our vision, how should we appear to our customers?

− Internal business processes: To satisfy our shareholders and customers, what business processes must we excel at?

− Learning and growth: To achieve our vision, how will we sustain our ability to change and improve?

According to Никонова and Шамгунов (2007), there are following milestones of BSC implementation process in a bank:

− Develop a strategy for a bank;

− Construct an objectives tree from the top goal of value enhancing to the functional goals;

− Determine the main factors affecting the achievement of functional goals;

− Determine KPI and targets;

− Organize the process of data collection about the achieved targets.

There are many successful financial service companies among the adopters of balanced scorecard (Norton 2006): Unibanco (Brazil), DnB Nord Bank (Scandinavian and Baltic region), Nordea Bank (North Europe and Baltic region), Chemical Bank (USA), KeyCorp (USA), Bank of Tokyo-Mitsubishi (Japan), Wells Fargo Bank (USA), Lloyds TSB Bank (UK) and others.

Relying on the own experience in banking and analyzing the publicly available information about the strategic objectives and targets of BSC users (Johnson, Beiman 2007; Kaplan, Norton 2003; Kaplan, Norton 2001; Никонова, Шамгунов 2007;

Тютюнник, Машонская 2009), the authors distilled the most general objectives and measures within the balanced scorecard perspectives for a bank's retail department. Authors' developed balanced scorecard is presented below (Fig. 1).

As we can see, the most attention is focused on customer measures. Loyal customers are the most important business asset of any company, including banks. In 1994, a professor James Heskett proposed a concept of Service-profit chain (Heskett *et al.* 2008). The service-profit chain es-tablishes relationships between profitability, customer loyalty and employee satisfaction, loyalty, and productivity. The links in the chain are as follows: Profit and growth are stimulated primarily by customer loyalty. Loyalty is a direct result of customer satisfaction. Satisfaction is largely influenced by the value of services provided to customers. Satisfied, loyal, and productive employees create value. Employee satisfaction, in turn, results primarily from high-quality support services and policies that enable employees to deliver results to customers.

Despite the internet banking development, the number of customers' visits to bank branches in European countries decreased only by 1 % during the period from 2001 to 2005 (Bidmead *et al.* 2007). The branch remains a key channel for retail banking customers. Thus, branch employees should retain the existing and attract new customers, cross-sell the products, thereby increasing bank revenues.

3. Research description

To achieve the main goal of the research, the authors of the paper developed questionnaires designed for the middle range managers – senior officers of the bank branches and customer service centers (CSC), and frontline employees (CSS– customer service specialists). 25 CSS and 15 managers from AS "Parex banka," AS "Latvijas Krajbanka" (LKB) and AS "GE Money Bank" were surveyed. The respondents were randomly selected. The only stipulation was appropriate position; work experience, age, name of an employer and other characteristics were not considered.

The main data about the survey are summarized in Table 1 and Table 2.

The authors' goal was to form a judgment about existing performance evaluation systems in retail departments of Latvian banks. The questionnaires included only closed questions, because they produce standardized data that can easily be analyzed statistically. The respondents were offered to select the appropriate variant from the authors' formulated alternatives. The authors used the multiply choice categorical and numerical questions.

