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Financial Planning In Ukrainian Banks Under Uncertainty

Operation of any bank and its successful performance depends on the ability to take such administrative decisions that allow the bank to provide the proper level of liquidity, profits and save contractors accounts from the negative impact of various banking risks. A key indicator of banking institution position is the strength and quality of financial planning. Banking activity planning is the process of setting goals for the future and finding ways to achieve them. Thus, it is impossible to reach appropriate level of efficiency, without proper system of financial planning.

Research on specific issues in the field of financial planning in the Ukrainian banking institutions devoted to the work of OV Vasyurenka, AP Vozhzhov, A. Epifanova, AM Frost, S. Kozmenko, AI Kuznetsova, A. Kolodzieva, LA Prymostky, IV Sala, MI Savluk, OA Creakle, B. Syurkalo.

Among Russian scholars the issue of developing effective solution for financial planning in banking institutions are devoted to the work of Laptyreva DA, VI Kolesnikov, OI Lavrushina, GS Panova, VM Usoskin and others. The importance of these issues is also discussed by Western scholars: G. Aylenberha, P. Rose, S. Myers, E. Nikbahta, G. Cinque, Timothy W. Koch, DP Whiting and others.

Despite the importance of achievements of domestic and foreign scholars in this field, current Ukrainian environmental conditions require to define the characteristics of financial planning and directions of optimization. In the face of uncertainty the financial planning process can not remain the same as under conditions of stability: planning horizon should be reconsidered, plans should be more flexible, it is necessary to set appropriate goals. One could well argue that the role of planning under uncertainty is not reduced, but the process of financial planning is much more complicated.

It is also important to take into account the shortcomings in the technology of Ukrainian banking planning itself that involves periodic set of goals and plans based on achieved results. This approach does not takes into account not only the continuous and dynamic nature of the variability of the environment, but also the potential of the bank, which significantly reduces the efficiency of financial planning as a management tool, especially in a crisis situation. Thus, the purpose of our study was to find areas to optimize financial planning in banks under uncertainty.

To solve this problem, we have defined the features of financial planning under uncertainty in Ukraine.

The complexity and diversity of managing the operations of the bank requires an integrated approach that involves the indissoluble unity of the assets and liabilities, income and expenses, which are interrelated and interdependent. Such an approach requires the development of methodologies and tools for integrated asset and liability management (ALM

later). An integrated approach to assessing business processes contributes to the improvement of information-analytical system of the bank, creating a comprehensive domestic regulatory framework, a logical completion of the organizational structure of the banking institution.

Since the essence of ALM lies in the field of coordinated financial management of the bank. Where through aligning management decisions certain proportions between assets and liabilities is achieved to increasing profits, reduce risk and control liquidity. The planning is an integral part of ALM.

In a constantly changing environment of the financial market the most crucial part of managing the bank is planning. It is where the policy of the bank is set starting from idea, then moving to introduction of specific measures and quantitative indicators to control the process, and up to the implementation of it.

Planning allows us to predict the future development of the bank. More efficient use of all resources, control of possible risks in active and passive operations, timely introduction of new services, improvement of the quality of service adjusted to market conditions. This all lead to better profitability and consistent growth of capital[1].

Planning is a complicated and extensive process that covers all aspects of organizational and financial management of the bank in the context of the external and internal environment at the strategic, tactical and operational levels.

The effectiveness of the planning system is based on certain principles, the main ones are:

1. Consistency — the introduction of a single integrated system of financial planning.
2. Collegiality — mobilizing and uniting the efforts of all departments in the process of financial planning.
3. Hierarchy — developing financial plans for individual units, which is the basis for the preparation of the overall financial plan for the bank.
4. Regulation — providing a clear segregation of responsibilities and the rules of interaction among participants of financial planning.
5. Versatility — establishment of formalized planning criteria and uniform rules of evaluating planning is needed to address coherence and summary financial plans of individual branches of departments in the overall financial plan for the bank.
6. Mainstreaming — targeting financial plans to achieve the objectives.
7. The balance — balance of banking operations in order to prevent significant imbalances in their structure and appearance of dependence on one market segment.
8. Flexibility — the ability to adjust financial plans in the implementation of financial goals by analyzing the results of the budget in the last stages of planning and taking into account the changes in the internal and external factors.
9. Consideration of risk — taking into account all risks and possible negative scenarios and "appetite" of the bank to risk.
10. Reality — setting real and achievable targets based on potential opportunities and possible changes in certain internal and external factors.
11. Motivation — implementation of financial plans should be an incentive of managers at different levels.
12. Controllability — monitoring the implementation of plans, preparation of proposals to improve the results.

