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Management Accounting in Achieving Competitive Advantage and Bank Controlling

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Our aim in this paper is to present a relatively complete theoretical and practical accounting system intended to meet the needs of strategic decision-making in banks, which acts in the form of managerial accounting to adress the internal and the external environments in which the bank operates. In the complex economic circumstances, strategicaly oriented management accounting becomes a very important factor for successful long-term bank operations. Strategic management accounting focuses upon the analysis of the management accounting data of the company and its competition to identify and monitor business strategies.

Introduction

In the current conditions of business doing the critical competence of the bank's strategic management is the ability to generate value for the bank owners and for the users of bank products. In order to survive in today's turbulent market, the bank has to change at a faster pace compared to its competition. A long-term prospect requires that the bank activities should be focused upon external factors, one of the most important among them being achieving competitive advantage. The modern information system of the bank becomes a key factor in enhancing strategic decision making and increasing control for the purpose of improving business efficiency. Competition becomes an increasingly important challenge to the bank.

The managers are expected to make the best and safest decisions for the bank's strategic position. The management of the bank is responsible for the development and policy enforcement, and the procedures oriented towards the managing board goals.

The changes on the market and in the competitive environment require that the existing system be redesigned to a significant extent to suit the needs of strategic management of the bank, special attention being paid to building a flexibly dimensioned management accounting. There is a high level of correlation between accounting reports and an efficient bank management.

Management (or: managerial) accounting has to be continually tested in view of its contribution to a successful performance of managerial functions in banks, that is, successful achievements of strategic goals, especially from the point of view of their contribution to the vision of the future business flows in the bank, as regards provision of adequate information to define various managerial models.

Our aim in this paper is to present the possibilities of strategic management accounting implementation in the bank. Also, we will discuss information potentials of management accounting in view of achieving competitive advantage, the strategic importance of bank controlling, as well as highlight important aspects of organizing profit centres in banks.

1. Management accounting system in planning and measuring financial performance

The concept of strategy means the implementation of a formal system of information management. Achieving goals requires that information be analysed in the decision making processes. If the strategic decision is a structured and planned enterprise, it will draw due attention. It is necessary that the management should proactively identify internal and external strategic strengths and threats, without ruling out the chances for strategic innovations. Managers are assumed to formally analyse competitive advantages and a meaningful assessment of resources allocation and use them as part of the development strategy. Such an analysis will be provided by formal information systems. The strategic management accounting is a useful tool managers can apply in making quality business decisions.

Strategically oriented management accounting is expected to ensure a powerful information support that would allow for implementing prevention measures in order to eliminate ineffective outcomes in the bank's business operations. It is necessary that the bank should be capable of successfully managing unexpected, unplanned changes in the financial sources, which require accounting calculations, which all lead to a conclusion that the bank responds to market changes in an adequate manner.

A major cause of necessary change are the dynamic changes in the external environment, and this demands that the collaboration between strategic managers and management accountants be close, especially in the sector of cost tracking and analysis, as well as in cost projection. Besides, a strong information support in the field of mesauring the profitability of individual bank products and changes in the bank's key clients is of great importance.

Strategically oriented management accounting is a multi-purpose information source oriented towards the management and towards the future, focused upon strategic business units. *Simmonds* defined and described strategic management accounting oriented to the company benchmarking in view of its competition [10]. He promoted collecting information required to define the market share, the competition price, costs and scope. The bank that monitors market share can measure to what extent it may achieve or lose competitive position.

As regards the fact that the strategic development of the bank is directly connected with the bank's development plans, it is necessary to stress that strategic planning is directly dependant on the management accounting information. In other words, it is necessary that a high level of coordination should be achieved between the planning and the reporting activities.

Given that the market environment is becoming increasingly dynamic and competitive, banks are forced to continually improve their activities in terms of anticipating their future business operations as accurately as possible, if they want to do business successfully. Namely, banks can no longer afford any incongruence between anticipated incomes and expenses. A growing importance of the budgeting processes in the banks makes the need for a detailed reporting system an increasing necessity.

In order that a proper design of a strategically oriented management accounting should be achieved in banks, we propose the *model* presented in Figure 1.