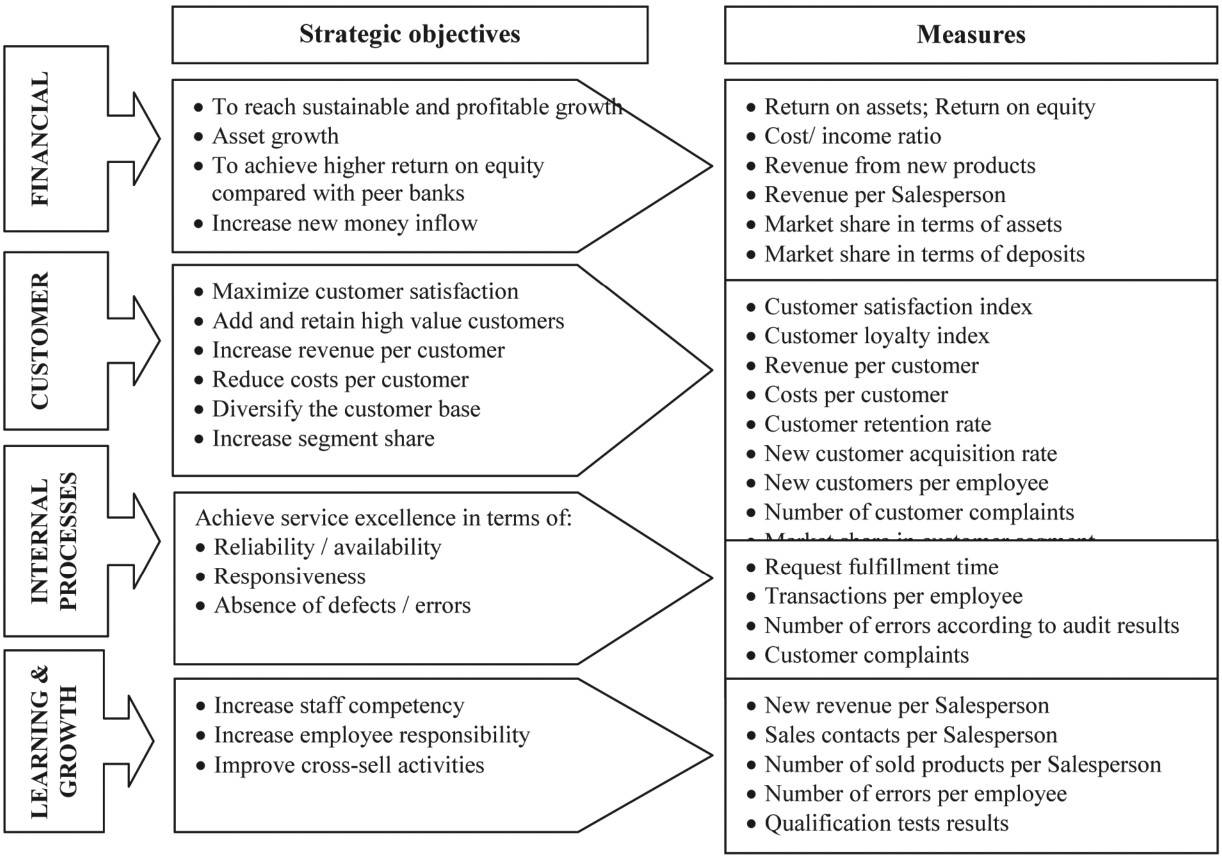

Fig. 1. Strategic Objectives and Strategic Measures for Retail Bank

Table 1. Description of the Survey

The aim of the research	To study the systems of indexes used to evaluate the performance of branches of Latvian banks
Approach	Qualitative
The source of data	In-person and mail surveys
Instrument	Questionnaire
The target audience	Middle range managers and customer service specialists of Latvian commercial banks
Location	Riga, Latvia
Period	November–December, 2009

Table 2. Respondents' Data

Criteria	Respondents' data			
Bank name		Parex	LKB	GE Money
Position	Managers	8	5	2
	CSS	17	5	3
Period in a position	<2 years	7	0	1
	2–5 years	15	8	1
	>5 years	3	2	3

The questionnaires were conditionally divided into two blocks. The questions of the first blocks allowed clarifying the general opinion of employees about the evaluation of their activity. The questions of the second block were the same for both groups of respondents and allowed detecting the gap between the viewpoints of frontline bank staff and their managers.

The second block's questions were related to the evaluation indexes. In particular, the respondents were offered to evaluate the importance of bank products for the bank performance. Besides, the respondents had to evaluate offered measures and to choose the most appropriate for their groups' performance evaluation.

