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Thesis in the area of Management Control

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THE MANAGEMENT CONTROL PROCESS  
IN SPAREBANK 1 RINGERIKE

By

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This thesis was written as a part of the siviløkonom-degree program/master program. Neither the institution, the advisor, nor the sensors are - through the approval of this thesis - responsible for neither the theories and methods used, nor results and conclusions drawn in this work.

## **ABSTRACT**

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The bank market has in recent years undergone several structural changes, and will most likely develop further in future years. Traditionally savings banks have been reluctant to carry out necessary actions to adapt their businesses to the new challenges. With this in mind, we have performed a comprehensive analysis of the Management control process in Sparebank 1 Ringerike.

We have investigated how their current process is suited to face the challenges of a changing market from an interactive and diagnostic view. The thesis thus starts with a presentation of management control theory with an emphasis on interactive and diagnostic control as well as two control systems; the budget and the Balanced Scorecard. It goes on to describe the current Management control process in the bank. The analytical part is concerned with relating this process to the normative theory, and proposes a solution to the gaps found.

During this work we discovered that both the Diagnostic and especially the Interactive process in the bank have considerable shortcomings when compared to the normative processes as presented in the theory. In the Interactive process these are especially related to the lack of involvement of the employees for various reasons. In the Diagnostic process we mainly criticize the use of the budget as a control system. In total the Management control process do not function optimally, a problem on which we have strived to find a solution.

## **ACKNOWLEDGEMENTS**

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Writing a thesis in the field of management control, and thereby getting the chance to perform a practical execution of the theory we have studied, has been of great interest to us. Considering our practical inexperience, we are very appreciative to the people who have helped us in the process.


We sincerely express our gratitude to our supervisor Mr. Trond Bjørnenak. Although we did not - as you expressed it - "run down your door", we appreciate the advices you have given us. We are especially grateful for the direction you gave us when we needed it the most.

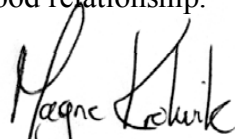
Considering the problem statement of the thesis, one understands the impossibility of gaining any value of it without first hand information. Our sincere thanks go to the Vice President in the bank, Mr. Steinar Haugli. Without your help through phone calls, e-mails and several meetings, we could never have written a thesis with this problem statement. You have not attempted to hold back any information, but provided us with the chance to obtain knowledge from internal documents and meetings, in addition to introducing us to your work and thoughts.

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**CONTENT**

---

**ABSTRACT** 2

**ACKNOWLEDGEMENTS** 3

**CONTENT** 4

**PART I - INTRODUCTION**

1.1 Background for the thesis.....8

1.2 Challenges for Savings Banks .....8

1.3 Problem statement.....9

1.4 Structure of the thesis .....10

1.5 Sources and methods.....10

**PART II – THEORY**

*2 Management control..... 11*

2.1 Traditional approach .....11

*3 Management control systems..... 12*

3.1 Interactive control .....12

3.1.1 The model.....13

3.2 Diagnostic Control Systems .....15

3.3 The use of management control systems.....17

*4 Budgeting..... 18*

4.1 Budgeting and interactive control.....18

4.2 Budgeting and diagnostic control.....19

4.2.1 The budget’s role in an effective diagnostic operation.....20

4.3 Anti-budgeting .....21

4.4 Making accounting systems more relevant .....22

<b>5</b>	<b><i>The Balanced Scorecard</i></b> .....	<b>23</b>
5.1	<b>The Balanced Scorecard framework</b> .....	<b>23</b>
5.2	<b>The Balanced Scorecard as a diagnostic control system</b> .....	<b>26</b>
5.3	<b>The Balanced Scorecard as an interactive control system</b> .....	<b>27</b>

## **PART III – DESCRIPTIVE**

<b>6</b>	<b><i>Sparebank 1 Ringerike</i></b> .....	<b>30</b>
6.1	<b>The foundation for Sparebank 1 Ringerike</b> .....	<b>31</b>
6.1.1	Vision.....	31
6.1.2	Values .....	31
6.1.3	Business idea.....	32
<b>7</b>	<b><i>Integration</i></b> .....	<b>32</b>
7.1	<b>Sparebank 1 Alliansen</b> .....	<b>34</b>
7.2	<b>Sparebank 1 Gruppen AS</b> .....	<b>34</b>
<b>8</b>	<b><i>Market and Competition</i></b> .....	<b>35</b>
8.1	<b>Sparebank 1 Ringerike’s view on the market and their position</b> .....	<b>35</b>
<b>9</b>	<b><i>The Management control process in Sparebank 1 Ringerike</i></b> .....	<b>36</b>
9.1	<b>Strategic control systems</b> .....	<b>36</b>
9.1.1	The Strategy document for Sparebank 1 Gruppen.....	37
9.1.2	The Board seminar .....	38
9.1.3	Action plans for focus areas .....	39
9.1.4	Budget and Plans.....	40
9.1.5	Accounting and Variance analysis.....	42

## **PART IV – ANALYSES**

<b>10</b>	<b><i>The Strategy document from Sparebank 1 Gruppen</i></b> .....	<b>44</b>
10.1	<b>Business strategies</b> .....	<b>45</b>
10.2	<b>Strategic uncertainties</b> .....	<b>45</b>
10.3	<b>Debate and dialogue</b> .....	<b>47</b>
10.4	<b>Conclusion</b> .....	<b>48</b>

<b>11</b>	<b><i>The Board seminar</i></b> .....	<b>48</b>
11.1	<b>Business strategies</b> .....	<b>49</b>
11.2	<b>Strategic uncertainties</b> .....	<b>50</b>
11.3	<b>Debate and dialogue</b> .....	<b>51</b>
11.4	<b>Conclusion</b> .....	<b>52</b>
<b>12</b>	<b><i>Action plans for Focus areas</i></b> .....	<b>53</b>
12.1	<b>Strategies and Strategic uncertainties</b> .....	<b>53</b>
12.2	<b>Interactive control system</b> .....	<b>54</b>
12.2.1	Signalling of strategic uncertainties .....	54
12.2.2	Cause-and-effects .....	55
12.2.3	Benchmarking .....	56
12.2.4	Bonuses .....	57
12.3	<b>Debate and Dialogue</b> .....	<b>58</b>
12.4	<b>Conclusions</b> .....	<b>59</b>
<b>13</b>	<b><i>Budget, Accounting and Variance analyses</i></b> .....	<b>60</b>
13.1	<b>The interactive Budget process</b> .....	<b>60</b>
13.2	<b>The diagnostic Budget process</b> .....	<b>62</b>
13.2.1	Setting and negotiating goals .....	63
13.2.2	Aligning performance measures .....	64
13.2.3	Designing incentives .....	65
13.2.4	Reviewing exception reports .....	66
13.2.5	Following up on significant deviations .....	66
13.3	<b>Summing up</b> .....	<b>67</b>
13.4	<b>A critical view on the criticism</b> .....	<b>68</b>
<b>14</b>	<b><i>Linking it all together</i></b> .....	<b>70</b>
14.1	<b>Links</b> .....	<b>70</b>
14.1.1	The links within the interactive process .....	71
14.1.2	The Interactive process linked to the Budget process .....	71
14.2	<b>Shortcomings in the Management control process</b> .....	<b>73</b>
14.2.1	The Interactive process .....	73
14.2.2	The Diagnostic process .....	73
14.2.3	Why shortcomings .....	74

<b>15</b>	<b><i>The Balanced Scorecard – the solution?</i></b> .....	<b>75</b>
<b>15.1</b>	<b>Does the Balanced Scorecard fit in the organization?</b> .....	<b>75</b>
<b>15.2</b>	<b>How can the shortcomings be improved by the Balanced Scorecard?</b> .....	<b>76</b>
15.2.1	The interactive shortcomings .....	76
15.2.2	The diagnostic shortcomings.....	78
15.2.3	Value for the Interactive process .....	79
15.2.4	Value for the diagnostic process .....	79
<b>15.3</b>	<b>Conclusions</b> .....	<b>79</b>
	<b>CONCLUSIONS</b>	<b>81</b>
	<b>CLOSING NOTE</b>	<b>83</b>
	<b>REFERENCES</b>	<b>84</b>

## **PART I - INTRODUCTION**

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### ***1.1 Background for the thesis***

This thesis is written as a part of the Siviløkonom degree at the Norwegian School of Economics and Business Administration (NHH). We have both specialized in the field of Management Control; hence this was the natural area for our thesis.

Management control systems used both interactively and diagnostically have been emphasized thoroughly in the specialization courses we have attended. This has led to an interest in the field from our point of view. Knowing that a thesis on this subject would require a great deal of information of strategic art, we chose to contact an organization Magne knows well. From Sparebank 1 Ringerike (SB1 Ringerike) we would get all the necessary information of both primary and secondary art, making it an easy choice to dive into their Management control process.

### ***1.2 Challenges for Savings Banks***

The market conditions for savings banks have gradually changed in recent years. Factors like technological development, deregulations, internationalization and changing customer behaviour have contributed to the increase of competition in the bank industry. The barriers of entry are reduced, giving foreign banks and other institutions the possibility to compete with the existing banks in the market.

Customers have got more options, and are more likely to end their relations with their bank and switch to a bank providing them with services of a more desirable level. Customer responsiveness to advertising is increasing, and the amount spent on advertising in the bank industry has increased accordingly. The technological development and the increased competition have also put pressure on the need to reduce costs. Consequently the needs to gain advantages through economies of scale and scope have led to a consolidation in the industry, through mergers, acquisitions and alliances. Additionally the macroeconomic factors have been important for the focus of savings banks in recent years. There has been a considerable pressure on net interest margins; the difference between the interest on loan and the interest on customer's deposits.



These factors question the feasibility for the savings banks to apply an exclusive focus on traditional banking. Incentives for banks to look at new ways to create value for existing and new customers through differentiation evolve. As the complexity of the market conditions increases with the rate of innovations, the competence of the employees are of higher importance. To succeed in this changing environment the savings banks need to exploit their knowledge and competitive advantages. They need to be aware of, and comprehend, the changing market conditions, and the way these are affecting their performance.

### ***1.3 Problem statement***

The challenges discussed above are as much of importance for SB1 Ringerike as for other savings banks. They face a changing environment and an increased pressure from new and more powerful competitors. Wanting to secure the investments of their owners, they need to search for new and profitable products and markets and be sure that their operations are on track. Consequently, a well functioning management control process is required. We have chosen the following problem statement:

*How can Sparebank 1 Ringerike customize their Management control process to a changing environment?*

We have elected to adopt such a broad problem statement to provide the bank with a comprehensive assessment of their Management control process.

In the search for new products and markets they need to continuously monitor the opportunities and threats in the market. In order to do this successfully they need a well functioning interactive process. We thus aim at answering the following questions; how is the current Management control process interactive? What can be done to improve the interactivity?

To secure that their operations are on track, they need a well functioning diagnostic process. Since the bank already has adopted the Budget accompanied by the Accounting and Variance analyses to take care of this matter, we aim at answering: Is this traditional Management control process suitable for such a purpose, and if so; is the bank realizing their full diagnostic potential?

## ***1.4 Structure of the thesis***

The focus in this thesis is on the Management control process. Therefore we find it natural to start with some theory on this topic in Part II. Control systems are a vital part in this, and we will give a thorough description of the theory on both interactive and diagnostic control systems as well as guidelines on how these should be utilized. Then we will go on to describe two control systems. Here we have chosen to present the budget which is in use in the organization today, and the Balanced Scorecard (BSC) which the bank already has some knowledge of, and are contemplating to implement in the organization. We aim to illustrate how these systems are best utilized in a management control process, thereby providing us with a normative foundation for later analyses.

In Part III we will give a detailed description of the bank, with a focus on their Management control process; the strategy development and the control systems used. All this leads to the analyses in Part IV, where we will try to point out the gaps between the theoretical correct management control processes as described in Part II and the way SB 1 Ringerike currently is organizing their Management control process. Then we will try to discuss what the bank can do to close these gaps, and to which extent the BSC is useful to this purpose. We will close with an assessment of our work on this thesis as well as some suggestions for future investigations.

## ***1.5 Sources and methods***

When describing theory we have used lecture notes as well as various books/articles. The works of Simons, Kaplan, Norton and Wallander have been especially useful to us. The information for the descriptive and analytical part of the thesis has been attained from the bank through both primary and secondary sources. Various internal documents have been valuable especially for the descriptive part. But more importantly, interviews with the Vice President have proven to be vital for the whole thesis. Magne has also through his work in the organization and participation in various internal meetings gained a comprehensive understanding of the organizational culture and workings also on the lower levels.

## **PART II – THEORY**

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We start the thesis with a description of the relevant theory. A natural place to start is with Management control. Then we go on to describe what characterizes interactive and diagnostic control systems, before we describe two different control systems, the budget and the BSC, and their strengths and weaknesses. But that comes later; we will start with the broader topics.

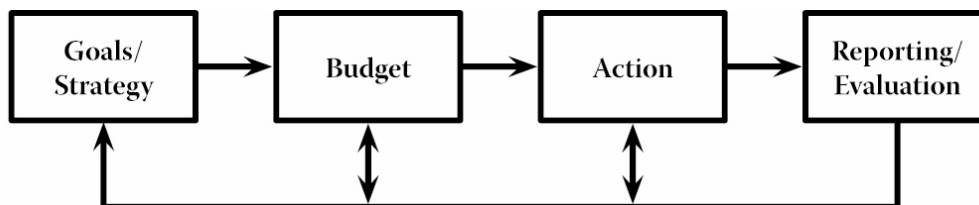
### **2 Management control**

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Management control can be defined as “the process by which managers influence other members of the organization to implement the organization’s strategies...Management Control involves a variety of activities, including: Planning, Coordinating, Communicating, Evaluating, Deciding and Influencing” (Anthony & Govindarajan 2004).

The key elements in most management control processes are strategy/goals, budget, action and evaluation/reporting. These have been in use for a long time, but as we will show, the relative importance and use of them have changed during the last decades.

#### ***2.1 Traditional approach***



*Figure 2.1 – The traditional management control process*

The traditional management control in organizations was mainly used for reporting and evaluation. Analysis of deviations between the expectations set in the budget and the realized results were the main focus of this system. Hence, the last box in the model was the area that attracted most attention. Goals and strategy are developed by the top managers, and these constitute the basis upon which the budget is generated. The budget defines restrictions on actions allowed during the budget period, usually a year. When the period is over, the results are analysed, and usually provide input in next period’s planning process.

Hence, the control system was mainly directed at the internal state of the organization, with a special emphasis on the financial aspects. Cause-and-effect relationships, in the degree they were analysed were mainly formula based. During the last decades we have seen a trend towards including both non-financial measures as well as external factors. This has improved the analyses, but it is still the case that “traditional control and performance measurement systems attempt to keep individuals and organizational units in compliance with a pre-established plan” (Kaplan & Norton, 1996). When a business operates in a stable environment this is less of a problem, but this is rarely the case for modern businesses. The pace of change is increasing, leaving these traditional systems in the danger of being outdated shortly after they are developed.

### **3 Management control systems**

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Before we separate between interactive and diagnostic processes/systems, we need to define what we mean by management control systems. By applying Simons’ (1987) definition we acknowledge that it is an important tool in both strategy formation and strategy implementation, emphasizing the link that should be between these two. Hence we will use the following definition: “Management control systems are the formalized procedures and systems that use information to maintain or alter patterns in organizational theory”. This is a broad definition that includes formalized procedures for planning, environmental scanning, budgeting, competitive analysis, performance reporting and evaluation, resource allocation and employee rewards (Simons 1987).

#### ***3.1 Interactive control***

“Interactive control calls management’s attention to developments – both negative and positive – that indicate the need for new strategic initiatives. Interactive controls are an integral part of the management control system” (Anthony & Govindarajan, 2004).

Management control systems become interactive when business managers use planning and control procedures to actively monitor and intervene in ongoing decision activities of subordinates (Simons 1990). Because “everybody watches what the boss watches” this is an effective way to make sure that the entire organization is focused on strategic uncertainties; “Uncertainties that the top managers believe they must monitor personally to ensure that the

goals of the firms are achieved” (Simons 1990). By definition these are unknowable in advance and emerge unexpectedly over time (Simons 2000).

### **3.1.1 The model**

Figure 3.1 illustrates how an interactive control system focuses organizational attention and stimulates the emergence of new strategies over time. The presentation of the model is based on Simons’ article (1990).

To explain why managers choose to monitor certain management control systems and delegate other aspects to subordinates Simons uses four concepts to develop the model; limited attention of managers, strategic uncertainties, interactive management control and organizational learning.

#### *Limited manager attention*

Managers do neither have the time nor the capacity to process all the information that is available to them. Their rationality is bounded by their cognitive capability; mind is a scarce resource for most managers as the organization grows more complex. In addition to this, a manager must engage in a number of different activities through the different roles he is to fill in the organization, e.g. figurehead, entrepreneur and disturbance handler (Mintzberg 1973). Because of this it is impossible for a manager to give attention to all the parts of an organization’s formal management control process.

