1 Managing central banks for tomorrow – practical challenges

by John Mendzela

Any institution should be managed by first envisaging future external demands and then planning the capability to meet those demands. As policymaking institutions, central banks take a strategic and long-term view of the world and their own role in it. They also have tremendous intellectual capability to apply. So one might expect central banks to be leaders in institutional management and highly receptive to change.

But it is not like that. Central banks are conservative institutions that are more likely to be laggards than leaders in management and change. For the most part, central banks have focused their top-level thinking on policy and operations, and (relatively speaking) have neglected institutional management.

That did not matter so much when they were less independent and faced more predictable demands. It matters a great deal today, in 2009, when central banks have become pivotal institutions in a dynamic global and technological economy.

The crisis that erupted in 2007 has presented more than a policy and operational challenge. It has also highlighted specific management inadequacies and change needs. Central banks have come under pressure to demonstrate that they have not only the technical skills to perform their roles, but also the institutional management to deliver those skills effectively and efficiently.

The management practices central banks require for the future differ considerably from those they applied in the past, in challenging ways.[1] The subsequent chapters in this book look at specific challenges and how particular central banks have met them.

An opening chapter would ideally present a top-level overview of "best practice" in central bank management. Sadly, that is not feasible. Each central bank has unique features and must blend its situation and modern management practices into its own "right practice". This opening chapter therefore tackles a specific and practical question: from experience, what key practical issues commonly arise in that process, and how can they be tackled? The list I will consider reflects the issues that I have found to occur most commonly and that have the greatest impact in facilitating or hampering better institutional management:

- governance;
- culture;
- pragmatism;
- efficiency;
- strategic management;
- human-resource management; and
- modernising support services.

The remainder of this chapter considers each in turn.

Governance

Much has been done about central bank governance – in its policy context. Far less attention has been paid to its institutional management context. "The modern institutional set-up of central banks is predominantly being driven by the quest for monetary independence; this may have resulted in poor solutions and poor accountability with respect to other central bank tasks."[2] The law of unintended consequences has been at work here.

In relation to institutional management, governance is simply "what happens at the top." Here structures, roles and processes need attention in many central banks.

In commerce, a critical mass of skilled external directors should provide independent and complementary oversight of institutional management. Structurally, many central banks entirely lack that outside-in view – their "boards" comprise only insiders who are also the top-level internal managers. And even where outsiders are involved in governance, the selection criteria are likely to reflect political accountability or technical expertise, not management experience.[3]

Involving boards chosen for other purposes in management oversight is usually counter-productive. And restructuring the governance of a central bank is difficult, often perilous. Fortunately, there are practical ways to improve the operation of a board that is less than ideally structured.

Firstly, members must make “the board” or “the governors” a collegial body. Individual members may have specific responsibilities or expertise, but the board’s decisions and communications must be those of a collective individual. If disunity is evident at the top, fragmentation and conflict quickly spread elsewhere.

Next, they should articulate and consciously manage the multiple roles of director and top manager. Keep role questions in mind: what “hat” am I wearing now? What does that require from me? An individual member might work on some topics in more detail, but the board should process short “executive summary” papers delivered to all members.

Thirdly, board members need to delegate energetically. Delegation is not abdication – the board that delegates a task remains accountable for the outcome. But sound delegation empowers managers to make decisions faster and at more appropriate levels, within documented formal authority.

Not everything can or should be delegated. Some decisions really do belong to the board, and some delegated activities (for example, public communication) need centralised coordination. But boards should be continually mindful that “the opposite of effective delegation is micromanagement … too much input, direction, and review of delegated work.”[4] Once micromanagement takes hold, managers will resort to “upward delegation” and avoid responsibility.

Typically a central bank will need some governance-level administration – a “corporate secretary” role or “governor’s office”. But that administration centre should not become an alternative power centre that makes delegations elsewhere ineffective.

Lastly, only sound documentation and disciplined processes can realise good intentions. In most central banks, board agendas are overcrowded and the total volume of papers is far too great. In many, formal delegations of authority are too prescriptive and legalistic, or governance and management processes are overly driven by procedure. Attention to practical matters – to better focus board time and attention – can do much to improve the quality of governance.

Culture

From a practical perspective, culture is the answer to simple questions: what really matters around here? How do things get done? How do people behave? I find it useful to consider four fundamental types of institutional culture.

In a "power culture" where might is right, good central banking and good management become highly constrained. The characteristics of a power culture are not restricted to countries where arbitrary regimes impose bad policy on their central banks. Many central banks that have more advanced cultures nevertheless face lingering problems from a history of autocratic governors, emulated by autocratic managers. For example, I have encountered situations where management policies are justified only by an out-of-context or incompletely informed remark by the governor – often to his later dismay.

An "authority culture" underlies many central bank traditions. The benefits include orderliness and consistency – positive aspects of bureaucracy. But negative aspects like inflexibility, slow responses and wasted talent are often apparent too.

Many central banks now want an "achievement culture". People are encouraged to be ambitious, challenging and focused on results. That has a downside, though, for example in rivalry, weak teamwork and short-termism. Central banks often talk of undesirable "silos", environments where by departments compete and minimise their interdependence, reducing institutional synergy and efficiency.