4. Empirical Results

The research evidence allows making the interesting conclusions. One of the common questions for both groups of respondents was about the main strategic goal for any bank (Fig. 2, Fig. 3). If the total number of the answers exceeds the number of respondents, it means, that the respondents have selected more than 1 response alternative.

As a main strategic goal, both managers and employees almost unanimously have selected the sustainable growth of profit (88 % of front desk staff and 67 % of managers). This response aligns with the results that the authors received in studying international experience in performance management area (Fig. 1).

However, the authors were perplexed with the fact of underestimating the importance of customer-oriented goal. Only 20 % of managers have chosen this answer.

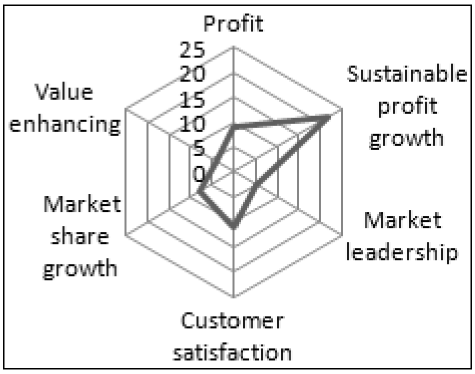

Fig. 2. Main Strategic Goal of a Bank (Viewpoint of Frontline Employees)

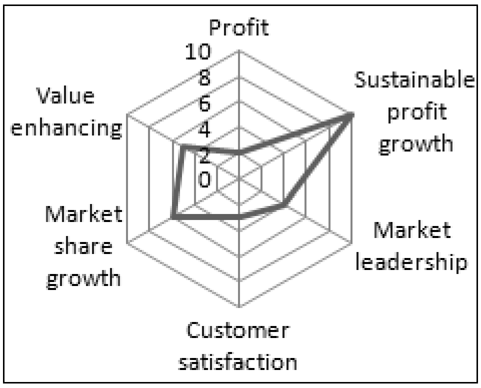

Fig. 3. Main Strategic Goal of a Bank (Viewpoint of Managers)

The importance of value enhancing was appreciated only by 33 % of managers and 16 % of customer service specialists. And this result only accepts authors' opinion that the bank employees do not have competent knowledge of Value.

As for personal attitude of bank employees to the performance evaluation system in their departments, 64 % of CSS and 40 % of managers are not fully satisfied with them.

As a positive point, the authors can mind the fact, that 22 of 25 front desk employees are fully informed not only about own performance targets, but also about the common department's tasks.

However, we cannot account for the fact, that the middle managers have no opportunities for changing the performance targets. The measures and targets are strictly determined by top executives. The opinions of middle managers are discounted, that is a gross mistake on the part of senior management.

Plan targets very often do not consider the differences between business groups, such as group's size, number of employees, consumer flow etc.

The respondents were offered to choose from a range of indicators those, which take into account these differences. The responses are presented in Fig. 4.

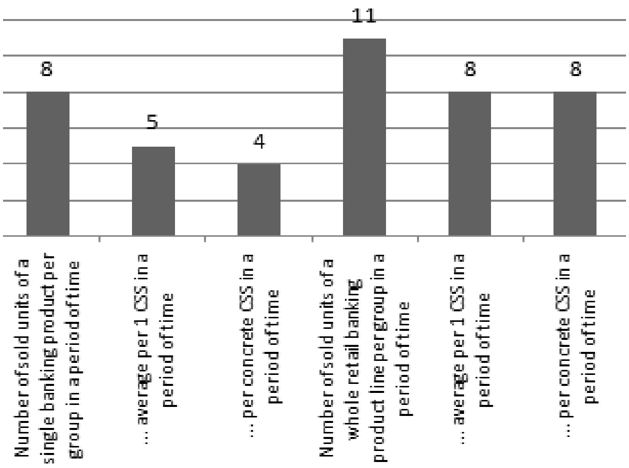

Fig. 4. Plan Targets for a Bank Branch (Viewpoint of Bank Employees)

The respondents' opinions were divided in this matter. However, the fourth measure (number of sold units of retail banking product line per group) was considered as a most appropriate by a plurality of votes. Actually, this is a rather fair measure. The selling results in banking largely depend on the location of a business group and social classes of customers. It is easy to expect a large number of corporate customers in a micropolis, and the appropriate number of opened accounts for entities. In turn, it would be almost impossible in residential district.