#### *Strategic uncertainties*

The managers must therefore focus on the parts of the control system that relate to the most critical aspects for the organization – the strategic uncertainties. These are highly dependent on the chosen strategy; two competing companies facing the same environmental uncertainties can choose to monitor completely different factors if their strategies are different.

#### *Interactive management control*

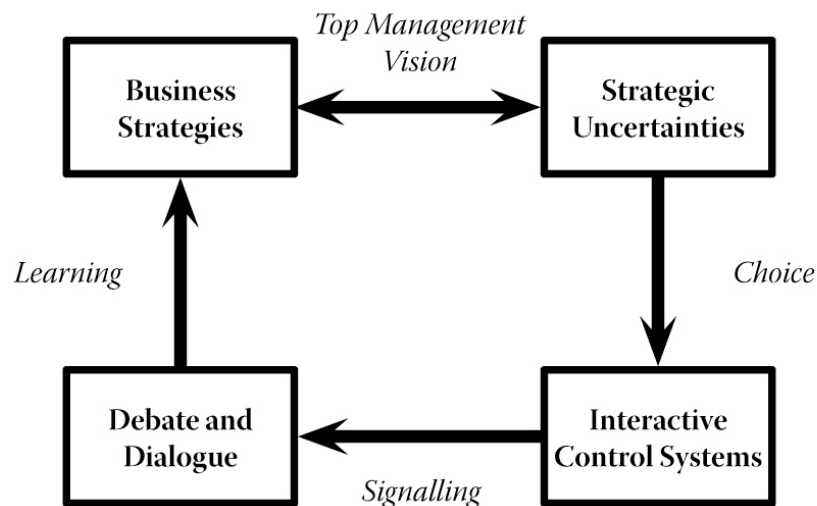
After the strategic uncertainties have been identified, it is natural to make interactive those control systems that provide information about these uncertainties. These systems can then be used by top managers for three functions; signalling, surveillance and decision ratification.

Signalling is the use of information to reveal preferences (Spence 1974). Through the formation of the interactive system, the management signals which aspects of the business is perceived to be more important, thus influencing decision makers throughout the organization.

Surveillance relates to the top management's personal involvement and monitoring of the decisions related to the uncertainties. When having officially signalled preferences, the interactive control system is suitable for justifying the necessary resource allocation and ratifying decisions.

### *Organizational learning*

Organizational learning describes the ways that organizations adjust defensively to reality and use knowledge to improve the fit between the organization and its environment (Hedberg 1981). The idea of the model is that the use of interactive control systems generates discussions and exchange of information related to the strategic uncertainties. This focuses the attention and learning in the organization on the issues that are strategically important.



*Figure 3.1 – Process model of relationship between business strategy and management control systems. Adapted from Simons, Levers of control p.102 (1995)*

These four aspects are then integrated in the model. Based on the top management's assumptions of the environment and the company's abilities, business strategies are developed and strategic uncertainties are identified. The current business strategies strongly affect the choice of strategic uncertainties, but at the same time the strategic uncertainties do affect the choice of business strategies. After identifying which of the uncertainties are most critical to

the business, they choose which control system to make interactive. This choice signals to the employees where the strategic focus of the organization should be, and stimulates to debate and dialogue on how to make improvements in this area. Through this they can discover new information/technology etc. that might change the foundation upon which the business strategy originally was based. Hence, this is a recursive model where the choice of management control systems can influence the strategy formation over time. Simons advocates that emergent strategies can be influenced and managed because of this. Management control processes are not only a mean for implementing goals, but can also be an instrument influencing how the organization learn and adapt over time.

Now we will go on to describe the diagnostic control system, and how it is suited to implement and monitor the execution of planned strategies.

### 3.2 Diagnostic Control Systems

Diagnostic control systems can be defined as the formal information systems that managers use to monitor organizational outcomes and correct deviations from preset standards of performance (Simons 1995, p.59). Output is measured against established goals and objectives, and managers will not take action unless the results fall below certain trigger points. The strategy is functioning as a constraint and the control system is there to ensure that orders are being carried out. Strategies are developed or approved by top managers and the plans are communicated downward through the organization. A set of formal systems are used to inform top managers if actions or outcomes are not in accordance with intended plans (Simons 1991). Hence this is a tool well suited for implementing intended strategies.

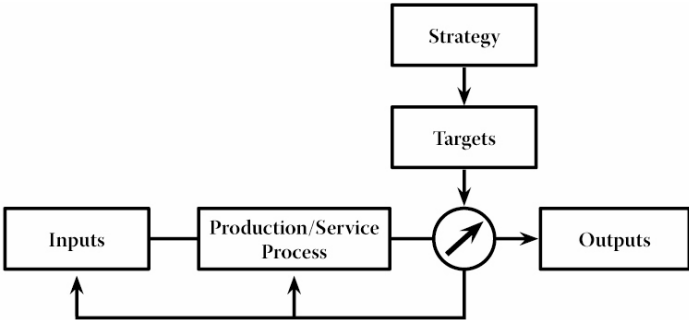


Figure 3.2 – Using Diagnostic Control Systems to implement strategy (Simons, *Levers of control*, 1995)

The two main reasons for making a control system diagnostic are to implement strategy effectively and to conserve scarce management attention (Simons 2000).

By using diagnostic control systems to monitor the critical performance variables – those factors that must be achieved or implemented successfully for the intended strategy of the business to succeed (Simons 2000) – the strategy is communicated throughout the organization. In his book, “Performance measurement and control systems for implementing strategy”, Simons identifies five important steps to achieve an effective diagnostic operation:

- Setting and negotiating goals. With basis in the strategy, goals are set up for the business. Different interests and scarce resources necessitate a negotiating process to derive these goals.
- Aligning performance measures. This means making sure that the performance measures chosen really reflect the strategic goals and priorities set up for the business.
- Designing incentives. To ensure that the measures get the required attention the rewards should be linked to the fulfilment of the established goals. I.e. no bonuses are paid out unless the minimum targets on the diagnostically controlled measures are fulfilled.
- Reviewing exceptions reports. Because these systems control the critical performance variables it is important to monitor these on a regular basis. Exceptions reports are generated and reviewed by the management on a regular basis. The work related to these diagnostic measures is usually performed by lower level staff, and as long as everything is on track, there is no need for the top management to get involved.
- Following up on significant deviations. If serious deviations should occur, management focus is immediately shifted to determine the cause of the deviations, and to find a remedy. This is called management-by-exception. If the system works, the cause of the problem and an effort to correct it will already have been identified and implemented by the time the top managers get involved.



Diagnostic control systems allow the managers to allocate their time to more important issues by setting the organization on autopilot. There are a few potential problems related to diagnostic control the managers should be aware of. The most important one is the risk of measuring the wrong variables. “What you measure is what you get” and incentive systems linked to performance measures that are not properly aligned to the strategy, can be fatal. Care should also be taken, to ensure that the tools employed by the staff are efficient in increasing the underlying goal, not just the measure itself. Finally, problems could arise when employees, trying to increase the probability of reaching goals, try to lower the bar as much as possible by building slack into their targets.

Now the interactive and diagnostic control systems have been defined and described, and the similarities and differences have been illustrated. The question the organization should ask is how these can be utilized together.

### ***3.3 The use of management control systems***

It is important to note that the difference between interactive and diagnostic control systems is not in their technical design features. A diagnostic control system might look identical to an interactive control system. The distinction between the two is solely in the way that managers *use* the systems (Simons 2000). It is also important to mention that although the objective of the organization is to better their interactive control, diagnostic control systems are necessary complements to the interactive control systems.

Studies show that most managers with a clear strategic vision only choose one management control system to be made interactive (Simons 1990). This has several reasons, the most important being that an interactive system requires a lot of resources for information gathering and processing, as well as management attention. This is diverting organizational attention from other tasks. Also, by introducing more than one interactive control system, the subordinates can get confused as to which aspect is more important and experience problems when trying to process all the information necessary to participate in the different debates. This is also likely to affect the quality of the work being done; superficial analyses and lack of perspective are two of the potential caveats.

At the same time there are many critical performance variables that also need to be monitored, but not on a daily basis. Organizations therefore need diagnostic control systems to supplement the interactive control system. The diagnostic control systems are used to implement planned strategies and making sure that operations are performed as planned.

We will now go on to describe two very different management control systems, the budget and the BSC, and see how they fit into the control process with respect to interactive and diagnostic use.

## **4 Budgeting**

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We begin with the budget; a very traditional management control system, and discuss it in an interactive and diagnostic context. When referring to the budget we mean the traditional budget set up for the whole organization.

### ***4.1 Budgeting and interactive control***

As described earlier, the interactive control is focused on the selection and signalling of strategic uncertainties in a way that stimulates frequent debate and dialogue on these issues within the organization. The internal learning resulting from this is related to the chosen business strategies, and contributes to bringing the strategy process forward. How does the budget fit in here?

If the budget provides the only mean for setting goals, strategic uncertainties might be detected through the process leading up to the compilation of the new budget. It is however important to differ between the process of setting qualitative plans and that of quantification in the budget. The strategic work should be performed regardless of the budget. The process of compiling the budget would consequently not provide any additional information. During the budget period the budget is not suitable for contributing to identifying these uncertainties.

Most budgets are set up for a longer time period, often about a year. This means that the discussions and learning are concentrated on the period of compilation. During the budget period the use of the budget is limited to giving guidelines for the operations and analysing deviations, which is much more resembling diagnostic than interactive management. A continuous updating of the budget could remedy this to some extent by forcing the

organization to constantly evaluate how they perceive the future. They should be more aware of the changes that occur and act proactively in relations to this. In order to achieve these effects they need to reassess all the assumptions upon which the budget originally was built, rather than just continuing the current trends.

But even if they did all this and increased the dialogue and learning in the organization, the majority of all budgets would not be interactive because of the content. The budget is a compilation of *all* the financial expectations for the next period. It contains detailed forecasts about all the costs and incomes for all the different departments in an organization. This is hardly consisting with the interactive focus on just a few strategic uncertainties. It is hard to signal which areas are to be prioritized as long as there have to be details on all levels. Some might shine through based on a higher share of the allocated money. But still, in most cases they will drown between the numbers.

Budgets set up for specific projects might have a tighter connection with the strategic uncertainties and apply for a shorter time period. But for our purpose it is safe to conclude that the budget is not suitable as an interactive management control system, due to the lack of focus on the strategic uncertainties and the time frame applied.

Most efficient organizations choose only one system to be used interactively. Nevertheless, they need to monitor the other critical performance variables, and we will in the next section go into whether the budget is suitable as a diagnostic tool to complement the interactive control system.

## ***4.2 Budgeting and diagnostic control***

In the theory about diagnostic control we described how these systems aim at measuring output variables that represent important performance dimensions of a given strategy. We will now discuss how a budget fits into an effective diagnostic operation. After adopting the theoretical approach we will review some empirical results from using the budget as a diagnostic tool in Svenska Handelsbanken.

### 4.2.1 The budget's role in an effective diagnostic operation

Applying a diagnostic approach, we relate the discussion to Simons' five important steps for effective diagnostic operations as described above.

*Setting and negotiating goals* will typically be done prior to, or in the early stages of the budgeting process. This is also where one has to make sure that the performance measures that are to be monitored diagnostically are *aligned to* the strategic goals and strategies set up for the organization. In this process the value of the budget is limited. Previous budgets and results are often taken into account when setting and negotiating goals. This involves negative effects i.e. good performance one year leads to an increase in the goals for the following year, making them harder to achieve. The budget should thus not be the sole influence of setting and negotiating goals or for the alignment of the measures to the goals.

The budget can be used as a basis for the *incentive systems*. Each of the most important performance variables will have a close link to at least one of the numbers in the budget. By making rewards dependent on fulfilment of these goals, it ensures that these areas are not forgotten.

An important part of a diagnostic control system is the construction and *reviewing of exception reports*. Again the budget makes a good foundation for this in those cases where the critical performance variables are closely linked with the budget numbers. Performance can be measured against the goals set in the budget. These reports will be distributed within the organization, and promote changes if the deviations are too large.

The *follow up* of the deviations is a vital part of the diagnostic process. Performing the four other steps is a complete waste of resources if the information provided by them is not utilized. The budget's part in this step is rather limited; when the deviations have been identified it is time to determine the cause and the possible remedy. Here an evaluation of the actual results and market conditions will be of more value than a reviewing of their original plans.

Before we acknowledge the critique of the budget, we can see that the budget is suitable as a tool in the diagnostic process. It can play an important role in the first four steps, laying the

foundation for a rapid implementation of the necessary adjustments. The budget can be utilized to monitor those of the critical performance variables that are reflected in the budget. For those of the critical performance variables not being closely linked to any of the budget numbers it is a necessity to set up a separate control system that enables the business to keep these under observation as well.

For the budget to really work as a diagnostic tool it is a necessity that the budget numbers are reliable. Managing after numbers that do not take into account the relevant market factors can prove to be fatal. This of course requires a lot of work in the preparation of the budget, but as we will see in the section about anti-budgeting, hard work alone might not be enough.

One of the early critics of the budget and its use was the Chief Executive Officer in Svenska Handelsbanken, Jan Wallander. In the next section we will look into the problems he identified in the 70's, as well as some of the more recent criticism.

### ***4.3 Anti-budgeting***

This paragraph is based on Jan Wallander's book "Budgeten – ett onödigt ont" (1994). He argues that any budget is based on estimates and assumptions of the future factors. The realism of it is completely dependent of the underlying assumptions being correct. If these assumptions turn out to be wrong, the budget work is at best a play with numbers. If the company have taken extensive measures and adapted the business to the budget, the incorrect assumptions may have fatal consequences.

Wallander's experience from various engagements in top management and directorships is that most budget forecasts are wrong, and often very wrong. So after a period as CEO in Svenska Handelsbanken, where he discovered that a large share of their budget forecasts were more than 50% off, he decided to eliminate the budget. He faced a lot of resistance, but in the following years Handelsbanken was among the best performing financial institutions in Sweden.

This all happened in the 70's, the relevant question for us then is of course: Are the forecasts better today, and thus have the ability to predict the future improved? In order to answer that, we have to look into why the forecasts were so wrong. We will again use Wallander's book

when describing these problems. And if our forecasts still are way off, is the budget used in a sensible way by SB 1 Ringerike, or are there room for improvements?

### *Forecasting problems*

Beside the difficulty of predicting the future in the first place, there are human factors making forecasting a hard task. Many find it difficult to deviate from the public opinion. The reason for this being that they are afraid of becoming the scapegoat if the forecasts turn out to be wrong. As long as everybody is wrong, no one can expect him/her to do better. It is also in the human nature to seek solutions close to the existing ones, thus making assumption that encompasses large deviations from earlier trends and experiences a rarity.

In general there is too much reliance on the forecasts. Deviations from the forecasts are all too often explained as natural variations rather than an early warning sign. Another problem with the budget is the fact that it serves as a power tool over the people who helps compile it. Bonuses and other incentives are often tied up to fulfilment of budget goals; hence the employees have incentives to adjust their input to the budget process accordingly.

Finally, the danger of applying a mechanic rather than a diagnostic attitude towards the budget process is significant (Bjørnenak). We have described the conditions for good diagnostics, including setting goals and aligning the budget targets to these. In practice however, the “same procedure as last year”-attitude is often applied, meaning that the revision of the compilation process from year to year is rather arbitrary. The problem is then that the goals set in the budget do not reflect the business strategies, or that the targets are not aligned to the goals. The result is a budget with minimal value to the management that easily could lead to less advantageous financial allocations or a total ignorance to the control system.

The final assessment of the budget as a diagnostic tool will therefore have to be that, although the theory presents it as a fairly suitable system, empirical results show that care should be taken in the formation and use of it.

## ***4.4 Making accounting systems more relevant***

We have now looked into the budget, that accompanied by the accounting and variance analysis have been given a large part of the blame for the lack of responsiveness in organizations. What can be done to improve the situation?

Much research has been done on this field, and gradually we have seen the trend shifting towards strategic management accounting. Elements like strategy based control and multidimensional cause-and-effect relationships are being linked stronger together. Neither of these are new elements, but the focus has been altered. Strategy receives more attention; it evolves based on information from various sources. Additionally, more effort is put into identifying drivers of performance, and how these affect each other. The description of cause and effect relationships grows more comprehensive as the businesses are trying to map out the best way to achieve the goals. These two actions combined provide the company with a solid foundation for the selection of measurements. Two of the pioneers within this field are Robert Kaplan and David Norton with their work on the BSC.

## **5 The Balanced Scorecard**

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The BSC has received massive attention during the last years. It is interesting to note that one of the few business areas where a positive effect from implementing the BSC has been identified is in the banking sector (Davis & Albright 2003). The bank looks upon their budget as a diagnostic control system, and have no intentions of changing that. We will still give a brief discussion on the BSC in relation to diagnostic control. For the bank the suitability and use as an interactive control system is of more interest. But before we can go into this, a brief description of the framework is called for. The description is based on the works of Kaplan & Norton.

