

# Strategic planning is not long-term budgeting

**W**hat's the difference between a strategic plan and a multiyear budget? If you're not sure, there's a good chance your community bank has an extended budget masquerading as a strategic plan.

There are substantial differences between strategic plans and long-term budgets—both in how they are created and in the end products. Very few organizations really need a multiyear budget. In fact, for many organizations, including community banks, they can sometimes do more harm than good.

**How they differ.** The function of the budget is to maintain, protect, and allocate the organization's resources. The strategic plan prepares the bank to make future decisions, enabling it to take advantage of opportunities as they arise and to avoid or lessen the effects of adverse developments.

The most important difference between the two is in the way they influence the bank's decision-making processes. Community banks have two choices: they can react to changes in the marketplace after they occur, or they can act now to shape the environment they will face in the future.

In budgeting, such critical issues are predetermined, either as finalized decisions or as assumptions. Central to budgeting is the task of forecasting levels of loans, deposits, and revenue. But forecasting is relatively unimportant in strategic planning. Similarly, the relationship between costs and revenue generation must be assumed in budgeting. In strategic planning, such relationships are at best a secondary consideration.

True strategic planning encompasses

*William R. Soukup, Ph.D., is a partner with CS Consulting Group, San Diego. He is also a member of the management faculty at the University of San Diego, where he is director of the Graduate Venture Management program.*

no such attempt to *predetermine* decisions. Instead, it provides a guide or framework within which future decision making will take place. It emphasizes longer range objectives, not so much in terms of specific financial performance, but in terms of where and how the firm will position itself with respect to customers, regulators, employees, product types, technology, and the community.

For example, a bank located in an

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area where the demographics are changing substantially may need to reposition itself by developing new products and services and corresponding outreach efforts to meet the shifting needs of the community.

The result of the strategic planning effort is a much more flexible frame of reference that can be used to guide and evaluate the countless alternatives that will present themselves to the bank's decision makers during the period covered by the plan. In a sense, a strategic plan is a navigational system, while a budget is a specific road map.

**Looking ahead.** Having determined the bank's objectives, strategic planning typically moves next to consider two important sets of purely exploratory questions: (1) What developments can management expect during the next few years that might have some implications (either favorable or unfavorable) for the bank? (2) What are we really good at, and which markets, actual or potential, can be best served by those capabilities?

These are exploratory in the sense that no firm predictions or operating decisions are made. Rather, the purpose is to lay the groundwork for making

future decisions.

Because so many strategic plans are referred to and viewed as "five-year plans," it is tempting for banks to think of them as five-year budgets.

The dangers of this approach are illustrated by the recent experiences of one moderately successful bank:

In describing his bank's most recent plan, the president proudly observed that the plan was truly an operating management tool, constantly used by both executives and operating managers. He also observed that the bank had found it unnecessary to update the financial projections of the plan, because they had hit the projections "right on the nose."

**Missed opportunity?** In further explaining their planning approach, he described a Small Business Administration lending department that had been added in order to provide an additional service to the bank's clients. The president explained that the new department had never been expected to make a significant profit. In accordance with the plan, it was very lightly staffed and expenses were kept under tight control. The result was exactly what had been budgeted: A very small department that comfortably covered its out-of-pocket costs and made a useful service available to customers.

What the president didn't realize was the fact that market conditions had changed during the past few years, increasing the profit potential of that particular group. In fact, several of his competitors had established far more aggressive SBA lending programs in this area and were realizing significant profit from them.

The point is not that the bank made an incorrect decision. After all, it may have been pursuing other opportunities with superior potential returns. The fact remains, however, that adhering to what was, in effect, a long-range budget prevented the bank from fully and correctly assessing a potential opportunity as conditions changed. □