The last questions of the questionnaires were related directly to operational level performance indexes. At first, it was offered to choose indexes that most properly evaluate group's performance. We focused only on financial, customer and learning&growth perspectives. We took as a basis the data of the previous research data (Fig. 1), but introduced some amendments. We removed high-level strategic measures and retained only operational indexes. Some indexes were substituted with the other measures. For instance, we replaced customer acquisition rate (New customers/ Existing customers) and customer retention rate (Customers at the end of the year / Customers at the beginning of the year, ignoring acquired customers) with another measure (New customers/Lost customers). On our opinion, this measure is universal and easier to be interpreted. Besides, we took some measures from the own business practice and added to the list (Fig. 5, Fig. 6, Fig. 7).

Both groups of respondents give the highest priority to the bank liquidity characterizing indexes. Today, in a period of global economic slowdown, the banks that have liquidity reserves take a very vantage place. However, the authors insist on using the index that reflects both money inflow and outflow. The volume of attracted capital simultaneously with big withdrawal does not guarantee increased revenues.

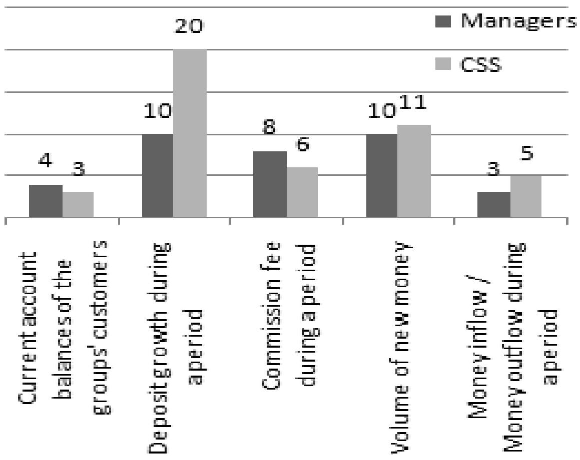

Fig. 5. Financial Measures

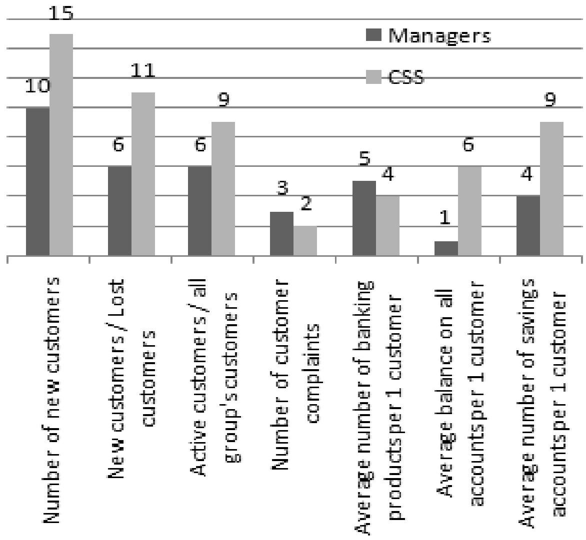

Fig. 6. Customer Measures

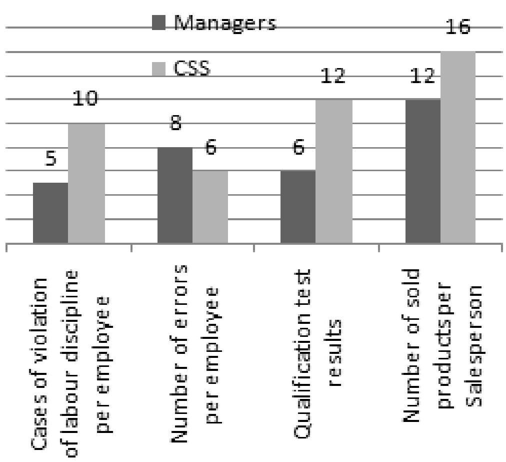

Fig. 7. Learning&Growth Perspective

As for customer measures, both managers and customer service specialists put more emphasis to the number of existing and acquired customers. However, as in the case of new money attraction, the number in itself does not matter. A person, who has opened a bank account, can be considered as a new bank customer, but this does not necessarily mean that the person will use this account. Thus, the number of customers increased, but this had no influence on bank performance result. The authors suggest using quantitative customer measures with monetary indicators.

As for learning&growth perspective, the authors offered four measures to be evaluated. The survey results prove the fact, that the questions of operational excellence are underestimated in our banks. The only quantitative measures of sales are in the focus. Tying of motivation bonuses to sales results yields insufficient respect for other measures from the part of employees.

The last task for respondents was to evaluate the importance of bank group's performance measures, using the numerical scale (0 – unessential for bank performance; 10 – critically important).