### ***5.1 The Balanced Scorecard framework***

“The most important benefit of the scorecard is its use in facilitating communication about strategy, not only at the top level, but throughout the organization. In order to achieve this, the departure point for any scorecard should be strategy visualization” (Olve et al. 2004). So it is fair to say that the strategy map is an important first step of the BSC process. “The strategy map provides a framework to illustrate how strategy links intangible assets to value-creating processes” (Kaplan & Norton 2004). It shows how different elements within the four perspectives influence each other.

### *Financial perspective*

Is concerned with how our owners/shareholders look at the company. Their main objective is making money; hence this is where we find the traditional financial measures linked to profitability and sales growth. These are in many ways the tangible outcomes of the strategy, and are important in order to control whether the actions taken really contribute to bottom-line improvements.

### *Customer perspective*

“The customer perspective defines the value proposition for targeted customers. The value proposition provides the *context* for the intangible assets to create value” (Kaplan & Norton 2004). Measures used here include customer satisfaction/retention/loyalty/profitability as well as market and account share in targeted markets. The customer perspective consists of several lag indicators. The customer perspective together with the financial perspective describes the desired outcomes from the strategy.

### *Internal Business perspective*

Here the managers identify and describe the internal processes that are critical to excel at in order to obtain the goals. They choose the measures that will have the greatest impact on customer satisfaction and achieving the financial goals (Kaplan & Atkinson 1998). Under this perspective we find two aspects that separate the BSC from the traditional approaches of performance measurement. First, the BSC approach will usually identify new critical processes whereas the traditional approach will be occupied with improving the existing ones. Secondly, the BSC “incorporates the innovation process into the internal business process perspective” as “the drivers of long-term financial success may require the organization to create entirely new products and services that will meet the emerging needs of current and future customers” (Kaplan & Norton 1996).

### *Learning and Growth perspective*

This perspective identifies the intangible assets that are of most importance for the strategy, supporting the internal business processes. People, systems and organizational procedures are the main sources for organizational learning and growth. By using the BSC one can identify the gaps between the existing capabilities and what will be needed in order to achieve the long-term financial goals. Activities to close the gaps include retraining employees, upgrading information technology and systems, and aligning organizational procedures and routines.



To create a good scorecard, all the perspectives should contain both leading and lagging indicators. The difference between these is fairly simple. While lagging indicators shows the results of earlier efforts, leading indicators show how we are performing in critical areas, giving us an indication on how we will perform in the future.

Figure 5.1 illustrates the theory on how to get from the strategy map to the action plan by using the BSC. After mapping out the important cause-and-effect relationships for the business it is straight forward to find the objectives. Based on these, measures are chosen and targets are set.

Strategy Map		Balanced Scorecard		Action Plan	
Process: Operations Management Theme: Ground Turnaround	Objectives	Measurement	Target	Initiative	Budget
<b>Financial Perspective</b> Profits and RONA Grow revenues Fewer planes	<ul style="list-style-type: none"> <li>Profitability</li> <li>Grow revenues</li> <li>Fewer planes</li> </ul>	<ul style="list-style-type: none"> <li>Market value</li> <li>Seat revenue</li> <li>Plane lease cost</li> </ul>	<ul style="list-style-type: none"> <li>30% CAGR</li> <li>20% CAGR</li> <li>5% CAGR</li> </ul>		
<b>Customer Perspective</b> Attract and retain more customers On-time service Lowest prices	<ul style="list-style-type: none"> <li>Attract and retain more customers</li> <li>Flight is on time</li> <li>Lowest prices</li> </ul>	<ul style="list-style-type: none"> <li># repeat customers</li> <li># customers</li> <li>FAA on-time arrival rating</li> <li>Customer ranking</li> </ul>	<ul style="list-style-type: none"> <li>70%</li> <li>Increase 12% annually</li> <li>#1</li> <li>#1</li> </ul>	<ul style="list-style-type: none"> <li>Implement CRM system</li> <li>Quality management</li> <li>Customer loyalty program</li> </ul>	<ul style="list-style-type: none"> <li>\$XXX</li> <li>\$XXX</li> <li>\$XXX</li> </ul>
<b>Internal Perspective</b> Fast ground turnaround	<ul style="list-style-type: none"> <li>Fast ground turnaround</li> </ul>	<ul style="list-style-type: none"> <li>On-ground time</li> <li>On-time departure</li> </ul>	<ul style="list-style-type: none"> <li>30 minutes</li> <li>90%</li> </ul>	<ul style="list-style-type: none"> <li>Cycle-time optimization</li> </ul>	<ul style="list-style-type: none"> <li>\$XXX</li> </ul>
<b>Learning and Growth Perspective</b> Strategic job Ramp agent Strategic systems Crew scheduling Ground crew alignment	<ul style="list-style-type: none"> <li>Develop the necessary skills</li> <li>Develop the support system</li> <li>Ground crew aligned with strategy</li> </ul>	<ul style="list-style-type: none"> <li>Strategic job readiness</li> <li>Info-system availability</li> <li>Strategic awareness</li> <li>% ground crew stockholders</li> </ul>	<ul style="list-style-type: none"> <li>Yr. 1-70%</li> <li>Yr. 3-90%</li> <li>Yr. 5-100%</li> <li>100%</li> <li>100%</li> <li>100%</li> </ul>	<ul style="list-style-type: none"> <li>Ground crew training</li> <li>Crew scheduling system rollout</li> <li>Communications program</li> <li>Employee Stock Ownership Plan</li> </ul>	<ul style="list-style-type: none"> <li>\$XXX</li> <li>\$XXX</li> <li>\$XXX</li> <li>\$XXX</li> </ul>
				<b>Total Budget</b>	<b>\$XXXX</b>

Figure 5.1 – A strategic theme defines the process, intangible assets, targets and initiatives required to execute a piece of the strategy (Kaplan & Norton, “How strategy maps frame an organization’s objectives”, 2004).

The use of both financial and non-financial measurements is not revolutionary; rather they have been adopted by most organizations for a long time. The value added by the BSC is the closer linkage of these. “The multiple measures on a properly constructed BSC should consist of a linked series of objectives and measures that are both consistent and mutually reinforcing. It should incorporate the complex set of cause-and-effect relationships among the

critical variables, including leads, lags, and feedback loops that describe the trajectory of the strategy” (Kaplan & Norton 1996). It also ensures that the long term achievements are not sacrificed in order to obtain short term financial goals by revealing the long term value drivers for superior financial and competitive performance.

## ***5.2 The Balanced Scorecard as a diagnostic control system***

The BSC can be used both diagnostically and interactively. Because the main interest for the bank is related to the interactive use, we will focus on that. But first we will give a brief description on the benefits and pitfalls of using the BSC as a diagnostic tool.

An important aspect of a diagnostic control system is to communicate and implement strategies. The BSC provides the organization with a control system clearly signalling cause-and-effect relationships. Being founded on the strategy map, the strategy is communicated and explained through applying both lead and lag indicators. Thus would the BSC be suitable in this respect.

The lead and lag indicators also have another benefit for diagnostic control. In the process of aligning measures to the goals the BSC will be beneficial. The goals are typically reflected in the lag indicators, as these often are related to the financial or the customer perspective. The performance measures are operative targets reflected in the lead indicators. The BSC thus makes it easier to see how the performance measures are aligned to the goals by acknowledging the relationships between the lead and the lag indicators.

With respect to the design of an incentive system, the BSC can also provide value. The cause-and-effect relationships imply awareness from the managers and the employees on how financial results are gained. As a bonus system is best aligned to factors potentially enhancing future performance and factors that the employees in fact can affect, the system should take the lead indicators into account. This can make the incentive system more reliable and understandable, providing a perceived justice among the employees

The pitfalls related to the diagnostic use of the BSC are mostly due to the construction and use. It is essential to get the cause-and-effect relationships right as these are the foundation of

the whole system. This requires a great deal of knowledge of the organization as well as the environment it is operating in.

Finally the reoccurring problems with diagnostic system have to be mentioned. Any targets used in the control system, being a BSC or not, must be strived to be made accurately. This goes for which targets to choose and the value of these targets. The BSC does consequently not provide excuses for not performing strategic analyses.

### ***5.3 The Balanced Scorecard as an interactive control system***

The Scorecard can be made interactive by incorporating measures linked to the strategic uncertainties identified by the management, and adopting a frequent follow up on these measures. Leading measures will have a key position in the work towards detecting strategically important changes in the environment, as these are visible to the organization before eventually resulting in changes in the financial results.

As mentioned earlier, any management control system could be used interactively. Here we will go deeper into why the BSC is especially suited for this use.

“The BSC represents a translation of a business unit’s strategy and vision into tangible objectives and measures. The four perspectives of the scorecard permit a balance (1) between short- and long-term objectives, (2) between external measures – for shareholders and customers – and internal measures of critical business processes, innovation, and learning and growth (3) between outcomes desired and the performance drivers of those outcomes, and (4) between hard objective measures and softer, more-subjective measures” (Kaplan & Atkinson 1998). Even though it can seem like the BSC contains several focus areas, and thus making it appear too comprehensive to be used interactively, the key is that they are all linked together to support one single strategy.

Traditional control systems are mostly focused on the financial measurements with an emphasis on lagging indicators. The BSC however is more forward looking. By encompassing a large share of leading indicators the organization becomes more proactive. They get earlier indications on the development of the financial results, which enables them to

apply the necessary measures to improve these at an earlier stage. The use of both leading and lagging indicators thus promotes interactivity.

A well-designed scorecard is both transparent and sensitive, meaning that anyone reading it can easily understand the strategy behind it. Therefore, it facilitates better communication of financial and non-financial goals in a way that enables the employees on all levels in the organization to better understand the financial consequences of their decisions. This provides the employees with the information and understanding necessary to really participate in the discussions and dialogues concerning business strategies and processes which are important in order to make the system interactive.

Because it is transparent and sensitive it is easier for the employees to see how they fit into the organization. By enhancing the understanding on how the profit is generated, the employees are allowed to easily see how they contribute to the financial results. Feeling a sense of purpose is motivating for the employees, and is likely to encourage harder work and strategic contribution.

#### *Critique related to the interactive use of the Balanced Scorecard*

A common problem for the organizations implementing the BSC is that they fail to materialize all the benefits identified earlier. It is not which control system you use, rather how you use it, that is of importance. Although the formation and original use of the BSC is interactive, the lack of a continually proactive approach towards the market and a corresponding updating of the control system, reduce the interactive value of the system. The risk is that eventually the continuous revision of business strategies necessary for the interactive control disappears, and consequently the system works merely as a tool for communicating established strategies. It is then transformed into another diagnostic tool.

The above paragraph shows that the structure of the BSC does not secure the interactive value of the system. This is underlined by the fact that an original Scorecard is not structured to frequently monitor competitors and technological development, as these perspectives are not directly included. However, an interactive approach in the organization will reveal the relevant perspectives by the continuous focus on strategic uncertainties. These are then in the next step indirectly implemented in the BSC through the benchmarks and the chosen target

indicators. Again; the interactive value should not be taken for granted just by implementing the Scorecard.

If properly constructed, implemented and used in the organization we find that the BSC could very well be utilized as either a diagnostic or an interactive system.

## PART III – DESCRIPTIVE

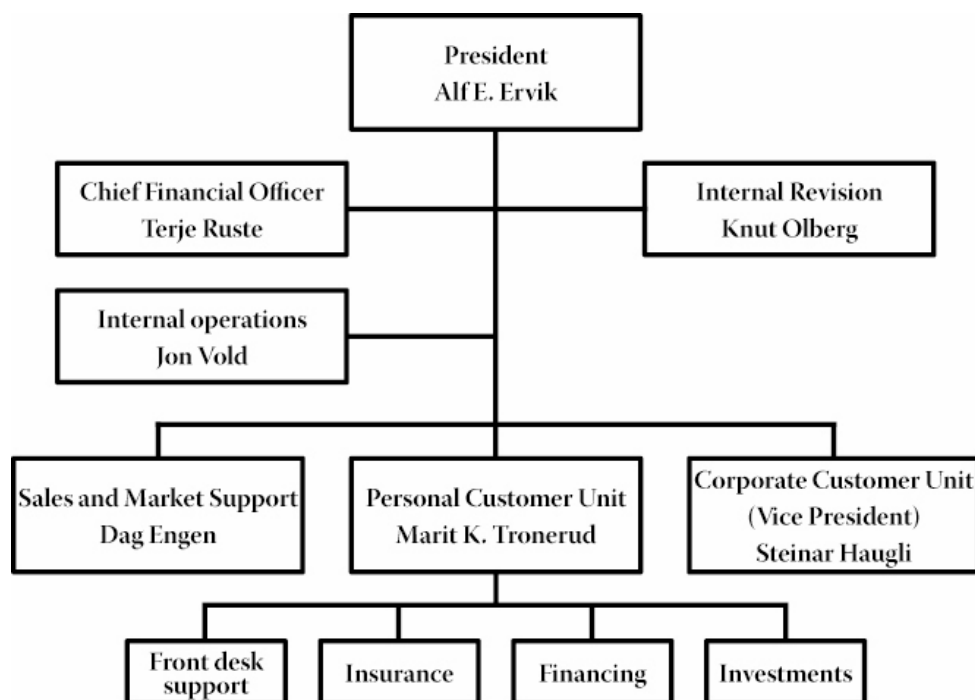
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We have now finished the theory description. In this part of the thesis we will give a description of SB 1 Ringerike, with a special focus on the strategy development and the control system used in the organization. But first we will describe the organization and the dynamics between the bank and its alliance partners and competitors.

### 6 Sparebank 1 Ringerike

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SB 1 Ringerike is a savings bank operating in the municipality of Ringerike and Hole. It is first and foremost a business managing money. Net interest margins on deposits and loans are the main source of income. The focus is very operational; none of the employees are occupied with pure strategic assignments. Figure 6.1 illustrates the structure of the organization.



*Figure 6.1 – Sparebank 1 Ringerike's organizational map*

The bank is divided into two departments, the Corporate Customer Unit (CCU) and the Personal Customer Unit (PCU). The CCU is a small department with 7 employees working closely together, while the PCU have 50 employees distributed across the branch network. The work environment in the two units is somewhat different as a result of this. The work in the CCU is generally more complicated and the employees are highly trained. Each of the

employees in the department has a customer base for which they are responsible, but the close environment secures several discussions on work related topics.

In the PCU the employees are spread on multiple branch offices. Even though there are a large number of highly qualified personnel working in this department, the level of competence is more diverse, and for some of them “it is just a job”. This makes it harder to get everyone interested and involved in the discussions in this part of the bank. But make no mistake; the competence is generally high also in this department, leading to a great deal of informal communication on business related topics.

## ***6.1 The foundation for Sparebank 1 Ringerike***

To get a better impression of the bank, we will look into the values they build on, and what they are trying to achieve. Information from the document “Strategi og Planer 2005 – Sparebank 1 Ringerike” is used in this section unless otherwise noted.

### **6.1.1 Vision**

Their vision is a pretty general statement of what they would like to be, and does not say anything about how they are going to achieve this: “Sparebank 1 Ringerike is to be the recommended and leading bank in the Ringerike area.”

### **6.1.2 Values**

Locally they use the slogan “Local and personal” to promote the bank. Here we can see a close alignment with the values promoted by Sparebank 1 Gruppen (SB1 Gruppen), “Close to you” and “Skilful”. These are more thoroughly explained in the 2004-07 Strategy plan for SB1 Gruppen.

#### *“Close to you”*

Meaning a mentally rather than geographical closeness. This term also encompasses an aspiration to be friendly and helpful, mentally and physically available. The employees try to understand individual needs and act on basis of these. Finally, the staffs are encouraged to show initiative and give relevant advices when dealing with the customers.

*“Skilful”*

“Skilful” means being focused on the customer, as well as possessing a solid branch knowledge, good skills and clear attitudes. Counselling and sales shall be based on high ethical standards and the advices predictable. To be skilful also means that one has the ability to cooperate horizontally within the organization, and to have the necessary profitability focus in the work situation.

### **6.1.3 Business idea**

SB 1 Ringerike is founded on the idea to be an independent, local savings bank for the Ringerike area. They offer financial services to personal customers, small and medium sized businesses, agricultural and public sector in the bank’s business area. All their operations are founded on high ethical requirements.

Their competitive edge is based on their closeness to the customers. Therefore they are continuously working on developing long-term customer relations based on mutual trust and loyalty. Additionally they make a conscious effort to actively contribute to creating value and a positive development in the Ringerike area.

## **7 Integration**

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We have earlier mentioned a few of the challenges facing the banks in the current marked. SB1 Ringerike is a fairly small bank; cooperation with other organizations through alliances is therefore very important for them. Before describing in more detail the nature of these alliances and the cooperation, we will start with an organization map showing how SB1 Ringerike relates to the other institutions. The source for this section is the Strategy document for SB1 Gruppen 2004-07, as well as information received directly from the Vice President, Mr. Steinar Haugli.