[1] Сало І. В. Фінансовий менеджмент банку: навчальний посібник. — Суми: ВТД «Університетська книга», 2007.

Development of a reasonable plan is impossible without a detailed analysis of the actual situation of the bank and forecast of future activities of the bank. Planning allows you to define tasks that ensure the effective functioning of the bank in the long term and rapid adaptation to changing environmental conditions.

In the process of financial planning one should define key trends of banking financial resources usage, establish the fundamental provisions to form financial relationships with contractors[1].

The main objects of financial planning at banks are assets and liabilities portfolio of banking services and related income and expenses.

Planned units in financial planning in the bank may include bank as a whole and its institutions (branches, additional offices); internal structural divisions of the Bank and its products (transaction services) and customers. Thus, planning is a continuous and comprehensive process. It is also important to determine the planning horizon — a period which made the construction of financial plans[2].

In developed economies planning horizon is 5 years broken down by year. With the development of Ukraine's economy, especially in the banking sector planning horizon should be no more than one year, given the volatility of interest rates and exchange rates. But most banks plan their activities on a quarterly basis with monthly breakdown.

This is not so much related to problems of predictability of financial and economic situation in the country, but to government regulations of forming mandatory reporting including taxes.

Planning stages, related to the preparation of management decisions on which emerging financial plans of the bank, include:

— oal setting (defined goals and objectives that need to achieve);

— search for alternative solutions (identifying all possible alternatives or ways to achieve goals and selection of alternatives that include a detailed study);

— evaluation of alternatives (impact assessment of alternatives to achieve qualitative and quantitative objectives in terms of expected future environmental situation of the bank, as well as the uncertainty of the internal environment of the bank, which is to change the same objectives, measures and restrictions);

— decisions (the selection of alternatives to be implemented and which will ensure the most effective operation of the bank's planned period).

As part of the implementation plan it consists of the following steps:

— implementation plans (implementation of the selected alternative and direct guidance on the implementation of plans to create incentives for the implementation of plans);

— control performance (determined by the actual performance of plans, compared with the plan, subject of a detailed analysis of the results of which, if necessary, the decision to hold a re-evaluation of alternative ways of development of the bank)[3].

[1] Сало І. В. Фінансовий менеджмент банку: навчальний посібник.— Суми: ВТД «Університетська книга», 2007.

[2] Любунь О. Планування та бюджетування як універсальні інструменти управління банківською установою//Банківська справа. — 2007. — № 5.

[3] Лаптырев Д. А. Система управления финансовыми ресурсами банка Процессы — задачи — модели — методы: учебное пособие/ — БДЦ-пресс, 2005.

Thus, the planning process — is a systematic goal setting and determination of the structure and sequence of measures to achieve them. With the help of financial planning goals and targets are set and readjusted along with objectives and activities of the bank, by setting specific absolute and relative indicators of performance. Financial planning requires a comprehensive and integrated assessment of banking strengths and weaknesses, organizational and financial structure, financial performance, personnel policy and oversight of the bank. The next step is to develop a plan of corrective measures that would have shifted the emphasis from the bank as such, to the results of this activity.

There are several strategies that not only allow to operate properly, but also to grow and develop operations even in conditions of uncertainty. The first one is to identify small but growing market segments in the stagnant sector. The hardest part of this approach is to make sure that segment is identified correctly and be able to forecast the segment properly. Another approach is to diversify activities on the basis of current operations, but improve the quality of it by introduction of new banking technologies. This approach is promising because successful innovation can bring significantly higher quality of service and contribute to a rapid growth of client base. The advantage of this approach is that it will also allow to win in non-price competition. And earn good profits by providing innovative services. The third approach is to focus on the dramatic cost savings that will give more competitiveness. Such approach will allow achieving higher profitability on bigger volume of operations. To introduce this approach one should close all unprofitable business units, structural units, reduce operational and economic costs by optimizing internal processes[1].

In today's banking industry not only provided services are important in competition, but planning methods and the ability of banking institutions to draw proper conclusions and make thoughtful decisions based on gathered information.