All the grades were reduced to the arithmetical mean value. The closer the mean value of the element to 10 the more important the given measure for performance evaluation from the viewpoint of bank employees. The elements in the table are ranked from the most important to the less important. The managers and employees were agreed on this matter. The same indexes are ranked among the first (Table 3).

Without reference to the results of the survey, it is clear, that the measurement system is integral part of business management. 17 from 25 customer service specialists affirmed that they need to be evaluated, because it helps them to perform their duties.

In conclusion, the authors suggest our developed model of objective tree for the bank customer service centre (Fig. 8). The objectives are supplemented by quantitative metrics from our conducted research.

The optimal number of measures for a business unit is in range from 15 to 20 (Kaplan, Norton 1993). We involved in our model 13 measures that can be complemented with the range of metrics related to specific banking products. Strategically important product lines for a bank condition the choice of these additional measures at each specific moment.

According to Norton and Kaplan (2000), the main strategies to achieve shareholders' value enhancing are *Revenue growth strategy* and *Productivity strategy*. As a main strategic goal for our hypothetical retail bank branch, we have chosen the purpose of increasing revenues.

Table 3. The Importance of Performance Measures (Viewpoins of Managers and CSS)

Measure	Range	Managers	Range	CSS
Term deposits	**1**	9,80	**1**	9,72
New money	**2**	9,67	**2**	9,64
Opened accounts for entities	**3**	8,6	**3**	8,84
Account balances	4	8,6	5	8,56
Commission fee	5	8,6	8	7,28
New customers	6	7,73	4	8,76
Administrative costs	7	7,73	10	6,64
Opened accounts for physical persons	8	7,33	6	7,68
Lost customers	9	7,07	9	7,08
Sold payment cards	10	6,6	7	7,6
Number of complaints	11	5,46	12	5,2
New internet bank users	12	5,07	11	5,68

5. Conclusions

In the current market environment the highest goal of any company, including financial institutions is creation and enhancing of shareholders' value.

To succeed in value enhancing strategy execution, it is extremely important to align performance targets with the overarching goal.

The most popular performance evaluation system is Balanced Scorecard, developed by D. Norton and R. Kaplan.

The balanced scorecard augments financial measures with objectives and metrics in three additional areas: customer relationships, internal processes, and learning and growth. The studying of international experience and the results of authors' conducted survey allow distilling the most appropriate performance measures for a business group of bank retail department.

In Latvian banks, the attention is mostly focused on financial and customer measures. Tying the system of remuneration only to selling results leads to the underestimation of other measures. It may be followed by increased number of technical errors and, finally, by depreciation of service quality.