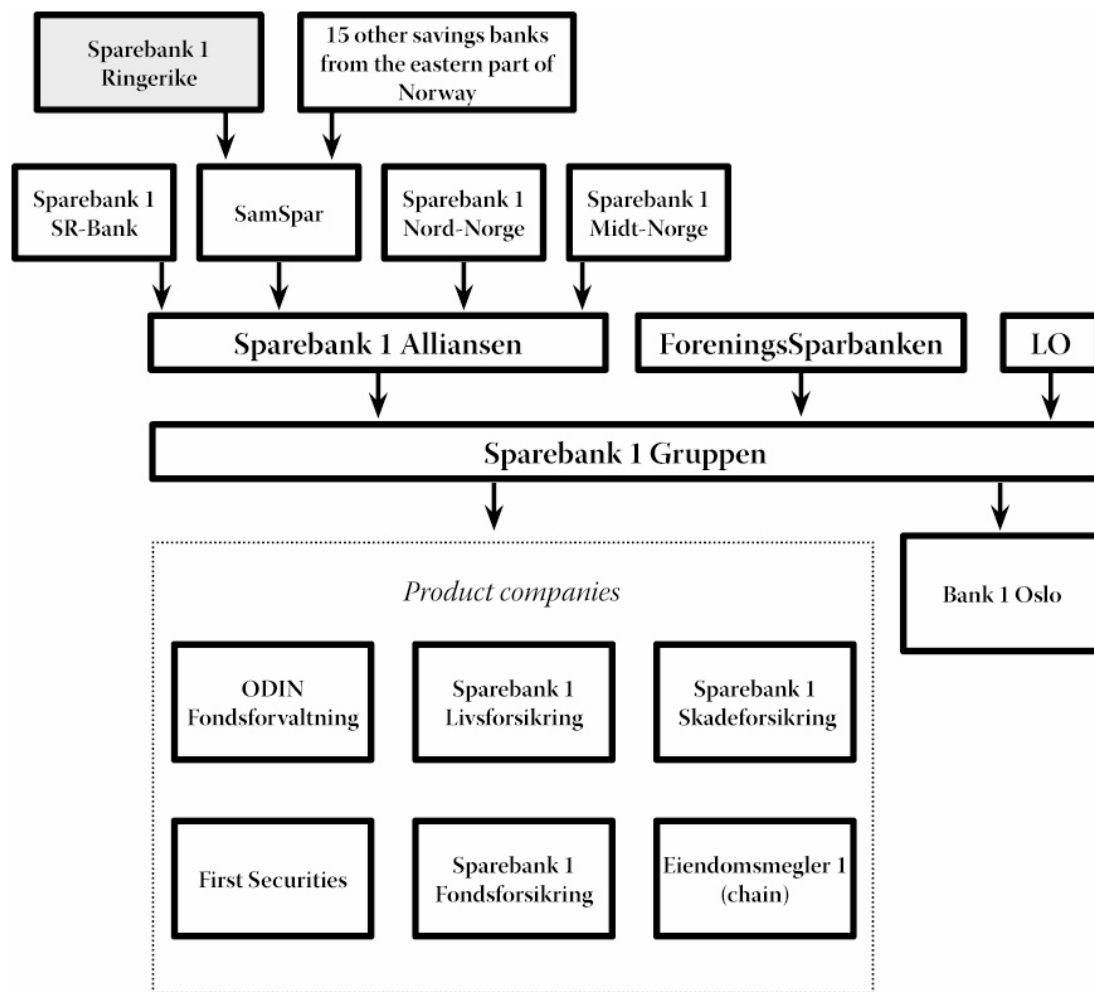


Figure 7.1 – Sparebank 1 Alliansen

Samarbeidende Sparebanker (SamSpar) was originally created to protect the ownership interests of the smaller banks. All of the 16 participating banks have an equal share in this company, and combined, they are about the same size as Sparebank 1 SR-Bank. SamSpar is a member in Sparebank 1 Alliansen (SB1 Alliansen) along with three other large regional banks. SB1 Gruppen was formed by SB1 Alliansen in cooperation with ForeningsSparbanken and The Norwegian Confederation of Trade Unions (LO). SB1 Gruppen is a mother company for various product companies. These subsidiaries provide financial products and services which are distributed through the members of SB1 Alliansen. There are direct links between each bank and the different product companies, to ease the communication. Finally, it is up to each bank to decide whether and to which extent they would like to sell the different financial products provided.

## ***7.1 Sparebank 1 Alliansen***

SB1 Alliansen is a co-operation between a number of local savings banks, all operating in different geographical areas, but with similar environments, visions and values. I.e. both SB 1 Ringerike and SB 1 SR-Bank are focused on giving back to the local community. SB1 Alliansen is based on a voluntarily participation, each bank deciding for themselves how much they would like to utilize the different services provided. The presentation of SB1 Alliansen is based on information in “Planer og budsjett for SB1 Ringerike” and a presentation held in Stavanger 15<sup>th</sup> of June 2005.

The background for the establishment of SB1 Alliansen in 1996 was the desire to maintain the local connection, and at the same time obtain the same efficiency as their best competitors. Thus, the main goals for SB1 Alliansen are stated as: 1) Ensuring each individual bank’s independence and regional foundation through strong competitive power, profitability and solvency. And 2) SB1 Alliansen is to represent a competitive adequately and regionally rooted alternative to centrally managed finance groups.

By using the same Sparebank 1 brand, just adding a geographical name when using it in the local area, they can exploit economies of scale trough joint marketing in national media. They also have a broad cooperation when it comes to technology, competence, purchasing, cross selling, and joint processes as well as utilization of best practices. The cooperation allows them to share the costs of development and make it possible to obtain the customer basis necessary to secure profitability. Simultaneously they are able to remain separate juridical entities and utilize the closeness to the local market.

## ***7.2 Sparebank 1 Gruppen AS***

SB 1 Alliansen, LO and ForeningsSparbanken are the owners of SB 1 Gruppen AS. For SB1 Alliansen the main idea behind the foundation of SB1 Gruppen was to make sure that the Sparebank 1 banks appear as reliable distributors of a wide range of financial products. SB1 Gruppen again is the owner of several subsidiaries; these product companies supply the members of SB1 Alliansen with different financial products. The range of products encompasses among others general insurance policies, life assurance as well as investment and savings alternatives in Odin Management Company.

Through the ownership of the product companies is SB1 Alliansen's ability to customize products that are suitable for distribution through banks increased. Additionally it makes it easier to secure ownership to the customer within a wider product range, as many customers are interested in obtaining all their financial services from one provider.

SB1 Gruppen itself is a separate financial entity and their purpose is stated in the Strategy plan as: "We are to develop, provide, sell and deliver financial services and products so that:

- Individuals can experience financial security and realize their needs
- Small and medium sized businesses can focus on their core operations
- LO-divisions can provide financial security for their members"

Cooperation between the subsidiaries exists in different areas, i.e. when it comes to raising the level of competence in the organizations. By introducing joint coaching/training of leaders SB1 Gruppen ensure cost efficiency as well as a unified follow-up and implementation of values and principles of leadership.

## **8 Market and Competition**

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On a national level the products distributed through the SB1 Gruppen faces stiff competition. DnBNor is the market leader with about 40% of the Norwegian bank market. A wide range of financial products are offered through a number of competing financial institutions. This does affect SB1 Ringerike through the sales of the financial products through the product companies owned by SB1 Gruppen.

In the Ringerike area, SB1 Ringerike holds a dominating position with a market share of just over 40% in the private customer market, and almost 50% in the corporate customer market. Despite of the large share of the market, SB1 Ringerike faces stiff competition from strong financial institutions like DnBNor and Nordea as well as the local bank Hønefoss sparebank.

### ***8.1 Sparebank 1 Ringerike's view on the market and their position***

The bank seems to have a very relaxed attitude towards changing market conditions and their own position. The Vice President claims that: "The business environment in Ringerike is stable, with low unemployment. At the same time the bank performs well when it comes to customer satisfaction and market share". They are confident that their main source of earning

will prevail; high quanta and net interest margins on loans and deposits. Even though there has been an increasing focus on other financial products customized to the customers, they believe that the business of managing money will continue to dominate. As the bank possesses comprehensive knowledge within this field, and has a solid position in the local community, they do not fear for the future.

## 9 The Management control process in Sparebank 1 Ringerike

We have already described SB 1 Ringerike, its partners and the competitive environment. Now it is time to return to the main focus area again, the Management control process. In this section we will start with an overview of the whole process, before we go on to give a description of the different elements, use and the interrelations between them. To which extent the structure of the process and the individual parts, as well as the way they are used, are to the purpose in relation to a normative management control process will be discussed in the analysis in part IV.

### 9.1 Strategic control systems

The bank has a clear procedure for using their strategic control systems and thereby setting goals and objectives. Although the procedure is not formally stated in any written document, there is a pattern in how the strategic work is handled yearly. Figure 9.1 illustrates the process.

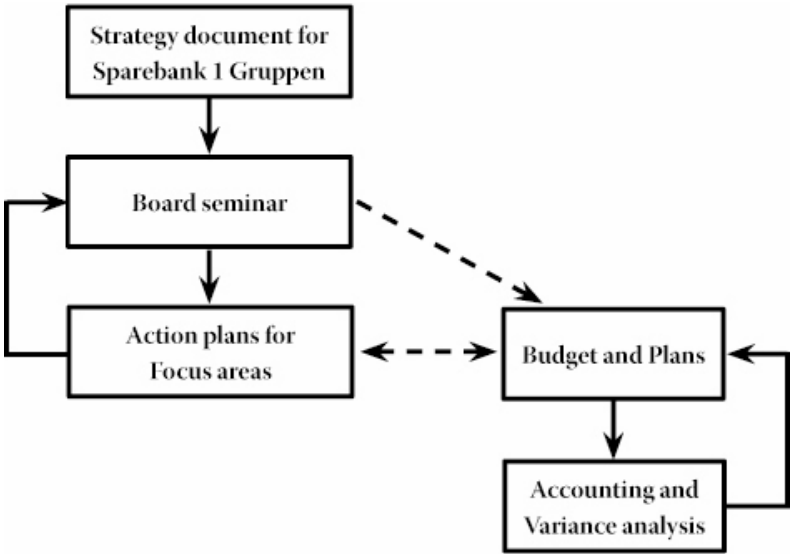


Figure 9.1 – Sparebank 1 Ringerike’s strategic control system

The Strategy document for SB1 Gruppen is developed by the group management. Here 2-3 year plans are made, and the focus is on long-term trends, challenges in the environment and how to respond to these. A section is also devoted to describing how their products should be managed. Finally, long term goals are set within important business areas. This document is important at the yearly Board seminar for SB 1 Ringerike, where they apply a local perspective. The Action plans for Focus areas also adapt a long term perspective, and are influenced by the outcomes of the Board seminar. Both the Board seminar and the Action plans provide a few guidelines that are taken into consideration when constructing the Budget and plans that are finalized in the fall. Simultaneously, budget restrictions affect the Action plans. The Budget is a natural basis for the Accounting and Variance analysis, and the results of these analyses give important input in the next period's budgeting process.

### **9.1.1 The Strategy document for Sparebank 1 Gruppen**

This document is formed as a strategic plan for the group as a whole. It is put together by the Board of Directors and the top management of SB1 Gruppen. It is to clarify who the SB1 Gruppen is established for, and how the expected market developments affect the operations in SB1 Gruppen during the relevant period. Through the strategy plan they are to determine goals and activities as well as securing a professional execution and follow-up. The plan states the premise and guidelines for the business areas and supporting units in SB1 Gruppen.

The document contains analyses of market related elements describing the national bank market. Issues such as macro economic trends, customers, competitors, distributors and employees are described, and the consequences of any trends/recent changes for the SB1 Gruppen are identified. The document is additionally stating the vision, purpose, goals and objectives and an estimation of SB1 Gruppen's future financial results for the relevant period of time.

As SB1Gruppen owns the product companies, a noticeable focus of the Strategic document is on the specific products. This involves discussing main strategic challenges and an estimation of future sales for each product. Analyses on how the banks could take advantage of the product possibilities, and which challenges they are facing in a changing product environment accompany the analysis of the current achievements of the products.

The time aspect for the Strategic document is 2-3 years, implying that all analyses are discussed within this time frame. The focus is thus on major strategic uncertainties, and the document is a valuable input to the Board seminar, where guidelines for SB1 Ringerike are drawn up.

### **9.1.2 The Board seminar**

The Board of Directors and the management meet yearly to discuss the strategy of the bank. It is one of the most important meetings for the administration during the year, as it gives the leaders a break from the operational focus that dominates the ordinary workday. As Mr. Haugli puts it: “It is very hard for me with operative responsibilities to set aside 15 minutes every day for strategic thinking”. During this seminar they have two days to focus on the strategic work. The Board act as a sparring partner for the management in the strategic dialogue. The Directors are carefully chosen to achieve a Board with a wide area of knowledge. This diverse competence together with the distance from the everyday routine creates a setting which facilitates good and creative strategic thinking.

As the bank operates in a market where they are facing the most powerful competitors in the country, and are affected by macro economic patterns, the foundation for this meeting is the above mentioned Strategy document. However, the focus is on breaking down the strategic opportunities to a local perspective. They start by describing the current situation. By using a SWOT analysis, the administration and the Board discuss the market specific strategic uncertainties SB1 Ringerike will face in the future, as well as actions to exploit the possibilities and handle the threats. Then they go on to describe the desired position 4 years forward in time. After achieving consensus on this point, they try to identify the change process that must occur, as well as positive/negative forces that will affect it.

The bank applies a long term aspect for these seminars. Thus the focus is on the important issues, and they do not distinguish between short and long term strategic uncertainties. They do however discuss the internal and the external issues separately, as well as looking into the dynamics between these.

### **9.1.3 Action plans for focus areas**

At every point in time there are 4-5 Focus areas where special efforts are made. This means that these issues get a lot of manager attention. Mr. Haugli's statement: "For me personally, this is most important, more important than the budget", illustrates this very well. The Focus areas are often mentioned in the internal meetings that are held on a weekly basis, as well as being a reoccurring topic in the more informal dialogue on the workplace. These are "relative long term action plans", and there is often a close link to the issues discussed at the Board seminar. We also find a close link to SB1 Gruppen, through the product companies, as plans are related to the distribution of these products.

The Focus areas are not constant over time. Market factors do influence important parameters, i.e. the establishment of Skandiabanken with their "no fees" offer, inspired the bank to establish an account with a fixed fee, independent of the usage. Hence, they are a result of careful consideration and analyses of both internal and external factors. The aim is of course to focus on the issues that can help the bank to build new competitive advantages and identify new potential profitable areas of business. They perceived themselves to be focused on the opportunities, rather than the threats that occur. An example of this is the OTP (mandatory pension schemes), where SB1 Ringerike was one of the pioneer financial institutions, and now are "best in class" among the SB1 Banks.

It is important to notice that even though they are usually passed for one year at a time, events may come up that requires immediate attention. If necessary, the Focus areas might be changed in the middle of a period, and it does happen.

To create motivation among the employees they tie bonuses to the fulfilment of goals and objectives linked to the Focus areas, mainly on group basis, but there are also some individual bonuses. The goals against which they are measured are largely based on last years' performance, with some adjustments for expected market development. Extensive sales reporting of products linked to these key areas are also generated in order to make sure that they are on track. This control system is to a large extent restricted to an excel-sheet revealing the budget fulfilment in the relevant areas.

On a higher level, the performances in these areas are compared to those of the other banks in SB1 Gruppen, using a centrally generated BSC. The focus of this scorecard is accounting, financing and employees. As SB1 Gruppen develops the scorecard, it facilitates comparisons of the bottom line and final sales figures of the different product categories, rather than performance on more detailed measures.

#### **9.1.4 Budget and Plans**

The yearly created document named “Budget and Plans” is by the administration identified as “the most important document in the bank”. This document is available for all the employees, and most of them have a copy of it in the drawer. It lays the guidelines for the operations during the next year.

As we have progressed in the work on this thesis, it has become clear that it is especially the Plans stated in the document that is of more importance. This is underlined by the fact that the document does not contain a full budget. Rather it identifies goals for activities and income; the cost side is hardly mentioned. A reason for this could be that the costs are mainly related to salaries and technology, which are of smaller interest to the average employee. But still it tells us that the Budget and the Plans should be treated separately on some aspects. We will start with a description of the document called Budget and Plans, and follow with the creation of this document and the Budget. In the final section we will talk about the variance analysis, and how it draws on information from both parts.

##### *Content of the Budget and Plans document*

The document starts with a brief summation of SB1 Ringerike’s vision, business idea, main goals and the strategy. After looking at restraints present in the national and local environment, important trends in the finance market and the competitive situation during the last year, they set up market goals mainly related to growth and income. Activities and points for improvement related to sales of the bank’s product are also mentioned in this first section.

The second part goes in more detail on the two different departments, PCU and CCU. Here they start with a fairly detailed description on how each department performed within the different areas of the operations. Then they identify the important goals for the next year, and list the important areas to focus on in order to reach these goals, followed by a detailed plan of the activities to be executed. We will illustrate this with an example from the PCU.