Currently, banks in Ukraine are experiencing a difficult phase of its development. Mergers and acquisitions are very frequent; market competition is greater than ever. Banks operate under conditions of economic recession, high inflation and low solvency of the population, so they have to take up new niche markets and offer new products. Banking activities are also affected by a number of other factors, such as the need for a positive rating by international agencies, a significant presence in the domestic market of foreign capital, compliance with international standards (including standards of Basel II). All this requires bank managers to improve the quality of management decisions. To address all these issues and find high-quality solutions managers need to organize proper assets and liabilities plan of the bank.

Assets and liabilities plan starts with defining overall strategy and goals of the bank in the market. And at this stage shareholders of the bank decide on the type of behavior of the bank in the market. After all, there is linear relation between profitability and risk, so they search for the optimal proportion of both. And this is the most important task in forming banks strategy[2].

Strategy formed by the following components:

— mission of the bank;

— position of the bank in the financial markets;

[1] Сало І. В. Фінансовий менеджмент банку: навчальний посібник.— Суми: ВТД «Університетська книга», 2007.

[2] Тим же.

— principles of customer and credit policy;
— management principles;
— banks image.

Mission of the bank — is the purpose for which a bank exists and goals that are planned to be achieved over a specified period of time. The mission is the basis for further activities of the bank that helps concentrate the efforts of workers in a particular direction.

In forming the bank's position in the financial markets the following topics should be considered:

— the products and services of the bank;
— characteristics of financial markets;
— organizational objectives expressed in quantitative terms (growth yield and profit);
— technology and innovation;
— internal concept of the bank (the degree of competitiveness of the bank management level).

Important role in shaping the strategy of the bank lies in its' image. The image of the bank emphasizes economic and social responsibility of the bank to the shareholders, partners and society in general. Clearly articulated strategy makes it possible not only to attract customers and improve business relations with partners of the bank, but also increases the interest and loyalty of the employees of the bank.

There are conservative, moderate and aggressive strategy for the bank. According to these strategies, the bank places the resources using the following methods.

Method of General Fund resources of the banks with aggressive policy, based on the optimization of a portfolio of resources through presentation of bank funds in a uniform manner.

Allocating resources is carried out in accordance with certain priorities, whose purpose — to help guide operational departments to solve the problem of the combination of liquidity and profitability.

Using the general fund assets in asset management gives the bank a broad choice of categories of active operations. In applying this method of solving the dilemma "liquidity-profitability" depends on the experience and intuition of bank management[1].

The method of asset allocation is an alternative to the previous method used by banks and is more conservative. Under this methodology, the management of the bank should consider the specific sources from which investment in assets is financed. Under this approach management should carefully analyze the ratio of short term deposits and long lived deposits volumes and volumes of loans in the money market and the total value of the bank's liabilities. Model of asset allocation determines the size of the necessary bank liquidity depending on the sources of the funds.

This model involves the creation of several "profit centers" within the bank that used to house the funds raised by the bank from different sources. After defining to which center in terms of their liquidity and profitability the resources are belonging, the bank's management determines the order of their placement to each center.

The main advantage of the this method is that it allows to reduce the proportion of liquid assets by mobilizing additional resources in loans and investments, leading to an increase in profit margins.

[1] Любунь О. Планування та бюджетування як універсальні інструменти управління банківською установою//Банківська справа. — 2007. — № 5.

Thirdly, we consider a method of scientific management of resource base of the bank and its assets, based on the creation, on the basis of modern software, mathematical and statistical models for predicting and describing cash flow and optimize their yield and the cost of their service in the bank. One method is the use of simulation, the results can be used to make strategic decisions[1].

When choosing an aggressive strategy of the bank the objective function is the maximization of profit subject to the limitation of risk by setting the maximum allowable value of its, banks with conservative strategy minimize risks to achieve a certain level of profitability with desired[2].

To achieve these objectives, the Bank uses models GAP, immunization of balance and currency matching is used depending on the chosen strategy. So banks with aggressive strategy use open GAP currency position and liquidity gaps while conservative use closed GAP currency position and minimum liquidity gap. Adjustment of these positions is at the tactical level planning of assets and liabilities.

According to the selected bank policy, management develops a financial model of the bank. In the financial model planned volumes of transactions, income and expenses are forecasted. These figures allow to construct targets for balance sheet, profit and loss, these are the most important indicators of performance of the bank. The financial model includes:

— balance of resources and investments, broken down by aggregated types;
— margin of active and passive operations;
— brokerage margin and commissions;
— expenditures of the bank;
— overall financial results.