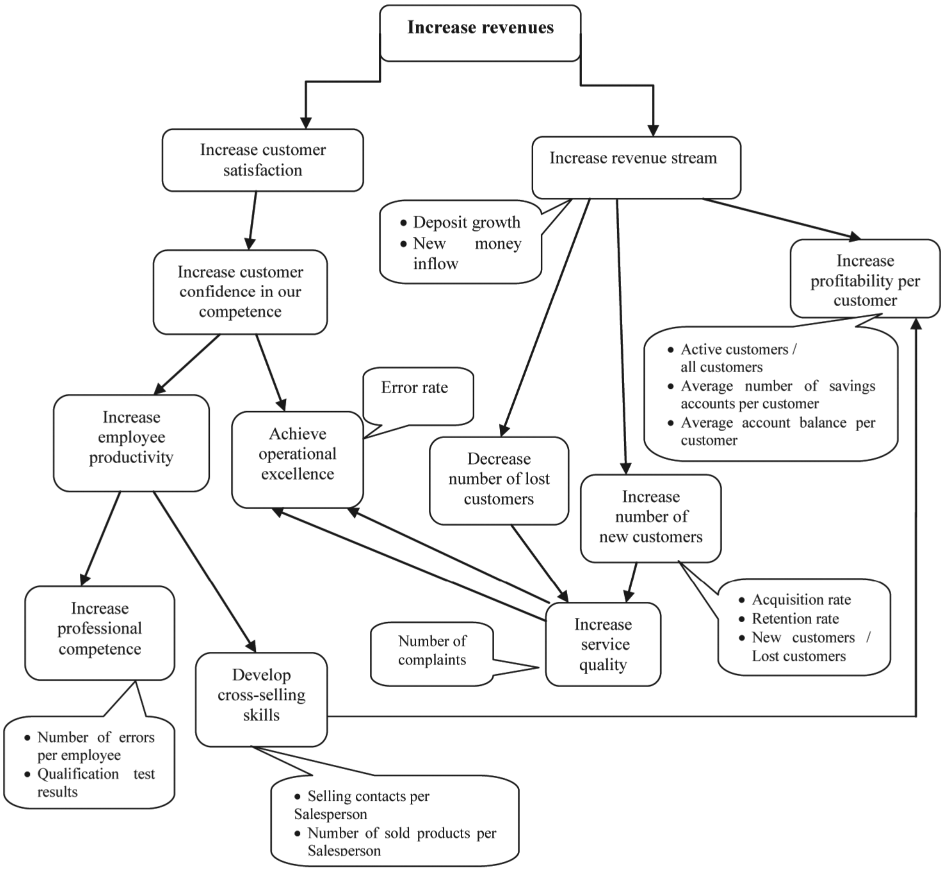

Fig. 8. Objective Tree for a Bank Customer Service Center (Strategy of Revenue Growth)

Considering the survey data and the experience of successful BSC adopters, the authors developed the objective tree with quantitative metrics for the customer service center of a retail bank. This model can be used as a framework for constructing the performance evaluation system for business groups in Latvian commercial banks.

References

Bidmead, N.; Massoud, G.; Romanowski, P. 2007. Bank Branches that Meet Customer Needs, *McKinsey Quarterly* August 2007 [online] [accessed 10 December 2009]. Available from Internet: <http://www.mckinseyquarterly.com/Bank_branches_that_meet_customer_needs_2040>.

BSCEE Group. 2008. BSCEE Review 2008 [online] [accessed 15 December 2009]. Available from Internet:<http://www.bscee.org/bins/2008_BSCEE_REVIEW_tcm23-11743.pdf>.

Copeland, T.; Koller, T.; Murrin, J. 2002. *Valuation: Measuring and Managing the Value of Companies.* Second edition. New York: John Wiley & Sons, Inc. 576 p. ISBN 0-471-00993-8.

Fisher, I. 1930. *The Theory of Interest* [online] [accessed 10 November 2009]. Available from Internet: <http://www.econlib.org/library/YPDBooks/Fisher/fshToI.html>.