In 2005 “building relations” and “incremental sales” are identified as the most important goals for this department. In order to succeed competence, initiative, customer care, follow-up of the employees and sales activities are listed as the key issues. Under the analysis of customer care they identify competitors’ activities towards trying to steal customers, and how they are going to increase their customer contact in order to respond to this. The PCU will continue using “event based marketing”, and new events might be added. A share of the staff will increase their knowledge of relevant areas to become youth consultants, in order to create bonds between the bank and the customers at an earlier stage. Finally they will aim at improving their ability to advise individuals on the need for personal insurances, giving them better financial security and the bank increased sales within this business area.

The document closes with a section on marketing activities throughout the year and a reminder of the fact that the bank is a member in SB1 Alliansen. It mentions key challenges for SB 1 Alliansen during the upcoming year, and a selection of the important areas from SB1 Alliansen centrally. This is to stress the importance of aligning the message and important business areas with the other members. In order to capitalize as much as possible on the generic advertisements, the different product areas will be promoted locally at the same time as SB1 Alliansen creates a focus on them nationally.

The document only includes budget numbers related to the activities and income, a full budget with details about all costs and income estimations for each branch during the budget period is also set up and distributed internally in the management and the Board. The content of this is pretty traditional; estimations of the incomes and costs in the different units for the upcoming year. We will not spend time describing it in more detail here, but rather go on to explain how the Budget and the Plans are created.

#### *Creation of the Budget and Plans*

As described earlier, this document’s name is somewhat misleading, considering that the Budget is incomplete due to the elimination of the costs. Nevertheless, these two parts are tied together, and are developed simultaneously.

The process starts in September the year before the budget year. Prognoses and expectations from the Ministry of Finance, large customers and Sparebankforeningen on inflation and

expected loans nationally lay the foundation for discussions in the management. Budget assumptions are then presented for and discussed by the Board. Different goals are set within the different areas, such as loans, deposits, insurance sales. Restrictions are also set concerning cost level and investments. The Action plans are also taken into consideration when appropriate.

The budgeting responsibility is then divided on a number of people, all responsible for a specific part of the Budget based on their area of responsibility. When necessary these managers discuss the Budget with other employees/managers. The Chief Financial Officer combines the input from various fields, and the final budget proposal is first discussed in the leader team. Multiple adjustments are usually made before the final consideration in the December Board meeting.

Once the Budget and the Plans are approved by the Board they are fixed, and will not be changed during the budget period (one year). But the Budget is not followed by the letter, if changing market conditions require responses; it is possible to break the budget restrictions.

The Budget is in large parts backward looking. The bank is aware of this, and the main reason is once again the fact that their main operation is managing money. This is the part which generates large incomes and it has been the core of their operation since the very beginning. The costs are to a large degree fixed as they are related to salary and IT.

### **9.1.5 Accounting and Variance analysis**

A traditional control system; during the year reports are compiled on goal fulfilment after the Budget and Plans, and prognoses for the rest of the year are set up. The profit and loss account for the relevant year is compared to the Budget. Deviations are measured against historical results as well as the budget numbers. The CFO is responsible for generating the report showing any deviations. This report is then dealt with by the top management, and presented to the Board of Directors.

The reports are being updated on a monthly basis, with a more thorough analysis when the quarterly report is to be presented for the stock exchange. If everything looks normal no immediate action is taken. However, if large deviations occur the responsible person is

contacted, and a report is to be presented to the top management. In addition to this, actions are made to correct the deviation.

The results of these analyses are also the foundation for prognoses performed monthly for the rest of the year.

As we now have finished the description of the current Management control process we would like to know how it can be customized to the changing environment. We will thus in the next part analyse how the current Management control process compares to a normative process as presented in the theory.

## **PART IV – ANALYSES**

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In the problem statement we established that the purpose of the thesis is to analyse how the bank can customize its Management control process to an environment we perceive to be changing. We have however explained how the management perceive the market to be fairly stable. This difference of opinions does most likely occur because the management acknowledge the strong position the bank has in the market. We do agree with the bank that their high market share and good customer relations goes a long way in securing a continuation of the great fiscal results the bank has delivered for several years. At the same time, for the market leader, there is always the danger of becoming complacent. And although their position in the market reduces the dangers of the threats from new and stronger competitors, the changes in customer preferences reinforces the need to adapt the Management control process.

We consequently argue that the Interactive process is vital to the bank in securing or potentially improving their position as market leader. We will discuss to what extent the current Management control process is interactive, and what can be done to improve this interactivity. The framework for this discussion is Simons' process model. As the organization usually makes only one control system interactive, the need for a suited diagnostic system emerges. We will thus complement the interactive analyses with a discussion on the diagnostic suitability of the budget. In total, we aim at finding how the full Management control process can be customized to the changing environment.

### **10 The Strategy document from Sparebank 1 Gruppen**

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This is chronologically the first step in the strategic process. As explained in part III, this is a document for SB1 Gruppen which is owned by several savings banks located in different parts of the country. Hence, the formulation of the Strategy document is not directed towards the interests of SB1 Ringerike specially. The document does however provide a starting point for the strategic discussion in the bank, and would be an integral part in designing an interactive control system.

## ***10.1 Business strategies***

We are starting the discussion with “Business strategies” in Simon’s model. Since the business strategies provide the foundation on which to determine the choice of focused strategic uncertainties, these are vital in the formation of an interactive control system. An important issue here is that the strategies of SB1 Ringerike are not necessarily the same as those of SB1 Gruppen, which would imply that the focus of the document is not directly applicable to the bank’s interactive process.

The differences in the strategies are mostly related to SB1 Gruppen’s extensive focus on products. As discussed in the descriptive part, the main purpose of the existence of SB1 Gruppen from SB1 Alliansen’s perspective is that it provides the banks with financial products through the ownership of the product companies. SB1 Gruppen’s strategies thus involve all the relevant factors in providing these products nationally, whereas SB1 Ringerike creates value partly by selling these products in the local market.

“The document provides us with a foundation for further strategic discussions as it presents thorough analyses of products we have in our portfolio, as well as a discussion on how the macro economic conditions will affect us and the other banks in SB1 Alliansen”, the Vice President states. The product strategies are thus an integral part of the document for SB1 Ringerike as well as SB1 Gruppen. The importance for SB1 Ringerike is related to the products’ role in the interactive control of the bank, being the main source for exploiting its competitive advantages through focus areas. One can further argue that the differences between the business strategies have no implications for the bank, as the *product* strategies are more important. But since the sales of these products are highly dependent on SB1 Ringerike’s position in the local area, customized product strategies are necessary. Conclusively, the bank must take the difference in strategies into account when discussing the document internally for strategic use.

## ***10.2 Strategic uncertainties***

Following the above conclusion there are strategic uncertainties in the document not relevant for SB1 Ringerike, and more importantly; uncertainties in the bank’s local market not dealt with in the document. Those presented in the document not applicable to the bank’s strategic

process should be fairly simple to sort out. These are mainly related to products not included in the bank's portfolio or to structural or conditional changes not affecting their local market.

But even the strategic uncertainties potentially affecting the performance in the bank's focus areas are not necessarily selected in the bank's Interactive process. The bank has to select the strategic uncertainties vital to their performance. It is the vision of the managers, their interpretation of the organization's competitive advantages and the external environment, that in the end decides this selection. Obviously, SB1 Ringerike does not have the same managers as SB1 Gruppen, implying that their vision is likely to be different. This subjectivity emphasizes the importance of strategic learning in the organization. Our impression is however that the document is considered to be a fundamental starting point in their strategic process widely because of the relevance of the strategic uncertainties presented.

In our opinion this is due to two factors; the importance for any bank in any market of macro economic trends and structural changes in the bank industry, and the benefits gained from the Sparebank 1 brand.

The importance of macro economic trends for SB1 Ringerike is obvious. Changes in interest rates, exchange rates, property prices etc. will affect the behaviour of people in Ringerike just as much as anywhere else. In the next step this will affect the sales of financial products. Additionally they compete in a market containing the biggest banks in the country. Structural changes in the bank industry like mergers, acquisitions and internationalization, will therefore influence the market conditions under which they compete. The strategic uncertainties of such art will thus be relevant to consider provided that these are adapted with a local perspective.

The financial products are supplied nationally through banks in SB1 Alliansen, competing with substitutes from strong competitors. The sales of these products depend heavily on the product's reputation on a national level. There are significant economies of scale in advertising through SB1 Gruppen benefiting from the Sparebank 1 brand, and the strategic uncertainties affecting this brand will strongly affect the sales of these products through SB1 Ringerike. We conclude that, although the brand of SB1 Ringerike and the above mentioned macro economic and structural changes of local art also are likely to affect their sales, the

analyses of strategic uncertainties with respect to these products are highly relevant also on a local level.

### ***10.3 Debate and dialogue***

The choice of an interactive control system is not relevant for this task seen separately from the others. Consequently, the discussion goes on to the “debate and dialogue”.

The forming of the document is performed without representatives from the banks present. The document will however be discussed in the Board of SamSpar where SB1 Ringerike is represented. It is up to the President of SB1 Ringerike whether he chooses to present the document to the Board. The current precedent in the bank is a presentation and consequently a discussion of the document in the Board. The learning in SB1 Ringerike is thus limited to the discussion of the document in Board and management meetings. However, this is only useful to the extent that the debate and dialogue is concentrated on business strategies relevant for SB1 Ringerike. It is also important to note that this learning is a result of meetings with representatives from other banks and employees in SB1 Gruppen, rather than an internal discussion with employees in the organization.

This debate and dialogue gives the management the opportunity to discuss macro economic conditions and strategies with the management from other banks in SB1 Alliansen. Both of these do create valuable inputs to the formation of business strategies. Since the foundation of Alliansen partly is based on similar strategic interests in the banks, the opportunities for interactive learning are significant. Apart from the creation of this document, there are also several meetings and seminars held to improve this cross communication adding to the management learning.

The purpose of the debate and dialogue in the model however, is to improve the organizational learning. When including the debate and dialogue across banks in SB1 Alliansen, we apply a broad definition of the term. The “organization” then refers to SB1 Alliansen, and the interactive control system would be the BSC applied. The Vice President has characterized this control system’s relevance for SB1 Ringerike as “doubtful”. The questionable benefits of the BSC for the bank are related to the weak signalling effect through benchmarks and target indicators perceived to be highly arbitrary. The main challenge is then

to utilize the information from the document by applying the relevant strategic uncertainties in an interactive control system internally. This would be suitable for directing the internal debate and dialogue towards increased strategic learning in the bank, and thus better utilize the internal competence.

#### **10.4 Conclusion**

We conclude that the document, if correctly used, provides valuable input to the bank's interactive process. It must be seen in context with the other tasks of the process, and can be treated as a starting point for further discussions in the bank. It is useful in the way that it affects managers' vision and perspective with respect to business and product strategies and provides input to the selection of strategic uncertainties.

The analyses of the products discussed in the document are vital interactively, the process eventually resulting in the bank's focus areas. The use of the document secures a utilization of SB1 Gruppen's vast knowledge of these products and markets. The challenge for the management is to capture the relevant strategic uncertainties provided in the document and adapt these to a local perspective. They also have a challenge when it comes to including the employees in the discussion of the document. The next step would be to apply the document in the internal strategic discussion, and linking the information attained to an interactive control system.

### **11 The Board seminar**

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As the second step in the strategic process, the Board seminar aims at analysing the strategic uncertainties the bank is facing in Ringerike, in addition to the core competencies of the bank. Since a large part of the analyses of strategic uncertainties in the Strategy document from SB1 Gruppen also is relevant for SB1 Ringerike, this document forms the basis for the seminar. However, the focus is now directly related to SB1 Ringerike and their local market. The discussion is meant to be strategic and interactive, performing a SWOT analysis.

The obvious consideration here is the trade-off between the backward- and forward looking elements. It is not *which* analyses you perform, rather *how* you perform these, which is of importance. Naturally the managers' and Board members' perceptions of both the core competencies of the bank and the nature of the environment are affected by their experience.



Consequently they are in danger of doing “business as usual”, resulting in minor strategic changes undermining the importance of being proactive. On the other hand, as mentioned in the descriptive part, only a small share of their financial performance is a result of new products. This implies that the backward looking element is valuable for the bank in utilizing their sustainable competitive advantages. The challenge is to build on these advantages by taking into account how emerging opportunities and threats affect their core competencies.

Is it then possible that the management could better utilize the Board seminar by actively considering the backward looking element in addition to the forward looking element? We studied the daily tasks of the management to find an answer to that question. The management of the bank is characterized by their vast experience in the bank industry generally and in SB1 Ringerike especially. They are continually stressing the fact that they are in the business of managing money, implying that most of the bank’s profit is a result of reiteration in the way they create value for their customers. They are well aware of the bank’s competitive advantages, where the local perspective and traditions are important elements. Additionally, the organization is very operative as not even the top management has exclusively strategic tasks. Quoting the Vice President: “It is very hard for me with operative responsibilities to set a side 15 minutes every day for strategic thinking”, is implying that the forward looking element is in danger of being undermined. We have thus not attained any signals that the Board seminar would be better utilized considering the backward looking element as it is better handled in daily work tasks than the forward looking element.

### ***11.1 Business strategies***

Performing a SWOT analysis, the forming and revising of business and product strategies are the main tasks of the seminar. As the choice of business strategies are highly correlated with the analyses of strategic uncertainties, and the choice of strategic uncertainties depends on the business strategies, any attempt to separate these discussions would be highly arbitrary and purely of academic interest. They result from the same analyses and discussions. The bank is consequently not making such a separation. We do however acknowledge the value of focusing on the formal procedure and separate between these.

Although it is natural to assume that the informal processes through “everyday communication” in the bank have a significant impact on the chosen strategies, this seminar

provides the main formal instance for strategy formation. The Vice President confirms this by dubbing the seminar “one of the most important strategic meetings for the management during the year”. As the focus of the seminar is on long term strategies, its yearly frequency implies a revision of strategies formed earlier as well as formation of new ones.

Following the conclusion after the discussion on the backward vs. the forward looking element, the seminar should be exclusively proactive. The Vice President does indeed argue that the objective of the seminar is to analyze the organization and its external environment with respect to future development. “The seminar provides an arena for strategic thinking and an advantageous distance from the daily operative environment”. He continually advocates the importance of independent thinking in the seminar and the role of the Board in performing the SWOT analysis. “We have carefully selected Board members with competence attained from various areas. Because each one of them possesses distinct abilities and strategic knowledge and experience, they have important roles in the strategic discussion at the seminar”.

## ***11.2 Strategic uncertainties***

The discussion of strategic uncertainties is treated in the SWOT analysis discussing opportunities and threats. Although the bank argues that they use the Strategic document as a foundation for the whole Board seminar, this would be the task where it is utilized the most. As discussed earlier, many of the strategic uncertainties in the document, especially those which are product oriented, are relevant for the bank to take under consideration. Additionally, the document provides the participants in the seminar with macro economic uncertainties, giving them the opportunity to apply these to a local level.

We understand that the bank does not separate the market specific uncertainties from the product specific uncertainties at the seminar. But it is obvious that they acknowledge the strong links between these, as the expected profitability from the sales of the products is highly dependent on how they deal with the uncertainties they are facing in the local market. They use “several hours” to break down the information from the Strategic document and use this to their benefit. This is accompanied by the strategic knowledge and experience of the participants, providing the foundation for finding the relevant strategic uncertainties affecting the performance of the bank.

The Vice Presidents points out several Action plans directly resulting from these analyses. An example is the effort to increase the share of highly educated employees resulting from the analyses of internal strengths and weaknesses. Among more, it was the opportunities in the OTP market which encouraged these actions, believing that this is a product with a good potential for future income. These analyses have of course also inspired the emergence of additional products as well as decisions to refuse to distribute products perceived not to be able to contribute to increased long term profitability. Structural changes have occurred aiming at utilizing the core competencies of the bank to better exploit the opportunities in various product markets.

Before jumping to the conclusion that a seminar lasting for a couple of days is the only internal source for strategic decisions, we hurry to point out that we believe there are both formal and informal processes in the organization accompanying the seminar. We do however think that the Board seminar is a vital part in this process, both because of the managers' lack of strategic focus in the daily operative environment and the strategic nature of the seminar.

### ***11.3 Debate and dialogue***

The debate and dialogue between the managers and the Board members is obviously considerable at the seminar. One of the important aspects of interactive control is however to include employees at various levels in the discussion improving the organizational learning. The relevant question is thus how the employees are being involved in this process without actually being present. Considering the importance of the seminar in the strategic process, and the highly competent work force, this question should be of great interest to the management.

The relevant debate and dialogue can be divided into the communication before and the communication after the seminar. In our opinion it is the communication *before* the seminar that is of more importance. This communication gives the employees the possibility to affect the formation of business strategies before these are formally set. This would be a dynamic dialogue improving the learning for both the managers and the employees. The communication *after* the seminar is more likely to be a monologue from the managers to the employees, as the strategies are set and any feedback is not likely to lead to any significant changes.