The financial model may also include a cash flow statement of the bank. Typically, a cash flow statement is a separate document which is approved by shareholders of the bank and consists of the following indicators:

— increase/decrease of share capital;
— formation and expenditure of funds based on budget data bank[3].

The process of building a financial model consists of several stages.

Collection, evaluation and analysis, including economic, legal, social and political factors, growth prospects and competition in existing and potential markets; financial prospects in key sectors; strengths and weaknesses of the bank.

Formulation of the main objective of the bank and the specific tasks that cover common areas of marketing, corporate financial performance, management methods of the bank, key markets and types of banking operations.

Decision making and formulation of action programs: setting specific quantitative indicators income, expenses, volume of credit losses on loans, the structure of active operations, the structure of the deposit base, etc.; specification of the ways to achieve

[1] Peter S. Rose Bank Management and Financial Services — 7th edition. — Published by Richard D. Irwin, Inc. — 2006.

[2] Сало І.В. Фінансовий менеджмент банку: навчальний посібник. — Суми: ВТД «Університетська книга», 2007.

[3] Там же.

them, a list of necessary steps, making decisions about the acquisition and use of resources, expansion or changes in organizational structure, staffing.

Documentation: design plans in writing in sequence strategy, tactical plan, budget, balance and financial statement on the level of units and the bank in general.

Coordination and approval of plans: an overview, negotiations, coordination of individual plans, approval of the plan by the Board.

Monitoring the implementation of plans: an analysis of revenues, expenses, results and effectiveness of plans, checking compliance deadlines, in case of significant differences analysis of the causes and corrective action formation, communication the bank's management about the progress of the plan and the results obtained.

One approach of planning in the bank is a compilation of individual plans of the bank employees. Individual plan serves several important functions.

Firstly, with the plan employees are set specific objectives and ways to achieve them and deadlines. This allows you to see the perspectives and serves as an incentive for improving the work of each specialist of the bank. Second, the individual plan allows managers to effectively organize the team and supervise the duties of each employee. Thirdly, the successful implementation of an individual plan is the basis for incentive professionals and the development of their careers.

A comprehensive financial plan is developed on the basis of pre-agreed documents: the financial model of capital flow, plan of development and implementation of new programs and projects, budgeting and calculation of predictive indicators. To centralize financial planning and participation of individual units in the preparation and approval of budgets one should consider two opposing approaches: the development of a financial plan, "top-down" and "bottom-up".

If the process of "top-down" approach financial and operational objectives are set by banks's management, based on the required results. Then separate departments submit their plans, which indicate how they plan to achieve the targets set. This approach is particularly effective when the institution must respond quickly to changes in external conditions or if before it is to restructure their activities so as to maintain or maximize profitability. When using "bottom up" approach individual units submit their proposals for review and discussion at the level of the bank within the general guidelines developed by top level management[1].

Another result of the practical application of financial planning is the availability of technology planning that have resulted from differences in banks by size, type of business and professional level staff.

Most recent planning technologies under uncertainty:

— Multivariate plans in which before making final budget plan, several options are prepared and analyzed. This approach is typical for large organizations, where the planning process involves a limited group of highly skilled professionals. This approach is used in banks with a high degree of centralization of management. This approach works well in the time of uncertainty, because it is based on different estimates where all potential scenarios and outcomes are considered — pessimistic, real and optimistic (Fig. 1);

[1] Лаптырев Д. А. Система управления финансовыми ресурсами банка Процессы — задачи — модели — методы: учебное пособие/ — БДЦ-пресс, 2005.

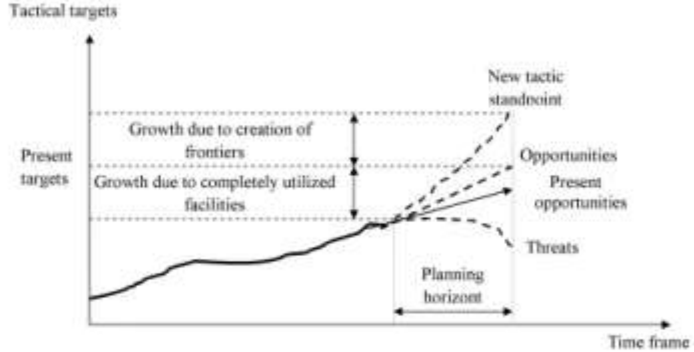

Figure 1 — The technology scenario tactical planning

— Iterative planning that requires repeatedly updating and coordinating the budget at all levels of responsibility. This technology is typical for large organizations in which budgeting process involves many experts from top management to end performers This technology is best for banks with less rigid centralization of management;