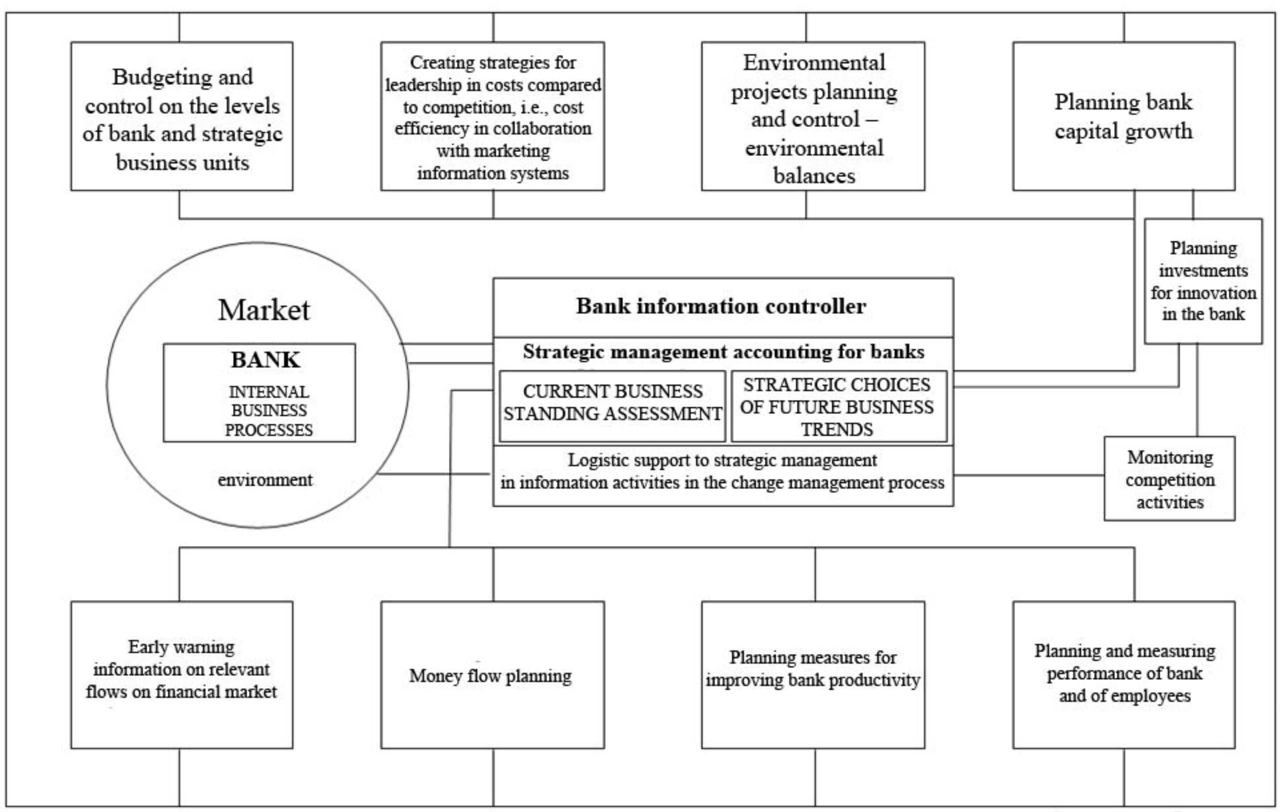

Figure 1. *Strategic management accounting dimensioning model in banks*

The information model of strategically oriented management accounting in banks presented above is meant to support identifying, analysis and interpretation of all relevant information that the management use as the basis to define strategic management goals, which in turn are written in strategic plans, in view of the accounting aspect in the bank's budget. Furthermore, quality and transparent information are meant to allow for the control, as well as for corrective actions in case any deviations occur as regards the planned values. The proposed model should support change in the market environment the bank does business in, especially for the purpose of achieving competitive advantage.

Strategic planning is a process of defining the development strategy of the bank, as well as the process of decision making in order that the adopted strategy should be implemented. It is of crucial importance for any bank to define the direction it should follow. The strategic plan is the basis for designing the operations plan which is generally devised for a period of one year. Organizational activities are undertaken to shape varied interests, including the bank, the specific strengths, as well as institutional pressures.

The strategic plan of the bank consists of two sections: qualitative and quantitative. The qualitative results section includes the analyses of the macroeconomic scenario, the SWOT analysis, the company's mission, the strategic guidelines and the action plan that serves to achieve the plans defined. The quantitative results section comprises the implementation of financial methods and models in the strategic management of the bank's finances. The strategy the bank has selected has to be translated into a succession of goals.