Helfert, E. A. 2000. *Techniques of Financial Analysis: A Guide to Value Creation.* Tenth edition. Boston: Irwin McGraw-Hill. 640 p. ISBN 0-07-229988-6.

Heskett, J. L.; Jones, T. O.; Loveman, G. W.; Sasser, W. E.; Schlesinger, L. A. 2008. Putting the Service-Profit Chain to Work, *Harvard Business Review* July–August: 1–13. [online] [accessed 15 December 2009]. Available from Internet: <http://hbr.org>.

Johnson, C.; Beiman, I. 2007. *Balanced Scorecard for State-Owned Enterprises: Driving Performance and Corporate Governance.* Manila: Asian Development Bank. 136 p.

Kaplan, R. S.; Norton, D. P. 2008. *The Execution Premium: Linking Strategy to Operations for Competitive Advantage.* Boston: Harvard Business School Press. 320 p.

Kaplan, R.S.; Norton, D.P. 2003. *Strategy Maps: Converting Intangible Assets into Tangible Outcomes.* Boston: Harvard Business School Press. 512 p. ISBN 1-59139-134-2.

Kaplan, R. S.; Norton, D. P. 2001. *The Strategy-Focused Organization: How Balanced Scorecard Companies Thrive in the New Business Environment.* Boston: Harvard Business School Press. 416 p. ISBN 1-57851-250-6.

Kaplan, R. S.; Norton, D. P. 2000. Having Trouble with Your Strategy? Then Map It, *Harvard Business Review* 5165: 45–53.

Kaplan, R. S.; Norton, D. P. 1993. Putting the Balanced Scorecard to Work, *Harvard Business Review* 4118: 6–19.

Lee, P. 2009. Investors and Long-term Value for Shareholders, in A. Black, A. (Ed.) *Questions of Value: Master the Latest Developments in Value-Based Management, Investment and Regulation*. London: Pearson Prentice Hall, 5–19.

Neilson, G. L.; Martin, K. L.; Powers, E. 2008. *The Secrets to Successful Strategy Execution* [online] [accessed 10 December 2009]. Available from Internet: <http://www.booz.com/media/file/The-Secrets-to-Successful-Strategy-Execution.pdf>.

Reh, F. J. 2009. *Key Performance Indicators (KPI).* [online] [accessed 12 December 2009]. Available from Internet:<http://management.about.com/cs/generalmanagement/a/keyperfindic.htm>.

Rigby, D. K. 2009. *Management tools 2009: An Executive's Guide.* [online] [accessed 3 November 2009]. Available from Internet: <http://www.bain.com/management_tools/Management_Tools_and_Trends_2009.pdf>.

Sinkey, J. F. 2007. *Commercial Bank Financial Management*. Sixth edition. Upper Saddle River, NJ: Pearson Prentice Hall. 1018 p. ISBN 0-13-090910-6.

Vries, B.; Groen, W. P. 2009. *The European Banking Sector and the Co-operative Banks: Economic Research Department* [online] [accessed 15 December 2009]. Available from Internet: <http://www.reportlinker.com/d010276730/Banks-trends-in-Western-europe.html>.

Никонова, И.; Шамгунов, Р. 2007. *Стратегия и стоимость коммерческого банка* [Strategy and Value of Commercial Bank]. Third edition. Moscow: Alpina Business Books. 304 p. [Nikonova, I.; Shamgunov, R. 2007. Strategija i stoimost' kommercheskogo banka, Third edition. Moscow: Alpina Business Books. 304 p.]

Тютюнник, А. В.; Машонская, К. И. 2009. Система сбалансированных показателей в банке – миф или необходимость? [Balanced Scorecard System in a Bank – Myth or Need?] *Управление в кредитной организации* [Governance in a Credit Institution] 3: 4–8. [Tjutjunnik, A. V.; Mashonskaja, K. I. 2009. Sistema sbalansirovannyh pokazatelej v banke – mif ili neobhodimost'? *Upravlenie v kreditnoj organizacii* 3: 4–8.].