— planning based on «significant accomplishment.» This technology is used both in a stable, well-projected business and where it is impossible to collect and process information about the quality of prospects. In this approach, the actual figures of the previous period are used as the basis for calculating targets. Targets are calculated with a certain growth and adjusted to reflect changes in the economy, fiscal policy and state legislative field of banking activities;

— planning «from scratch» a technology planning which must constantly justify the planned revenues, expenses and other indicators as if they operate for the first time. Planning «from scratch» requires each center responsibilities detailed analysis activities to identify inefficient operations and selecting the most beneficial uses of resources. Unlike the previous, this method allows to identify problems and solve them on the planning stage. However, it is more expensive and requires considerable expenditure of time and money;

— technology «Rolling Budget» (or «sliding» planning technology) is typical for venture directions when the situation both external and internal, can vary dramatically. This technology allows for rapid adjustment plans based on analysis of performance in previous stages of planning. Most important factor in this approach is to model the behavior of the market. This technology is an alternative to periodic plans. The essence of this method lies in the continuous adjustment of future plans based on analysis of budget execution of previous steps. The goal is to provide a clear picture of the operational performance under real financial situation while maintaining unchanged medium-term planning horizon (Fig. 2).

Financial planning on "sliding" appears to become continuous in time, which increases the sensitivity of the Bank to changes in changing environment and enables them to respond quickly. By accumulating previous data and experience of using this technology, "sliding" approach allows to significantly reduce planning time and increase quality of the plan. Another advantage of this method is the ability to avoid the problems of inconsistency and intermediate objectives. All these advantages are particularly relevant in the face of uncertainty inherent in the crisis economy. In conditions of uncertainty banks should comprise not only the operational plans, but also medium term plans. Although, the concept of medium-term plan in difficult economic environment is changing itself. Second, the plan should not set targets, and course of action depending on the implementation of various risk factors. Thirdly, the plan should be flexible enough to take into account the dynamic variability of the environment. So the key features of this approach to financial planning is a reduction of detail, increased flexibility and responsiveness.

Given the need for increased flexibility and efficiency in the financial planning under uncertainty, we propose a possible adjustment of financial plans in the implementation of agreed targets under changing internal and external factors. This opportunity gives the method of «sliding» plan, which is an alternative formulation of periodic plans (Fig. 2).

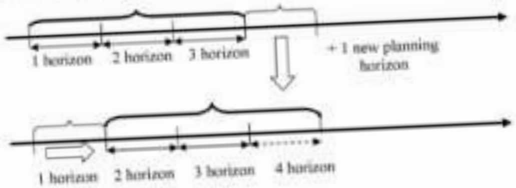

Figure 2 — Mechanism of «sliding» of financial planning

It is also advisable to select multiple rules to increase the realism of financial planning in crisis conditions, which are subject to high uncertainty. Firstly, planning based on a pessimistic forecast. In operational terms appropriate to use pessimistic premise of factors and provide maximum compensating measures will somewhat negate a high degree of uncertainty. Second, the preparation of crisis plans should be based on expert assessments of employees and, most important, increase the powers of branches in the preparation of plans. This approach will give affiliates greater independence and create the conditions for creativity leaders and specialists of regional offices, which will take into account the real possibilities of branches and use the full internal and external potential, given local conditions and to determine the real needs of customers, to achieve objectivity, reasonableness and reality developed financial plans. Using peer reviews is one of the main problems for uncertainty. This method can not get accurate data and forecasts. Thirdly, it is responsive to changes. Under conditions of high uncertainty the bank has to strengthen macroeconomic data gathering and be able to broadcast the results in time to get fast response.

Thus, the process of financial planning is tailored to certain conditions of the bank. Understanding of financial planning in banks under uncertainty and implementation of directions of its optimization allows to take into account when planning a continuous and dynamic nature of changes in the external environment, the possible negative scenarios, potential threats and risks and to plan measures to prevent them. And with the ability to adjust financial plans in the implementation of the set objectives can significantly improve the efficiency of the developed plans as a management tools. We propose to use scenario planning where dynamic changes of the environment are taken into account. All potential threats and risks are considered and measures planned in advance to prevent them. Important feature of this approach is to introduce mechanism of "sliding" financial planning that allows to continuously adjust financial plans to meet required result.