<u>In order that the strategy should be implemented, three issues have to be resolved:</u>

1. Which performance dimensions the banking institution tends to develop?

2. How the goals will be set in an adequate manner?

3. Which rewards and/or penalties should be linked to the achievement of the performance standards?

Strategic bank performance management can be described as an activity of managing the bank solvency in order to define the optimal ratios, on two levels: maximizing the returns and meeting the requirements of regulatory institutions focused upon the preservation of the banking system stability, at minimum risk in business operations. This is, however, far from easy to achieve in practice, as the goals are basically opposite: larger returns means taking greater risks and vice versa.

Orienting the bank's business operations towards the realization of the strategic performances of the bank is a rather complex process, due to the opposing goals of the bank's shareholders and bank's depositaries. The information horizons of management accounting in the realization function is extended to the following strategic goals of the bank:

- Identifying opportunities and weaknesses from the aspects of cost component (bank product price), relative market share and the amount and structure of the fees and commissions;

- Trends in expanding or narrowing the bank's scope of business on the national or foreign markets, in the domain of financial indicators;

- Comparison of achieved strategic goals and tasks with the planned ones; types and causes of deviations, and taking corrective measures to eliminate negative deviations.

The role of performance measures in the organization is a critical one, both in testing how efficient the banking institution is in achieving short-term goals, and in identifying necessary improvements. For the purpose of the financial performance analysis it is necessary that financial projections are set on the balance sheet and income statement positions with anticipated trends, as well as the projection of the following business performance indicators:

<u>a) Indicators of bank's capability of earning income</u>:
- Returns on Assets (ROA) ratio;
- Return on Equity (ROE) ratio;

<u>b) Indicators of interest margin</u>:
- Interest bearing assets / total assets;
- Average interest rate on interest bearing assets;
- Average interest rate on interest bearing liabilities.

<u>c) Indicators of capital adequacy</u>:
- Total capital / total assets;
- Capital assets / total assets.

<u>d) Indicators of growth rates</u>:
- Total assets growth rate;
- Interest bearing assets growth rate,
- Credit growth rate;
- Deposit growth rate;
- Income frowth rate;
- Profit growth rate

e) Solvency indicators:

- Total credits / deposits;
- Total credits / deposits +capital.

f) In addition to the rate of returns on equity capital of the bank the following indicators are used in assessment of the bank's ability to earn and the quality of returns:

- Yield difference from other revenues and other expenditures;
- Yield before extra items and tax.

g) Other important indicators: [1], [7], [8]

- (Current deposits – Previous deposits) / Previous deposits;
- (Current credits – Previous credits) / Previous credits;
- Debts / Net value;
- Low credit quality / Low credit quality and discount;
- Credits / Deposits;
- Regulatory capital / Risk weghted assets;
- Revenues from sales / Number of employees in the bank;
- Profit before tax / Number of employees in the bank
- Net interest profit /average earned assets from interest;
- Reservations for credit losses / Average credit portfolio;
- General expenditures and reservations for losses / Average total assets;
- Operations expenditures / Average (assets);
- Regulatory capital / Risk weighted assets.

Strategically important is the analysis of the bank's market share in individual segments (e.g., short-term dinar deposits and foreign currency trading). Also important is the analysis of the bank's strategic plan, both from the aspect of the amount of investment into information system and from that of expanding branches, in order that proper estimates should be made on the future growth and strengthening the bank's market position.

Strategic management accounting is expected to provide a large number of indicators as regards the position of the competition, with special attention paid to market leaders, close and *slow* competitors. The reduced market share indicates the loss of the bank's competitive position, with the implications of the future fall in profits, whereas the increase in the market share indicates the improvement of the competitive position with prospects of increasing profitability in the future.

The *Balanced Scorecard* concept is also worth mentioning in the context of strategic planning. It shows the intention to preserve the balance between the short-term and long-term goals, between financial and non-financial measures, as well as between lagging and leading indicators. Namely, the point is that the manager should lead the bank towards achieving strategic goals [3].