It has been said that the future of central banking demands a "value-add" culture, in which people willingly contribute to collective results without necessarily gaining individual recognition. But then performance management becomes difficult …

There is no mystical right answer. An optimum "blend" of cultural characteristics, continuing and new, can be articulated and targeted. But incentives, not rhetoric about values, will motivate behaviour. For example, if people see cross-functional contributions earning visible respect and (even better) counting towards performance ratings, then those contributions will happen. But if they believe that "individual brilliance" is what really matters, then they will hoard data and ideas to maximise personal impact.

Culture change is hard, but essential: "If behaviour doesn't change, nothing does." Supporting systems such as codes of conduct, competency-based job descriptions, consultation processes and training courses can help change and reinforce behaviour, but in the end, culture is caught, not taught. So leadership by example, and from the top, is vital.

Pragmatism

Some years ago, I found a central bank applying management systems designed for a manufacturing environment. Unsurprisingly, they worked well in currency processing but badly everywhere else.

Few central banks would make that mistake today. They recognise the need to "adapt, not adopt": to customise new management practices to their unique needs. But central bankers face an occupational hazard.

In design, management is an inherently imperfect craft. The Pareto "80/20" principle and the law of diminishing returns apply. In execution, management is a fluid sport. Analysis, systems and training can support good performance in management, but they cannot create it. Central banks are inclined to approach management too intellectually, using the tools they apply to their technical disciplines. To take some examples:

A simple performance appraisal system, operated energetically and well, will deliver far more value than a complicated system that people dislike and struggle to use. And the costs and learning curve of system change need careful consideration. But the pursuit of a technically more perfect system, with frequent changes, is common.

The "balanced scorecard" is a valid and appealing concept to guide planning and management. But the comprehensive and elaborate reporting systems that external consultants (or internal enthusiasts) often recommend bring high overhead cost and do not fit many central banking activities well. A concise and simple framework, improved over time and with experience to maximise the net value it adds, is preferable.

Central banks' job descriptions frequently describe staff that cannot be found in the local market or will not be attracted by the remuneration available. Financial-supervision staff are a common example. For a central bank to deliver what it promises, realism may demand conscious compromises of scope or activity when designing functions, structures or individual jobs.

Central banks cover a wide span of activity, the scope militating against unduly uniform application of management systems. The common complaint "HR designs everything for economists" is a danger signal. A reasonable balance between common principles across the institution and localised variation should be accepted.

In institutional management, be pragmatic. Pursue optimisation, not perfection.

Efficiency

Gone are the days when central banks could loftily wave away questions about their efficiency by talking of risks to their effectiveness. Today, stakeholders demand both effectiveness and efficiency. What specific issues arise?

In terms of total employment, central banking is a rationalising industry. The continuing shift out of labour-intensive operations and the evolution towards supranational central banks will continue the "downsizing" trend. Central banks have typically been close-knit institutions that find it painful to shed staff. But central banks that wish to maintain relevance and credibility need to respond positively to rationalisation: to lead, not lag behind.

Branches offer special challenges. Are they needed? What functions should they perform? How much autonomy should they have? Who should oversee them and how? What should the efficiency target be?

There are no easy answers. Central banks often worry that too much focus on efficiency and cost will reduce capability and add risk. From experience, that fear is misplaced.

Central banks are in reality rarely constrained by resource budgets.[5] Apparent budgetary pressures usually result from ineffective management systems that do not properly prioritise outputs or value resources. A one-off "zero-base" review followed by more strategic resource management can achieve efficiencies that easily meet stakeholder expectations and allow investment in areas short of resources. It should also deliver added knowledge and skill for future institutional management.

To succeed, a zero-base review must be creative and challenging. For example, it is vital to focus on "net added value" for stakeholders, not just "quality" for technicians. And benchmarking will often need to look beyond other central banks.[6] A stronger efficiency focus is not a problem. It is an opportunity to strengthen the institution and its management.

Strategic management

Strategic management is a cycle of planning, implementation, measurement and monitoring. For central banks, planning is not a major challenge. But implementation often is. It is common for central banks to have impressive (intellectual) strategic plans but struggle with their (practical) implementation.

Where do central banks implement best and worst? To generalise:

- high implementation success is often visible in monetary policy implementation, other specialised operations and core technical capability;
- success is less common in dealing with new functional demands, multi-institution projects, and market-transferable capability; and
- implementation failure is often evident in withdrawal from functions, linking strategic and operational management, and internal rationalisation.

Central banks that understand the weaknesses in implementation they are likely to have can target special attention to those areas.

Measurement and monitoring of strategic performance are difficult for any organisation. What is easily measurable may be incomplete or inappropriate. Timeframes are difficult to set. Data and intuition both count. Some central banks have adopted methodologies that seek too much precision at the strategic level, too soon. It is relatively easy to produce a long list of key performance indicators (KPIs) for operations and outputs, but much harder to produce a "simple but profound" one-page strategic scorecard.