After discussing the subject with the Vice President, we conclude that there are no formal procedures in including the employees in this discussion before the seminar. We do however acknowledge the informal communication, and accept its importance for the bank. When asking how and if the different managers' discuss the programme of the seminar, the answer is: "It is my impression that most team leaders do discuss this with their employees". Although the communication obviously is present, the vague answer confirms our impression that this at best is emphasized variably and highly arbitrary, and purely on an informal basis.

The management of the bank is aware of this problem. The Vice President does question the involvement of the employees in this process, and accepts that there could be an advantage for both the management and the employees to improve the formal communication within the organization. After talking to several of the employees in various fields and branches in the bank, we find no reason to disagree with his opinion. It is our impression that several of the employees are neither aware of the programme of the seminar nor how it affects their work.

The danger of lacking influence from the employees in this process is obvious. Excluding them from the most important interactive discussion would only make it more difficult to take advantage of the internal competence in the organization. This would weaken the organizational learning and competent employees' motivation to contribute strategically.

#### ***11.4 Conclusion***

We conclude that the Board seminar should be, and as far as we have reason to believe; *is* interactive by nature. Being the most important arena for strategic discussion, it strongly affects the formation of strategies in a perspective of 3-4 years. We appreciate the interactive approach at the seminar, and the deliberate selection of Board members for strategic benefits. We have no reason to doubt neither the value nor the importance of the seminar.

We do however question the involvement of the employees. The debate and dialogue is comprehensively discussed, concluding that it is formally limited to the learning in the management with only an arbitrary involvement of the employees. But taking into account the strong organizational culture and the small size of the groups and teams in the bank, we accept that the informal communication is significant also on this subject. This may give

competent employees chances to take some part in the debate and dialogue. However, we do not think this is sufficient and are convinced that a more formalized communication system would improve the organizational learning to the benefit of the bank.

## **12 Action plans for Focus areas**

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After having performed the strategic analyses, the bank has clarified its business and product strategies and the relevant strategic uncertainties. The next step is to exploit the opportunities the bank has in the competitive market, and reduce the danger of the threats.

These Action plans naturally ensue from the strategic discussion in the Board seminar. The Focus areas mirror the bank's selection of financial products from an array of products provided by the product companies owned by SB1 Gruppen. Their emergence depends on the management's vision on how to utilize the bank's competitive advantages given the future strategic uncertainties.

### ***12.1 Strategies and Strategic uncertainties***

These Action plans are merely executions of strategies set earlier in the process. The relevant strategies and the matching strategic uncertainties are comprehensively discussed under the Board seminar. We will consequently limit this discussion to establish that the distinct strategies for each Focus area are best characterized as product strategies. These must obviously be in accordance with the bank's business strategies, and have emerged from the SWOT analyses. Both the strategic uncertainties directly related to the products and those specific on the local market should thus be made allowance for.

A few examples of Focus areas have been presented earlier. With respect to these, an interesting reflection from the Vice President must be mentioned; "Most of the Focus areas have resulted from perceived *opportunities* in the market". We do not necessarily disagree with that, but acknowledge important decisions we perceive to be clear results of threats from competitors and weaknesses internally. Examples are products directed towards younger customers resulting from the pressure on fees after the entrance of cost effective competitors, and the effort being made on attracting younger candidates to apply for positions internally partly as a result of an aging workforce. The first is a result of an external threat, the second

an internal weakness. But when having taken action and introduced new products on these grounds, utilization of the bank's strong position in the market may often give foundation for increased long term profits, and would thus be perceived as opportunities. Consequently, considering the changes in the bank industry, we are of the opinion that these Action plans often emerge from a combination of several factors including threats and weaknesses.

It is then our impression that these Action plans are the clearest results of the interactive processes in the bank. The Vice President confirms this by saying: "The Focus areas emerge from our awareness of what happens in our competitive market and a consideration on how well the bank can serve its customers with these products". This "awareness" alludes to the management's proactive approach through strategic analyses, and their passive collection of market information through retaining customer relationships. Consequently we do understand that the bank's closeness to its customers and its position in the local market, act as important sources of information complementing the formal analyses in the interactive process.

## ***12.2 Interactive control system***

The only current control system that might be characterized as interactive is linked to these Action plans. This can best be described as a basic system containing the Focus areas with budgeted sales targets for the next year and the different teams' attainment of these targets. The purpose of the forthcoming discussion is to deal with the extent of the interactivity of this control system.

### **12.2.1 Signalling of strategic uncertainties**

As stated above, the Focus areas dealt with in this control system have resulted from the most interactive process in the bank. However, the conclusions under both the Strategic document and the Board seminar are partly critical to this interactivity. This will be discussed further in "linking it all together". As stated in Part II, the purpose of an interactive control system is to signal the chosen strategic uncertainties internally to create debate and dialogue and thus improve the learning. When doubting the completeness of the process leading to business strategies and the choice of strategic uncertainties, we also doubt the value of an interactive control system as part of this process. The incomplete process may in the worst case scenario signal the wrong strategic uncertainties and thus lead to a disadvantageous internal discussion.

In this case the negative effects of even a perfectly designed control system would exceed the positive effects.

But the design of this control system can under no circumstances be dubbed perfect. Shortly, this control system provides no direct information about the chosen strategic uncertainties. This is merely a basic system meant to give feedback to the employees on how they perform on areas strategically important for the bank.

The signalling of the strategic uncertainties does however require a more thorough discussion. At the end of the day, the main desire for the management is to direct the internal focus towards the financial products identified in the analyses of these uncertainties. This is true under the assumption that these products result from a comprehensive interactive process and thus are important for the long term profitability of the bank. Although the strategic uncertainties are not explicitly signalled in the control system, the signalling through the products would secure the correct focus. The internal discussion on the sales of the products is then indirectly taking the strategic uncertainties into account. However, the obvious problem with this is that it is difficult for the managers to gain any strategic benefit from these discussions, as the discussions will not be directed towards the causes of the choices made, rather the effects. In our opinion the lack of signalled strategic uncertainties in the control system limits the internal discussions with an interactive focus to an absolute minimum.

### **12.2.2 Cause-and-effects**

We do believe that motivating the employees to learn is the best mean for gaining strategic benefits from their competence. We also believe that to improve the motivation a good follow up is not enough, but has to be complemented with a system visualizing the financial effects of each employee's efforts. That is a system providing cause-and-effect relationships, showing the employees how their daily work tasks fit into the broader picture in the bank. This control system however, is merely a sales report. As it is one dimensional, it does not provide the employees with any opportunities to see if their efforts are important to the bank. After talking to several of the employees it is evident that they trust the management to have taken the correct decisions, and thus they expect their work to create value for the bank. They also point out that one easily can derive information from the quarterly financial reports, and as long as the bank delivers excellent financial results they get the necessary confirmation.

This may be correct, but any confirmation on *what* and *how much* they contribute with is not given. We question how the employees can contribute strategically when given such limited opportunities to see the broader picture.

### **12.2.3 Benchmarking**

When considering the design of this control system, it is easy to acknowledge the importance of the benchmarks. Any fulfilments of short and long term objectives with respect to sales of these products are measured relative to the chosen benchmarks. Obviously, since these are the standards on which the employees are measured, any signalling effect would depend heavily on the value of these measures. We do however think that the benchmarks are chosen somewhat arbitrary, and question if the management's proactive approach is reflected in these.

Already in the first meeting we had with the bank, the Vice President expressed his desire to get more information on benchmarking. He clearly acknowledged the importance of these in the current control system, but let the inadequacy of the process leading up to these shine through. A good interactive control system would include both external and internal benchmarks with a forward looking perspective. Having accomplished a process somewhat interactive implies the bank's focus on the forward looking perspective through the analyses of strategic uncertainties qualitatively. The question is however the process of collecting information for quantitative measures, external and internal, used as benchmarks.

Currently, the main source for gaining external benchmarks is the BSC used centrally in SB1 Gruppen. We have however earlier pointed out the Vice President's doubts in this system. This Scorecard does provide the bank with information on collaborating banks' achievements in sales of several financial products. Some of these financial products are adopted by the bank and reflected in the Focus areas. The main problem is then the different focuses of the banks, as the banks are free to choose how much resources and efforts to allocate to sales of each of these products. Naturally, this inflicts on the banks' turnover for each product, and thus gives doubts to the benefits of the benchmarks.

As the bank is aware of this problem, their use of the BSC is reduced. Other sources for external benchmarking are however absent. Instead of using external benchmarks, they turn to



the internal. Since the bank puts a great deal of emphasis on qualitative plans for these Focus areas, they do include the analyses of the external environment in forming future trends with a basis on historical achievements internally. In practice we thus claim that they start with the achievements from last year, and adjust these for perceived development in the market. But since they lack concrete quantified external benchmarks from competitors or collaborating banks, we doubt the accuracy of these. We thus believe that the backward looking aspect of these benchmarks is evident, as the historical internal achievements predominantly found the basis for next year's benchmarks. The benchmarking is however improved by the use of different teams' and branches' attainments of goals. This provides the opportunity to compare the efforts of one group not only with its own historical performances, but also the performances of similar groups. Anyway, although slightly improved, the focus is still on historical achievements corrected somewhat arbitrary for future trends. The following inaccuracy reduces the signalling effects, and thus limits the benefits of the control system interactively.

#### **12.2.4 Bonuses**

Being aware of the Focus areas' importance for the bank, the management have tied a bonus system to the sales of these relative to the discussed benchmarks. These bonuses are mostly team based, but some are aligned to individual performances of exceptional arts. Of course, having criticized the benchmarking, any bonus system aligned to these would be questionable.

On the positive side, we acknowledge the signalling effect from the bonus system applied. Having worked in the organization, we know that the bonus gets the employee's attention. They understand that these Focus areas must be important to the bank since they are willing to reward sales of these. It is also our impression that this bonus system makes the employees focus more on sales of these products, thus improving the turnover. Accordingly, at first glance the bonus system serves as a tool well suited for improving sales on strategically important areas.

But what the bank should focus on from an interactive perspective is whether the bonus system contributes to the strategic learning in the bank. A well suited bonus system would play an important role in strengthening the effects of signalling through strategic uncertainties and cause-and-effects relationships. It should be suited for a direction of employee's

discussions towards the strategic uncertainties. We incline that the attributes of the control system make this an impossible task for any bonus system. Nevertheless, if the signalling effect is as argued above this bonus system would at least improve the situation.

But as the Vice President says, these bonuses amount to a “pretty small share of the employee’s total salary”. The most important reason for not increasing the bonuses is the management’s fear of weakening the organizational culture which must be characterized as one of the greatest competitive advantages for the bank. They fear that an increased bonus would increase the competition internally, and thus undermine the good work environment and informal communication. Our impression is that the employees support this view. Additionally they mention the danger of being too aggressive towards the customers and too focused on their own personal sales, leading to suboptimizing. In sum, although the bonuses create a certain amount of excitement in the organization, the size of the bonus is not large enough to strengthen the signalling effect significantly.

To sum up we incline that the control system is very limited for an interactive use. It does not signal the chosen strategic uncertainties, it contains no cause-and-effects relationships, applies arbitrary and highly backward looking benchmarks and a rather inconsiderable bonus system. Could the debate and dialogue related to these Focus areas still be beneficial to the learning?

### ***12.3 Debate and Dialogue***

In spite of the incompleteness of the interactive control system, it does signal the strategic focus of the bank by visualizing the Focus areas. That implies a signalling effect from the management to the employees. We have earlier established that the informal communication internally is significant. Considering the general competence of the employees, these signals from the management may well direct this communication towards the causes of the Focus areas. Generally the strategic uncertainties are well known among the competent employees, often because of their tight relations to the market. The combination of signalled Focus areas, the employees’ knowledge about the market and the low threshold for giving feedback to the management improve the chances of improving the learning among employees and gaining strategic benefits from this.

The various teams in the bank, both at the CCU and the PCU, have weakly meetings. There the managers clearly are preoccupied with the importance of focusing on these Focus areas. The Vice President illustrates this by saying that “Even if I may have a greater interest for other areas in the bank, I carefully choose to start the meetings with the Focus areas”. After participating in some of these meetings, we clearly acknowledge that this debate is not only concerned with the turnover for each product but also the strategic uncertainties. It is also evident that, as the focus on these uncertainties increases the complexity of the debate, the interactive perspective discussed increases with the competence of the employees participating. The latter comes as no surprise, but illustrates that the bank is focused on utilizing the knowledge of the employees also for the interactive process.

We acknowledge that the debate and dialogue goes a long way in making up for the lack of signals from the control system. The importance of these Focus areas is underlined by the focus of the managers in internal meetings. But at the end of the day, when the debate and dialogue is not founded in any control system, it gives an informal impression. The following arbitrary feedback to the management shows the importance of employing competent employees able to take initiatives on their own.

## ***12.4 Conclusions***

We conclude that these Focus areas result from the clearest interactive process in the bank. These financial products are chosen from the array of products provided by the product companies owned by SB1 Gruppen. The selection of these products reflected in the Focus areas is a direct consequence of the strategies set earlier in the process.

The value created in this part of the Interactive process is related to the control system. The problem is that this system is most incomplete for the cause it is set to serve. It can be characterized as a simple, one dimensional system providing sales reports for different teams and branches in the bank. It does not directly signal any strategic uncertainties, does not visualize any cause-and-effect relationships and applies a doubtful benchmarking and bonus system. In total this system is not suited to create any value for the bank in the Interactive process. It is not designed to improve the debate and dialogue and direct it towards the strategic uncertainties.

The informal communication and managers' focus on these areas verbally in meetings accompanied by the employees' competence, somewhat diminish the problems with the control system. Nevertheless, the conclusion under the Board seminar is supported. Relying on this informal debate and dialogue implies greater risk of incompleteness in the strategic learning, and increases the probability of not realizing the potential profits from the Focus areas. The need of an interactive control system signalling the strategic uncertainties is evident.

## **13 Budget, Accounting and Variance analyses**

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The Budget is a part of the internal document "Budget and Plans". Understandably, the content of this document is both qualitative through the Plans and quantitative through the Budget. Seen analytically, we regard these parts as separate. Short term objectives for each department would be provided independently of the quantitative budget. Unless otherwise noted, discussions of the Budget refer to the quantitative parts of the document.

The Accounting and Variance analyses serve as a tool leveraging the Budget. We thus regard these analyses as a part of the same process as the Budget. Thus, for simplicity we refer to the whole process of forming budgets accompanied by the reporting and evaluation through accounting and variance analyses as *the Budget process*.

As the Budget covers all the product areas and departments in the bank, they have no intention of using it interactively. At best, it will be well suited as a diagnostic control system. The interactive approach can however manifest itself through the arguments for forming it, and its use if focusing on a few Focus areas. We will thus firstly establish if there are any signs of an interactive approach in the budget, before we analyse it in a diagnostic context.

### ***13.1 The interactive Budget process***

This is a traditional budget for all the departments and product areas in the bank. We have in Part II concluded that such a budget is not suited as an interactive control system much because of its broad focus on more than a few strategic uncertainties. The Vice President confirms that they never had any intentions of utilizing the Budget in their interactive process by saying: "The Budget never deliberately provides new impulses for potential Focus areas".

As we have defined the process leading up to the Focus areas as interactive, we interpret this comment as a refusal to see the value of the Budget in forming new business strategies. Nevertheless, we want to investigate if there is anything in the budget process contributing to the interactive process.

In Part III we have described the bank's process of finding trends, and quantifying these for the sake of the Budget. Obviously these are concerned with finding the main developments of macro economic and market structural art. These are further on obtained with the bank's bottom line in mind. The Vice President continually stresses the importance of managing money for the bank, so factors affecting loans and deposits are of greater interest. But since the turnover in the Focus areas obviously depend heavily on such macro economic and market structural factors, we acknowledge the strong link to the strategic analyses performed with an interactive perspective. Even though not all of the information obtained in this process is relevant interactively, we appreciate the proactive approach towards the market consulting various public and private institutions to gain information on future trends.

As we know, the document consists of both Budget and Plans. Closely linked to the future trends are the Plans for the coming year, as these obviously result from the same process. But, contrary to the trends, these are qualitative by definition and not created to be quantified in a Budget. The pedagogic framing of these in the document make them interesting for further debate and dialogue internally. As for the trends, these are applied for the whole business. They do however make an effort to point out the most critical Plans for each department. This results in a partial overlapping of these Plans and the Focus areas. For a comprehensive interactive use of the system this link would have to be stronger. For the Plans related to the Focus areas however, we believe these can serve as short term updates of the longer term plans in the Interactive process. This requires a tight link between the Interactive process and the Budget process. We will in "linking it all together" see that this condition hardly is fulfilled.

Anyway, we stated in the theory that these kinds of plans should be performed regardless of the Budget. The reason why these are mentioned here is our impression that these are not independent from the Budget in the bank. To the extent that these Plans are useful in an

interactive perspective, the Budget process should get the honour claiming the execution of these.