In the bank's business performance assessment it is important to define the criteria from a number of aspects:

First – Financial perspective: revenue management, market share, profitability capacities, assets management;
Second – Client's perspective: reach the client before the others, client profitability, client retention, specific financial services;
Third – Prospect of internal business process – information system creation, information support to management, maintaining business quality.
Fourth – Prospects for learning and professional development of managers: knowledge and development of managers, team work, policy of incentives and rewards.

It is also important to mention the role of bank controlling that is used for an adequate information communication in the bank, so that the variance between the set strategic and operations goals and the achieved results should be as small as possible.

An adequate cost management requires an assessment of alternative strategies or plans that display all costs. The design of an adequate information model of the strategic management accounting requires the engagement of a variety of experts: management accountants, experts in planning and analysis of business operations, financial and other bank managers, information technology experts, etc. Monitoring the activities of the competition, especially in the domain of achieved performance, can help the management team position the bank in the future in relation to its competition.

A significant support to the improvement of the business performance of strategic business units is expected from the bank's marketing manager. Marketing research allows for the estimates of the future outcomes and results that make it easier to take decisions on various opportunities of costs assessed in accordance with the corporate goals. The managers engaged in management accounting attempt to identify the competition cost structure and then price the bank products, taking care to neutralize inflation effects upon the variables they take into consideration [13].

An adequate assessment of prices set by the competition begins with the cost analysis and continues to analyse the impact of possible changes in prices upon other competitors on the financial market, which needs an accounting analysis. This is followed by an analysis of the scope of the market share. Naturally, the competitive advantage cannot be expressed only by one variable, but rather by a group of indicators that reflect the competitive picture the strategic management will use to control whether the bank goes in the right direction.

Information on the costs of the competition enables the bank to identify when the competitor tries to change a relative competitive position, e.g., to manipulate prices. The strategically oriented management accountant is expected to anticipate business events from a financial aspect, that is, to create the business vision of the bank using management accounting information.

In many fields concerned with environmental protection there is an increasing interest in transparent calculations and analyses that frequently include not only economic, but also financial calculations. On the business system level, the so-called *Environmental (protection) accounting* is recognized as a segment of financial accounting, however, also as a segment of management accounting of a strategic orientation. Especially important for the bank reputation is the social responsibility in terms of financing environmentally sustainable projects, financing project that improve energy efficiency etc. Hence it needs information as basis for forecasting, both financial and non-financial in character. The fact is that the bank competitive advantages are achieved primarily by improving the logistic service, which means a more adequate availability of the bank product, which is in turn preconditioned by reducing the costs to as low a level as possible, without affecting its value.

Changes such as new cost allocation methodologies, new approaches to the money value assessment and a larger share in the budgeting process have initiated a more intensive communication between managers and accountants. Banks today focus upon a more productive budget, oriented towards profit from product and reduced costs. Various information systems are implemented to different organizational levels. For example, in case of a five-year budget, profit planning and a five-year sales trend forecast, executives use the support systems – *Executive Information Systems*, whereas in case of the management-control level of the system for designing an annual budget and the analysis of capital investment and sales management, the management information system is implemented. On the same organizational level, in the analysis of profitability, expenditures and sales by regions, the *Decision Support Systems* are used. The accounting information system is part of the *Management Information System* and has the characteristics of a business information system that supplies various information to be used in achieving different goals.

Effective reports supported by adequate banking software on operations risk for the bank supply managers with detailed information necessary in strategic decision making. Such reports are also useful to the board of directors, the executive board, the operational *risk* managers and the executive *risk* managers and are of an early-warning character.

2. Bank controlling and bank strategy

The controlling in the bank is a type of information centre that synthetises and disposes of information important for the bank management, in order that the activities of organizational business units be synchronised and their goals be conformed to the general objectives of the bank. One of the earliest tasks of the controlling is the establishment of an adequate reporting system that is meant to provide information on the overall business operations of the bank.

The basic responsibility of the bank controlling is to create the infrastructure adequate to controlling attitude on all the levels of bank management, aware of the specific features of a particular bank, as well as ensure the implementation of controlling. In accomplishing this task, we recognize four significant segments of the bank infrastructure employed in the real bank controlling, as presented in Figure 2 [4].

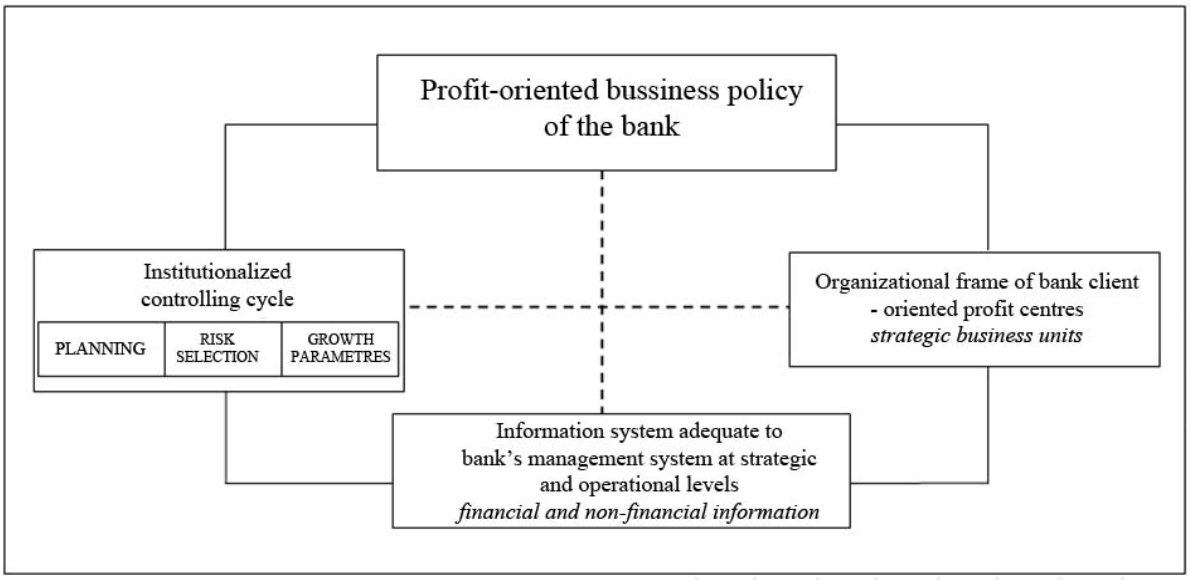

Figure 2. *Bank controlling instruments*

The key issue for the management of any organization is „how good is its performance“?

A profit orientation in the business philosophy, as basis of the controlling system, can be equalled to the bank management concept that puts profits into the focus of consideration in the business policy creating process. Only in this case can the controlling systems act efficiently.

Strategic business units are partly autonomous units responsible for their own budgeting, and the business strategy implementation that should be adjusted to the broader corporate strategies. In this sense, the following is expected from the institutionalized cycle of bank controlling:

Firstly, to formulate the strategic and operational goals underlying the profit oriented business philosophy and translate them into strategic and operational plan values;
Secondly, to systematically compare the achieved values with the planned values, on all the planning levels, and perform an analysis of deviation trends in the segments in which they are identified;
Thirdly, to assert or state precisely, from an organizational aspect, who is responsible for the planning, what should be planned, when and with which tools planning should be carries out and controlled.

The bank controlling system is simultaneously a managerial system where the activities of planning and control are not conducted in an isolated way, but are integrated into a complex hierarchally structured regulation model, Figure 3.

The strategic bank controlling is a complex function that, in addition to planning, performs a selection of risks immanent to banking business, by which the reality and planning processes are simplified. All the bank profitability components as well as the risk and growth parametres that affect them are the referent points in the strategic controlling process, viewed in a long-term period. Hence it is important that risks are adequately identified so that the manner in which they will be measured (e.g., quantitative/qualitative), as well as the risk measuring method should be defined.

3. Profit centres as strategic business units in the bank

An important corner-stone of an adequately controlled infrastructute is the organizational structure of a bank since, in addition to pursuing a definite idea, there must be a concrete organizational framework within which the profit-oriented business philosophy on the market can be transformed. Here, decisions are primarily made as to the organizational principles by which individual sectors of a company are divided, and later coordinated again in their activities and also to what extent the decision authority should be delegated to lower management levels. Within one controlled *Controlling* system for credit providing institutions a client-oriented organization of profit centres is proposed, with a large-scale decentralisation of decision making, since it is generally compatible with requirements directed towards the