We do therefore conclude that the *process creating the Budget* is of a certain interactive value. However, the proactivity ends as the Budget starts. The Budget process and accordingly the debate and dialogue internally evolve around too many strategic uncertainties for this process to be dubbed interactive. We will thus look at the bank's Budget as a diagnostic tool with great interest.

### ***13.2 The diagnostic Budget process***

Serving as a diagnostic system, the function of the Budget process is to serve as a tool for measuring output relative to preset standards. In contradiction to the interactive control system, the diagnostic control system is not concerned with giving feedback to the business strategies, but takes the strategies as given. Actions are taken when performance deviates from preset standards. As the work in a diagnostic process is delegated, the employees get the operative responsibilities making it well suited for communication of strategies.

In the Budget we define the goals as the sales and financial targets. Further we define the performance measures as the activity targets that need to be achieved in order to achieve the goals.

The diagnostic preset standards would in the Budget process refer to the goals set in the Budget. The Accounting analysis provides information about the actual attainment of these goals, whereas the Variance analysis compares the actual attainment to the goals. Although a full traditional budget is formed, the presentation of the Budget in the document is concerned with income as the costs, mostly related to salary and IT, are considered fixed. Consequently, the targets will mainly be related to accumulation of income through the focus on quanta and margins.

We will use Simons' "five important steps to achieve an effective diagnostic operation" as the basis for this discussion.

### 13.2.1 Setting and negotiating goals

Before setting and negotiating goals, the bank must have a clear strategy to which they can link the goals. Because of the nature of the budget, covering the whole organization, the process of forming this strategy is different from the process forming business strategies in the Interactive process. This because the foundation for interactive control is a continuous updating of the business strategies, whereas the diagnostic strategy serves as a constraint and is thus more or less fixed during the budget period. For the bank this means a broader strategy securing the bottom line. The Vice President stresses that it is not the financial products per se that is the focus for this strategy, these are merely the effects either as Focus areas or areas under diagnostic surveillance. It is however the main business strategy being *local* and *personal* that is of importance. This is seen in connection with the bank's cause to manage money, providing the starting point for setting and negotiating goals.

The setting and negotiating of goals in the Budget is obviously closely related to the allocation of funds, as this is done on basis of the goals set. The Vice President emphasizes the significance of the management's negotiation with the Board to be granted adequately funds for the operative business. Our impression is that this process is one of the main focuses in the whole budget process, both with respect to attention and time consumption.

But prior to the allocation of funds, the bank must find the main goals in the Budget. As these goals result from the trend analyses, this is the process analysed under the interactive budget process. The quantification of such trend analyses is problematic. The critique from Wallander with respect to the inaccuracy of the forecasts and the following effects for management control are highly relevant to consider here. When enquiring about the forecasts the bank makes, the Vice President replies "I am sure they can be wrong sometimes". Our impression is however that the management fail to acknowledge the consequences of the wrong forecasts as "these do not affect the bank's operative work".

From a diagnostic perspective, the inaccuracy of the forecasts in the Budget is relevant to consider since the Budget provides the preset standards in the Budget process through the goals. The problematic forecasting thus gives doubt to the benchmarks with which the actual achievements are compared.

### **13.2.2      Aligning performance measures**

The diagnostic control system should monitor the bank's critical performance variables. Using the budget diagnostically these variables should be reflected in the concrete performance measures under each business area in the Budget. These are activities related to the goals, and are suited to provide the employees with concrete objectives that are easy to understand and relate to. To obtain consistence, these must be aligned to the goals and thus the strategy. Aligning these would require a thorough understanding on which performance measures results in attainment of which goals. Considering the great knowledge and experience in the bank, we have no reasons to believe that this is done incompletely. These cause-and-effect relationships are however not visualized in the Budget.

Being aligned to the goals and thus being strongly affected by external and internal changes, both which measures used and especially the measure values should, as the goals, vary to secure that the system measures the strategically critical factors. We do however feel the need to stress that these goals and measures will not have to be subject to a continuous updating as the measures related to the strategic uncertainties in interactive control, but are still important to assess regularly to keep the organization on track.

With respect to which performance measures to be used in the Budget, there should be a discussion on which factors are important to monitor in order to keep the bank on track. Naturally, in a changing environment there are also changes in which measures are critical to the bank's performance. This is thus concerned with the critical performance variables at any time being reflected in the performance measures in the Budget.

The measure values will probably be subject to a greater volatility. As macro economic and market structural changes prevail, the conditions under which the bank competes change, leading to adjustments of expectations and goals in the Budget. Aligning the performance measures to these goals, these measures must be adjusted accordingly. We are thus concerned with the management's approach to the problem of performing forecasts as discussed above, in addition to reflecting the performance measures to the critical performance variables.

With this in mind, we were surprised with the Vice President's reaction. We were originally of the opinion that the management did not take the necessary adjustments under



consideration when forming the budget. The surprise was how strongly the Vice president confirmed this suspicion. “The process of forming the Budget is by all means backward looking” and “the factors in the Budget are very seldom adjusted from the previous year”, the Vice President critically declares. There are thus reasons to be very critical to the choice of the performance measures. We conclude that these choices are performed with a mechanic rather than a diagnostic perspective. Considering the forecasting process though, we have no reason to believe that the values of the goals, and then the performance measures, are done mechanically.

The mechanical use of the Budget is thus related to the performance measures not reflecting the critical performance variables at any time. Since the performance measures are aligned to the goals in the Budget, we incline that both the selection of goals and performance measures are subject to a mechanic perspective.

After getting these responses from the Vice President, we had to enquire *why* they use the Budget and if they see any *value* in it. His reluctance to answer is the clearest answer we could ask for. Next he specifies that for the daily operations the interactive Focus areas are of much more importance than the Budget. This would also give an answer to why they fail to acknowledge the problematic forecasting and the mechanic perspective. There would not be any problems readjusting their operations after inaccurate forecasting when this forecasting provides little or no value to the control of operations. Similarly, the bank would feel that there is no point in using resources on updating a system to make it diagnostic when the perceived value is zero. But then, why is the Budget used?

### **13.2.3 Designing incentives**

Under the Focus areas we have discussed, a bonus system is aligned to the fulfilment of goals. This bonus system is however not tied up to the traditional Budget in the bank. Additionally the bank has a bonus system linked to the bottom line. The bottom line performance is the foundation for the Budget, linking the bonus system to the Budget.

We do however refuse to see the diagnostic advantages with this bonus system. It is dubbed “social democratic”, which basically refers to the even share of “bonuses” awarded to each employee. It has got nothing to do with the performance related to the attainment of the

performance measures. The Vice President admits that “this system does not make my employees run any faster” and “we employ this system mostly due to old habits”. As the bank has no other formal incentive system, we conclude that there are no incentives designed to increase the performance in the diagnostically controlled measures.

#### **13.2.4      Reviewing exception reports**

In Part III we described how the bank updates and controls its Budget using the monthly Accounting and Variance analyses. Since the responsibility and follow-up of this practice lay with the CFO, it would be an insult to say that it is performed by lower level staff. Only deviations perceived as significant are discussed in the management, implying a management-by-exception attitude. The monthly control of generating exception reports implies a good focus on reviewing the attainments of the performance measures.

The updating of the Budget, making forecasts for the rest of the year based on the Accounting analyses, requires an ambiguous view. These are performed in addition to the reviewing of exception reports, and will thus have no influence on any actions taken on grounds of the deviation analyses. The reason for doing this is of course to increase the accuracy of the performance measures at any time during the year to improve future planning. These forecasts do claim a greater involvement and attention from the management, hampering the management-by-exception attitude. However, using actual numbers, this is still done with a *backward* looking view. Their ability to tell the future would not improve in this process, so what is the value of it? We do acknowledge that the starting point for these forecasts is corrected, but if you have estimated the trends incorrectly from the start, you have absolutely no guarantees that you will make correct estimations the next time. We are thus not convinced that this improves the Budget’s suitability as a diagnostic control system; the critics against such quantification through forecasting prevail.

#### **13.2.5      Following up on significant deviations**

Related to the above paragraph is the follow-up on the deviations which are perceived to be significant. We have of course discussed the faults of the measures the follow-up is based on. Any follow-up on benchmarks likely to be arbitrary would be equally arbitrary. We are thus doubtful to this process even before considering how it is performed.

Independently from the above critics, we study how the bank carries out this task. We understand that the persons responsible for the areas with performance measures showing significant deviations also are given the responsibility to correct these. In light of the hunger to perform updates by forecasting as discussed above, one could argue that also significant deviations only would be perceived as “natural deviations”, undermining the need to carry out necessary efforts. The Vice President does however argue that “we regularly carry out efforts we think are necessary on basis of the deviation analyses”. In our opinion, this goes a long way in questioning his statements with respect to not perceiving any problems with inaccurate trend analyses because of the unimportance of the Budget in the operational control. Either the Budget must be perceived important enough to be the foundation upon which to make corrections, or any potential corrections should be executed on basis of more information than the Budget process provides. The reality is probably the latter; as further internal and external analyses would complement the deviation analyses in the Budget process before potentially result in action taken.

Anyway, our impression of the Budget process is that the management is not aware of its value for the bank. This leads to arbitrary performance measures, which in turn inflict on the follow-up. Even if the follow-up is done adequately, we doubt the value of it unless adapting formal or informal procedures complementing the Budget in giving grounds for any actions taken.

### ***13.3 Summing up***

Not surprisingly; the Budget is not suited as an Interactive control system in the bank. However, the process of creating the Budget may have an interactive value. Close links between the Interactive process and the Budget process is then necessary, a point we doubt in the next chapter.

With respect to the diagnostic Budget process, there are several shortcomings:

The danger of significant inaccuracy in the forecasts is prevailing, leading to doubts in the diagnostic benchmarks.

There is a practice of not adjusting the performance measures in the Budget to the variables that at any point in time are critical. They merely keep the same performance measures as last year implying a mechanic use of the Budget process.

There are no incentives designed to increase the performance in the diagnostically controlled measures.

The reviewing of the Budget supports a diagnostic approach promoting management by exception. We do however doubt the value of the updates by forecasting done through the year as these do not improve their ability to tell the future. The forecasting critics thus prevail.

Although not necessarily supported by the bank, we believe that the foundation for any corrections when actual attainments deviate significantly from preset standards is not only given by the Budget process. With respect to this the Budget process is incomplete, as it in our opinion is complemented by other analyses before any actions are taken.

The shortcomings can be explained by – and has probably resulted in – the lack of value in the Budget process with respect to operational control. With basis in the theory presented we thus doubt if the bank should use a budget at all in the future.

### ***13.4 A critical view on the criticism***

We cannot end this chapter with a comprehensive slaughtering of the Budget process. There are in fact advantages in keeping the Budget. To illustrate these we take a look at the competitive advantages of the bank. Two of these are the strong organizational culture promoting strategically important values like being local and personal, and the vast experience mainly from this bank, but also from other banks, in the management and among the employees.

The great experience possessed by the managers is by all means a competitive advantage. In addition to the obvious benefits obtained from their knowledge, the customers are familiar with the persons in the management, claiming trust when being local and personal. But in our opinion, the fact that the managers have worked in the bank for several years, makes them attached to their control systems. The Budget process represents the clearest example of such

a control system. Irrationally or not, the perceived safety of having a budget should not be undermined.

Similarly, the same applies for the employees. They are important contributors to the organizational culture. The document with the Budget and Plans are distributed in the whole organization, thus being familiar. As for the managers, but perhaps not to the same extent, the document is perceived to be safe and promotes a preferred conservatism. They have a familiar document to relate to.

Perhaps even more important is the fact that we are talking about the control system in *a bank*. Customer consultants at the CCU usually demand a budget along with a business idea etc. to finance projects customers may have. This implies that they have gained a fundamental belief of the value of the budget as a tool stating the predictions for the future. This applies to the employees at this department as well as some managers since they have operational responsibilities. Naturally, getting rid of a control system with such a basis in their beliefs could very well be received negatively.

So if they elect to keep the budget, how should they use it? We can safely conclude that using the Budget interactively is not feasible. Following our discussions, the bank will find it hard to make good use of the Budget diagnostically as well. There are too many sources for potential mistakes to be made there. The document containing Budget and Plans is however “the most important document in the bank”. The content is well communicated in the organization and gives direction to the employees. It also provides the employees and the management with a view of the whole organization irrespective of how inaccurate it may be. We do believe that if the bank is to keep the document, a stricter focus should be on these aspects. We would also support a decision to quantify only what have to be quantified for the benefits of the users, because the qualitative plans do provide significant values to these purposes. We are however doubtful to the practice of linking the Accounting and Variance analyses to the Budget, and think they should be used towards a control system better suited for diagnostic control.

We believe that a well functioning diagnostic control system is a necessary complement to the interactive control system to achieve a Management control process customized to the

changing environment. The Budget must thus be accompanied by another control system utilized diagnostically. There will be more about the necessary attributes of such a control system in the next chapter.

## 14 Linking it all together

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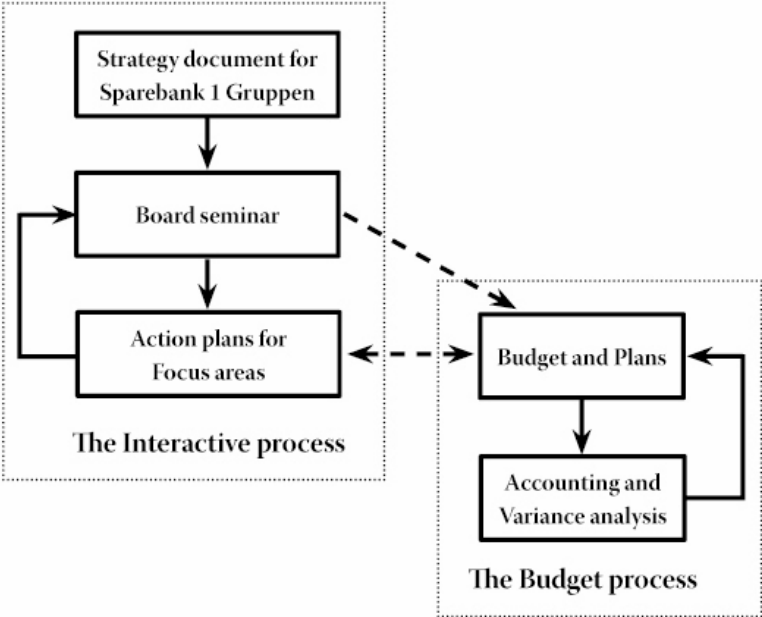


Figure 14.1 – Sparebank 1 Ringerike’s strategic control system

We have analysed all the parts in the Management control process separately. Now we want to take a look at the broader picture; how these parts are linked together, and what is lacking compared to a normative management control process.

### 14.1 Links

Here we will establish the links in the current Management control process. This involves a focus on how each part of the process currently is linked to the other parts in the process, and the consequences of these links.

### **14.1.1 The links within the interactive process**

In the analyses of the Strategic document, the Board seminar and the Focus areas, we have not made any attempts to hide that these are tightly linked together. These are the parts in what we have dubbed “the Interactive process” in the bank.

The main link here is the financial products from the product companies being owned by SB1 Gruppen. An elaborate analysis on the strategic uncertainties concerning the various products is given in the Strategic document. This document does in the next step provide the foundation for the strategic discussions at the Board seminar. There the management and the Board lay the foundations for the creation and revision of business strategies for the Focus areas. In the last step the bank selects which products to sell from the lot in light of the business strategies.

The consequences of these tight links is that the shortcomings in the control system somewhat used interactively is spread in the whole interactive process. This is illustrated by the main question asked in the conclusions of each of the three parts; the involvement of the employees. The advantage is of course that if the bank successfully implements an interactive control system designed to improve the involvements of the employees; this can easily remove the problem for all the three parts.

### **14.1.2 The Interactive process linked to the Budget process**

In terms of being linked with the other parts in the process, the Budget process is the bad seed. This is emphasized by the dotted line in the model, showing that the relations are vague. The weak link between the Board seminar and the Budget implies that the strategic analyses at the seminar “gives signals that we should acknowledge in forming the Budget”. But the longer time perspective at the seminar results in the signals merely functioning as starting points for further analyses used in the forecasting.

The link between the Focus areas and the Budget implies that the Focus areas “are acknowledged” in the creation of the Budget. But the share of allocated funds to these areas is “diminishing” as the bank’s focus in the Budget mainly is on quanta and margins in the business of managing money. At the same time, the one-year-plans for each department in the Budget do also involve the Focus areas, implying that the signalling effects from the Budget

also gain these areas. But the significance of these signalling effects vary from area to area and department to department, and is thus to be characterized as arbitrary.

The consequences of the weak link between the Board seminar and the Budget are related to a non optimal creation of the Budget, with respect to strategies and trend analysis. We have stated under “the interactive Budget process” that the creation of the Budget may have an interactive value if, and only if, there are tight links to the Interactive process. The strategic work performing trend analysis is proactive by nature and could complement the strategic analyses performed for the Focus areas. The weak link, much because of the different time perspective, decreases the interactive value of the Budget to a minimum.