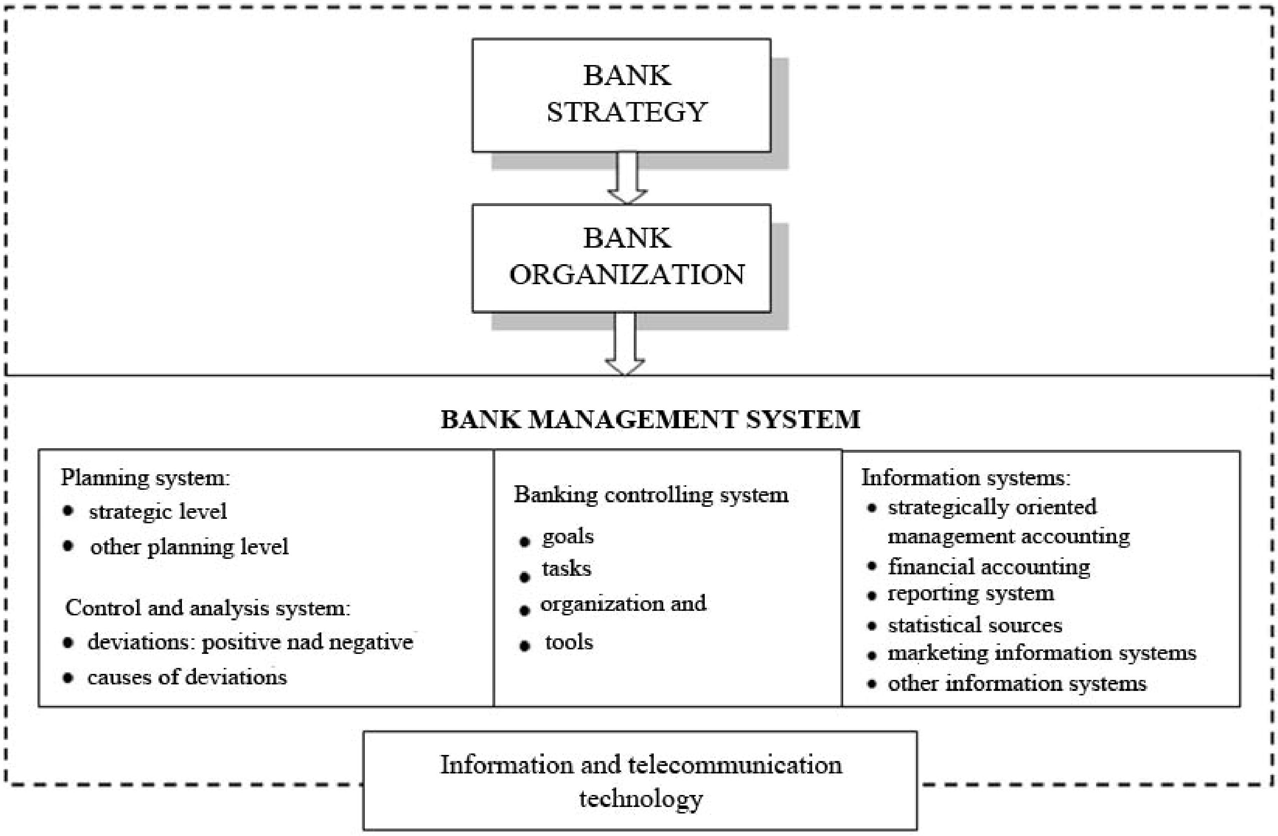

Figure 3. *Institutionalized bank controlling cycle*

organizational transformation of the concept focused upon profitability in bank management.

Strategic business units can also be viewed as organizational units with an access to competitive strategies. The key precondition for the compatibility of objectives between the managers of strategic business units and the goals of the banking institution as a whole is the definition of an adequate policy of financial incentives for the achieved business performance. The manner in which a strategic business unit will ensure a competitive advantage, achieving the goals of the bank at the same time, is defined by the strategic business unit plan. Strategic business units may be organized as profit centres that are the operational generators of the bank profits. A branch operates as a *profit centre* within the bank and has a responsibility to observe the principles of solvency, liquidity and profitability in its work. For example, one national bank has the following profit centres: (1) Profit centre – *solvency assets*, (2) Profit centre – l*oans and investments*, (3) Prrofit centre – *retail operations*, (4) Profit centre – *external economic relations* and (5) Profit centre – *marketing*.

The client oriented organization of profit centres provides the organizational structure for a market field that raises the orientation towards clients to a ruling organizational principle. Here the market fields are arranged according to the client characteristics (not according to income) since it is only in this way that a congruence is reached between the performance hierarchy and the company hierarchy, which means that individual performances of the bank institution sectors can be summed up to an aggreagate that in their own sum conclusively present the total bank performance, without disturbing the responsibility for a complex market performance. The client orientation especially means that the client himself is viewed as a ruling source of choice. If the organizational structure should follow the path of the bank success, it becomes oriented towards clients as well, i.e., towards their needs. Thus the organizational framework has to be "built around the clients". Namely, it is important to "entice the client before the others (competition). The clients of the bank are regarded as client-firms (standardized performance, individual performance and specific target groups). The reports today require a more intensified role of the financial control that should play a proactive role in the communication with all the managers in order that it should explain the reports per centralized fields of responsibility as well as per performance for selected groups of clients and offer answers to a large number of questions. Control is a complex process the purpose of which is that the bank management should see whether the decentralized units achieve the defined goals. The control process is conducted by the short-term measurements of the achieved financial performances and redirecting activities in case discrepancies appear between the real and the desired positions.

Conclusion

A new, dynamic role of the bank in a complex environment requires that the management develop a system of strategically oriented management accounting as a support to the strategic planning of the bank growth and development, i.e., to the strategic decision-making. The management accounting system in a competitive environment has to support the bank strategy which is not possible to accomplish if the elements of strategically oriented management accounting are not part of it. The focus is upon a strong connection between the management accounting and the bank strategy.

Marketing is to diagnose external market situations and communicate them to the strategically oriented management accounting. Everything is subject to change, the flow of events takes different courses. In order that these courses direct the events in an efficient manner, it is necessary that bank managers dispose of valid information on the force of changing conditions that impact or will impact the events, both in the bank itself and in the environment in which it operates. The reports today require that the role of financial control be intensified so that it should take a proactive role in the communication with all managers to interpret the reports and give answers to different questions.

The strategically oriented management accounting is no revolutionary information model made up for the needs of management. It is rather a long-lasting systemic process that is continually adjusting and modifying to suit the changes in the bank, and especially in the environment in which the bank operates, and also to meet the information needs of the strategic management. There is no universal information concept or model of a strategic character for the needs of the management that could be used to provide valid solutions to all management problems in a long-term. Namely, it is difficult to anticipate the behaviour of financial institutions in a turbulent environment. An increased competition and the innovation level of bank products can be viewed as generators of bank development.

The knowledge of a relative market share and the cost structure allows for assessment and decision making in the light of the possible reactions of the competition.

Not only should the bank be compared to its competitiors, but the advantages of its products should be assessed from the point of view of both its clients or users and the bank itself. Information used to make strategic decisions will have to be future oriented, not based on the past costs and the ability of adjusting to the changes on the financial market.

Banks can organize themselves into strategic business units on the basis of critical activities, accumulate accounting data for each of the activities, where they have to create reports for each of the strategic business units.

In the dynamic business conditions, in the conditions of economic crisis and in the conditions of general competition, the strategic information becomes the major driver of the bank's growth and development. Especially important indicators used to measure the bank's business performance are the following: returns on equity, returns on property (capital), net interest margin and earnings through commision.

The bank controlling concept emerged as a need to empower the management system oriented towards an integral profitability and risk management, and ensure the stability of the bank as a financial institution. Financial institutions are subject to permanent pressure to retain their clients, to manage risk in an adequate manner and to implement modern technologies as source of their competitive advantage. The market objectivity of the bank initiates change towards the innovation growth in the banking business, as well as towards the development of information systems to enhance the bank management. Strategic controlling is a type of logistic support to the bank top management, as it aids the bank to fulfill its mission and goals. It enhances the development of an integral information system and its basic segment – strategically oriented management accounting.

An important issue of a further bank growth and development in this country is creating an efficient and rational system of information circulation, so that they should be timely processed and implemented in the business decision-making process. Current practice has shown that so far, these problems have not been paid due attention in our banks; consequently, the quality of much information, especially the strategically significant information, permanently lagged behind the real needs of the bank management for an efficient and effective real-time decision making.

In view of the current situation in our banks, it is necessary that conditions should be first created for an adequate integration of the management accounting system into the bank's information system, and then allocated a strategic dimension. Banking institutions should measure exact *outputs*, as well as any other *outputs* that may have an impact upon the bank.

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