Seen from a diagnostic perspective, the input from the Board seminar to the Budget is the more important. Obviously, since the main arena for strategic discussions is at the Board seminar, not taking advantage of these discussions in setting strategies and goals in the Budget is not advantageous. Since the strategy laying the foundation for the diagnostic use of the Budget in the bank is more general by nature, one can argue that the lack of input from the Board seminar is less important. However, the process of setting qualitative goals with basis in the strategy will in the Budget be performed yearly and results from strategic analyses. But since the strategic analyses in the Board seminar and in the creation of the Budget are performed by the same people, these gain knowledge from both of these processes. This knowledge will obviously also be utilized in both the Interactive and the Budget process.

The weak link between the Budget and the Focus areas are mostly related to the arbitrary signalling effect of the Focus areas in the “Budget and Plans” document. The Vice President acknowledges this and says: “I think it would be an advantage for the bank if these parts were strongly linked together”. With the current use of the Budget mostly as a document for signalling managers’ preferences, and considering the lack of signalling through a less than well functioning Interactive control system, we understand this view. We would however like to point out that increasing the signalling of the Focus areas in this document, would not be optimal from an interactive perspective since the Budget could hardly suit as a well functioning interactive control system.



## ***14.2 Shortcomings in the Management control process***

### **14.2.1 The Interactive process**

We have now completed a comprehensive analysis of the Interactive process in the bank. As the parts in this process are strongly linked together, the shortcomings have surfaced in the discussion on the separate parts. We do not intend to repeat these discussions here, but merely give an overview of the shortcomings. Since the Interactive control system is supposed to signal the focus of the organization and direct the debate and dialogue to the strategic learning, the shortcomings are related to the current control system:

- I<sub>1</sub>. Lack of signalling of strategic uncertainties
- I<sub>2</sub>. Lack of visualizing cause-and-effect relationships
- I<sub>3</sub>. Arbitrary benchmarking
- I<sub>4</sub>. A doubtful bonus system

The fourth shortcoming mostly comes as a result of the other three. These strongly hamper the involvement of the employees in the internal debate and dialogue. Except from the obvious result of not gaining strategic advantages from the competencies of the employees, we argue that this also leads to an interactive approach applied only once a year. This happens because the control system hampers the iterative process in Simons' model. The bank merely starts with the discussions of business strategies and strategic uncertainties in the Board seminar, but gains no formal feedback from any strategic learning preventing a continuous updating of these strategies.

### **14.2.2 The Diagnostic process**

We have strongly criticized the bank's use of the budget process as a diagnostic control system. Generally, a budget is widely used diagnostically, successfully or unsuccessfully, despite the problem with the inaccuracy of the forecasting. The budget process is however not proven well functioning diagnostically for the bank, leading to the argument of implementing another control system better suited for diagnostic control.

They need a diagnostic control system that can remedy some of the shortcomings related to the Budget used as a diagnostic system today, the most important of these being:

- D<sub>1</sub>. The preset standards results from doubtful forecasting
- D<sub>2</sub>. Performance measures set with a mechanic perspective
- D<sub>3</sub>. Lack of a well functioning incentive system

These shortcomings result in a diagnostic system where they cannot be sure that they are monitoring the variables that are critical for the strategy, and an incentive system that do not encourage the employees to work towards targets that reflect the chosen variables.

### **14.2.3 Why shortcomings**

Although the critique of both of their current control processes is quite harsh, they still manage to achieve great financial results. We will therefore look into some of the elements that can explain why their performance remains good despite of the shortcomings in their control process. Factors that might explain why they have no incentives to deviate from the current Management control process will also be mentioned.

The most apparent reason for not making any big changes is that the bank is performing well. The “why fix it when it is not broken attitude” reveals itself here, as in so many organizations. This relates to income, but also the bank’s strong position in the market. As stated earlier, they perceive the market to be stable, implying that the incentives for changes are weaker. The inherent resistance against changes in the organization necessitates a crisis before drastic measures are put into action.

Then there are the features of the organizations that allow them to perform well despite of these shortcomings. Important here are the strong organizational culture and the large amount of informal processes in motion throughout the organization. In addition to these there are the strong connections with the local business environment and the comprehensive knowledge of the market the bank is operating in. This allows them to quickly pick up on any external changes that will affect their business, without applying a well functioning formal process.

Finally they obtain great value from their ownership in SB1 Gruppen. SB1 Gruppen’s knowledge of the macro economic factors and the different financial products might compensate for the lacking involvement of the employees in certain areas.

The strong financial results and the bank's position in the market have come as a result of utilization of the bank's competitive advantages. Having been in business for 173 years in Ringerike, they have built a strong organizational culture and deep local roots. As the Management control process can affect these competencies, any change in their management control system should only be done without harming these. At the same time; to continue to build on these competitive advantages they need to continually adapt their Management control process to the contemporary challenges.

## **15 The Balanced Scorecard – the solution?**

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In the previous chapter we summarized the main gaps between a normative formation and use of the management control process, and the bank's current Management control process. Since the bank is familiar with the BSC from its function in SB1 Gruppen, they have expressed a desire to get more information about the BSC's suitability in their Management control process. We will thus in this section aim at discussing *if* and *how* the BSC can contribute in closing the gaps, both in the Interactive and the Diagnostic process in the bank.

### ***15.1 Does the Balanced Scorecard fit in the organization?***

The focus in this chapter will not be on designing the BSC. However, as the design of the scorecard with respect to the choice of perspectives and target indicators is vital to fully exploit its advantages, we would like to stress the necessity of a conscious selection of these. We argue the importance of designing the scorecard to reflect the bank's competitive advantages, underlining the relative high importance of including the local perspective and target indicators reflecting customer satisfaction for the bank. If the design is performed correctly, the new control system can in fact improve the awareness of the organizational culture and local roots, instead of hampering the utilization of these competencies as some would fear.

Since the staffs are such important assets to the bank, the fear of imposing changes, which are perceived negative, on them can prevent the implementation of a new control system. In light of this, it is important to stress that the purpose for implementing the BSC should be to improve the involvement of the employees strategically as well as improving the reliability of the monitoring, not increase it.

## ***15.2 How can the shortcomings be improved by the Balanced Scorecard?***

Before we start with how the listed shortcomings can be improved with the use of the scorecard, we would again like to stress that it is always the *use* of the control system that is of most importance. The BSC does not facilitate reasons for not continually being aware of how the control process is functioning.

Generally, for both the Interactive and the Diagnostic process, the great advantage with the use of the BSC is its design to communicate business strategies through the perspectives and the cause-and-effect relationships. As this is a vital aspect in both the Interactive and the Diagnostic process, this should be acknowledged by the bank in their efforts to improve the formal communication internally.

### **15.2.1 The interactive shortcomings**

#### **I<sub>1</sub>. Lack of signalling of strategic uncertainties**

The strategic uncertainties to be signalled in the interactive process have emerged from analyses of business strategies with the bank's competitive advantages in mind. By designing the BSC with basis in these competitive advantages one can include the perspectives containing the strategic uncertainties. An example is for instance to include a market and competition perspective. By signalling these, the BSC is well suited to communicate these strategic uncertainties throughout the organization.

#### **I<sub>2</sub>. Lack of visualizing cause-and-effect relationships**

The BSC is well suited to visualize the cause-and-effect relationships. Its foundation is on explaining how the attainments of lead indicators eventually result in improvements in the lag indicators. But the selection of these indicators must be performed with care. It requires comprehensive knowledge of the bank's value creation, gained through experience. As the experience and knowledge in the bank, both among the employees and the management, is good, we believe that they possess the necessary resources for finding the relevant cause-and-effect relationships.

We do believe that the management is currently aware of these cause-and-effect relationships. Several of their decisions reflect an awareness and utilization of these. A recent example is the in-work educational courses all the employees had to attend. The ethical education was an integral part of these courses, which is consistent with their objectives to do business with high ethical standards. This is just one of several examples of actions being taken to improve what would be target indicators in the learning and growth perspective with the objective to finally improve their financial performance.

### I<sub>3</sub>. Arbitrary benchmarking

The benchmarking in the current interactive control system is highly arbitrary because it mostly employs an internal and backward looking perspective. The management consequently hope to attain external benchmarks relevant for their interactive control. The BSC can hardly help in this process. The BSC can however easily improve the sources for internal benchmarking. Using a control system with several perspectives and visualized cause-and-effect relationships, it is easier to comprehend how each department performs in factors critical to the Interactive process. Linking these to the lead indicators, the attainments of these will affect future performance. However, it is important to establish that no matter how good the comparisons between the departments in the bank are, these benchmarks are not forward looking and is thus not attained with a proactive attitude.

### I<sub>4</sub>. A doubtful bonus system

The bonus system can be improved by the use of cause-and-effect relationships and the signalling of strategic uncertainties in the bonus system. Tying the bonuses to lead indicators reflecting the strategic uncertainties and clearly visualizing how the attainment of these targets result in improvements in the financial results, makes the bonuses understandable and obtainable to the employees. Understandable because they comprehend why the bonuses are related to these indicators, obtainable because they in fact can affect the attainment of these indicators. The interactive focus of the managers will then be clearly communicated potentially improving the strategic learning.

Using these elements in the BSC, it is also easier to justify why bonuses are linked to the relevant strategic uncertainties. This provides a foundation for increasing the part of the salary being tied to bonuses. Any decision to do so would however have to take the organizational culture into account. But increasing the bonuses would be suited to direct more attention to the strategic uncertainties, benefiting the debate and dialogue.

### **15.2.2 The diagnostic shortcomings**

#### **D<sub>1</sub>. The preset standards results from doubtful forecasting**

Currently using the Budget process in their diagnostic control, the preset standards result from the forecasting in the Budget. Since we have concluded that the bank should apply another control system in their Diagnostic process, benchmarking will substitute for the forecasts.

We have under I<sub>3</sub> discussed the arbitrary nature of the benchmarks in the interactive control system. With respect to collecting external benchmarks, the approach is the same here. However, although the benchmarks in a diagnostic control system should be aligned to a strategy that is likely to change, the diagnostic benchmarks are not subject to the same proactive approach as the interactive. We argue that the continuous updating of the benchmarks in the Interactive process is not necessary in the Diagnostic process.

Then the same arguments as in I<sub>3</sub> are relevant for the diagnostic benchmarks. The BSC does provide an improvement in the internal benchmarking. However, it does not facilitate any improvements in collecting external benchmarks for comparing the bank's operative performances with collaborating and competing banks.

#### **D<sub>2</sub>. Performance measures set with a mechanic perspective**

Here we refer to the use of the BSC. We do however feel inclined to argue that the design of the BSC can contribute to its diagnostic use. The cause-and-effect relationships in the scorecard make it easier to align performance measures and goals to the strategy. The fact that the strategy is clearly signalled in the control system should make it easier to update the indicators in the BSC when it is strategically necessary. But, this is still merely a contribution to the way it is used by the managers.

### D<sub>3</sub>. Lack of a well functioning incentive system

We can relate this discussion to I<sub>4</sub>. The difference is that in diagnostic control one is only concerned with the attainments of the goals, not the signalling effect. As for interactive control, the BSC does facilitate a chance to apply a fair bonus system suited to increase the incentives for the benefit of increased attainment of critical performance targets.

#### **15.2.3 Value for the Interactive process**

Adopting the BSC will certainly improve the foundation for debate and dialogue in the bank. Through the increased signalling of strategic uncertainties and visualizing cause-and-effect relationships, the employees will be given increased opportunities and motivation for strategic discussions. Linking a bonus system to the cause-and effect relationships will further strengthen the signalling. Provided that the managers facilitate mechanisms to comprehend and make use of the subsequent strategic learning, they can achieve a comprehensive iterative process in Simons' model providing opportunities for continuous proactivity towards the market.

#### **15.2.4 Value for the diagnostic process**

Compared to the budget process, the BSC is likely to contribute with significant diagnostic value. Considering the drawbacks of forecasting, applying benchmarks, although only internal, would probably be beneficial. Since the design of the BSC goes a long way in improving the diagnostics, we believe that implementing it would decrease the chances for mechanical use of the diagnostic control system. It is also well suited for designing an incentive system to direct the necessary attention to the relevant performance measures. Additionally, although not a shortcoming in the budget process, the BSC is well suited for communicating strategies making it a good alternative for diagnostic control.

### ***15.3 Conclusions***

The BSC clearly has several advantages both for interactive and diagnostic control. Compared to the current control systems in the bank, we opt to assert that the BSC would serve as an improvement either used interactively or diagnostically. But, as we have mentioned here and further explained in Part II, it will always be the way that the managers *use* the BSC that is of

importance. Especially for the shortcomings related to the external benchmarking a control system can never be the sole solution.

Since the success of implementing the Scorecards depends on the managers' and employees' attitude towards it, as well as their willingness to make good use of it, we will not take a stand to whether it *should be* utilized in the interactive or the diagnostic control process. We do however acknowledge that the bank is unlikely to remove their budget, implying that an interactive use of it is more likely. Additionally we consider the Focus areas' fiscal importance to be increasing and acknowledge their development in the bank over the last years. Consequently, we believe that if the bank opts to introduce a new control system, it will be in their interactive control process. If we assume correctly, we hope that the management uses the BSC actively to increase the internal debate and dialogue, as well as building on their current knowledge of – and position in the market to achieve continuous proactivity in their Interactive control process.



## CONCLUSIONS

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The challenge we strived to overcome in this thesis was *how Sparebank 1 Ringerike could customize their Management control process to a changing environment*. In the theory we were concerned with interactive and diagnostic control, the budget and the Balanced Scorecard presented with a normative perspective. We argued that the bank would need a well functioning interactive control process to capture the strategic uncertainties relevant to their business strategies, and signal these by using an interactive control system. We also acknowledged that the bank would have to complement the interactive control process with a diagnostic control process suited to keep the bank's operations on track.

In the analytical part we found several shortcomings with respect to both of their processes. With respect to the Interactive process, the managers' interactive attitude is not reflected in the control system. The lack of signalling, cause-and-effect relationships, as well as arbitrary benchmarking and bonus system hamper the debate and dialogue and presumably lead to an interactive approach only once a year. The Diagnostic control is in the bank performed through the Budget process. This process is however highly mechanic and applies doubtful preset standards as well as a non existing incentive system.

We do however acknowledge why these shortcomings have prevailed in their control systems. The bank's strong position in – and knowledge of the market, the organizational culture claiming significant informal communication, and the utilization of the competences in SB 1 Gruppen are all factors reducing the incentives to revise their Management control process.

Our conclusions as well as the bank's curiosity did however lead to further investigations on how the Balanced Scorecard could participate in improving the shortcomings. We do argue that the BSC could remedy a great deal of the shortcomings both in the Interactive and the Diagnostic process. We do not take a stand to if and in which process the BSC should be implemented. We find it more important to stress that the managers must comprehend and adopt the necessary strategic attitudes for any control system to function well in the Interactive and the Diagnostic control process.

The solution to the problem statement must thus be to improve both their Interactive and their Diagnostic process. The Interactive process will be improved by employing a control system

facilitating the debate and dialogue, whereas the Diagnostic process will be improved by directing focus towards improving the mechanic approach. If successfully achieved, we believe the bank will be even more capable of coping with future challenges.

## **CLOSING NOTE**

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We have reached the end of our thesis, and it is time for some final reflections on our work and the results we have attained, as well as making some suggestion for further research. We would also like to take this opportunity to once again thank all the people who have contributed to the thesis.

### ***On the work***

The description of the bank is based solely on our subjective interpretations of the information obtained through the internal documents as well as the interviews that we have conducted. As we have not actively participated in the process, there are bound to be elements that have not received our attention. Neither do we possess a comprehensive knowledge of the bank's local environment nor the bank sector in general, that might have influenced our view on certain issues. Finally, we have not performed a comprehensive investigation to test whether our interpretations are correct, and we acknowledge that misinterpretations may have occurred. Regardless of this, we feel that we have obtained a solid understanding of the organization and how it works. The employees in the bank have generously and openly answered all of our questions and there have been no restrictions as to which documents we have been given access to. Finally, Magne's work experience from the bank has also provided us with valuable insight that would have been almost impossible to obtain otherwise.

### ***Suggestions for future research***

The final section describes how the BSC could remedy some of the shortcomings identified through the analysis. Although we have identified some positive attributes with the use of the Scorecard, we would like to stress the importance of conducting a more thorough analysis on all the consequences of an implementation of any control system in the organization before starting the development and implementation process. This analysis should draw upon the internal competence present in the bank, involving more people from various levels of the bank.

We end with a humble wish that this thesis can be of value for the bank especially and others who have taken the time to read it.

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### ***Meetings***

- Bjørnenak, Trond – Counselling sessions related to the work on the thesis.
- Haugli, Steinar – Interviews to get more information on the bank. Performed on several occasions, over the phone, the Internet and face-to-face meetings.