Balance can be hard to achieve. In hindsight, many would say that inflation measurement and reporting received too much attention from central banks, while measures of potentially unrealisable assets in the financial system received too little. Performance measurement is always a journey, not a destination. A thoughtful process of thinking about performance measurement often adds more value than the measurements themselves.

Strategic management is not just a higher level of operational management. It demands more time and attention from the top, and a more holistic and intuitive approach. Reluctance of top managers who already feel overloaded to "spend more time on management" is understandable, but mistaken. Strategic management processes can deliver a high return on investment of scarce top management time. By contrast, inappropriate or unnecessary involvement in operational detail is a typical source of ongoing overload that often crowds out strategic thinking.

Strategic management includes the establishment of project management frameworks and the management of strategic projects. In this area central banks face two key vulnerabilities: their tendency towards complication and a reflex to “form a committee”.

Neither vulnerability is insurmountable. Specific criteria can distinguish between activities that demand a genuine and ongoing peer interaction across functions or departments (a committee with a charter) and those which demand multiple participation towards a finite and strongly directed goal (a project with a brief). Project management frameworks that apply common principles differently and optimally to varying projects can readily be developed.

Strategic management also includes management of strategic risk from an institutional perspective. As financial and public institutions, central banks have always emphasised traditional risk management through authorities, controls and audit. Financial risk can threaten profitability and capitalisation, but more fundamental and less tangible risks such as reputation and capability often need more attention.

The welcome new emphasis on risk management needs to be thoughtfully directed. Integration is important – a new bureaucracy should not be created. And risk management that is not positively oriented readily becomes risk avoidance, a characteristic often too evident already in central bank management culture.

A central bank can achieve greater benefits from strategic management by building competence across an integrated set of strategic-management processes.

Human-resource management

The effectiveness of a central bank relies on the quality of people it engages and the quality of what they do. But “engage” has several meanings. People are engaged with their work when they are committed and motivated. Human-resource management aims to attract, develop, retain and reward people accordingly.

The model central banks have traditionally applied – lifetime careers that begin with a long apprenticeship, proceed through slow promotion and end with good pensions – simply will not succeed any more. The time horizons and expectations of new staff have changed. International mobility of skilled people means that central banks can no longer even count on their national labour pool.

Increasing specialisation and technological change make it difficult to produce generalist "central bankers". There is no magic formula for replacing the traditional model. But some key elements can be identified.

First, broaden the planning focus. Replace individual succession and training with institutional capability planning and development.

Second, distinguish between core and non-core skill sets. Excellent economists may well spend their productive career entirely at a central bank, which will be a centre of excellence in their field. But excellent information technologists usually need varied experience in a number of organisations to do their jobs well. Human-resource management needs to accommodate both extremes, as well as intermediate cases.

A third element is to develop flexible contractual packages. A central bank can successfully compete in the marketplace for skilled and experienced people at middle and senior levels for parts of their careers. The more diverse and evolving capability base that results will be more valuable than a closely inbred lifetime group. Too many central banks still "shuffle the pack" when the more realistic solution is to add some fresh cards.

Fourthly, differentiate between technical and managerial career paths, and reward performance in both dimensions; both are important, but their skill sets differ considerably. It is tragic to see some central banks still distorting organisation structures to compensate for weak management skills, for example by fragmenting work across many small units. It is also tragic to see central banks de-motivating staff by appointing as managers people who would instead contribute better in a technical role and do not enjoy management anyway.

Fifthly, make career planning a joint responsibility. Set realistic expectations. Link training and development investments to contribution, not just ability, then target specific benefits from those investments.

Lastly, reconsider rank-based staff classifications. Role-based systems that individually evaluate, recruit for and remunerate each job are likely to fit a more specialised and less hierarchical world better.

This list of key elements for better modern human-resource management could continue. Listing is far easier than implementation. But reactive, incremental adaptation of traditional models will not win the competition for scarce talent and changing skills. Central banks need to approach human-resource management more energetically, and more comprehensively, than ever before.

Modernising support services

Outlining key issues in just a few words tends to highlight the challenges, not early gains.

Are there no quick and easy wins? In fact, any particular central bank will be able to identify wins specific to its situation. Modernising support services is one such win that is available to most. As a bonus, progress here can directly contribute to progress elsewhere.

What do I mean by "support services"? Support services are those general business activities that merely support the central bank's specialised outputs. So the term excludes specialised activities like economic research and financial market trading, but includes human resources, office services, information technology and accounting.

Why is modernising these a quick and easy win? Cost-benefit judgments are easier to make. Support services should operate strictly on value-for-money principles, with fewer strategic trade-offs to consider. By definition, change and transition risk is lower for non-core activities.

Effectiveness and efficiency can improve quickly. Modern organisations outsource – "buy, not make" – a widening range of non-core goods and services. Even where non-core activity is kept in-house, its performance is measurable against external alternatives. Most central banks have been slow adopters and still have substantial gains to make. Yet the required tools – measured service and satisfaction on the customer side, defined standards and charges on the supplier side – are established and simple to use.

Modernising support services is also a catalyst, with substantial indirect benefits. More businesslike interaction with internal suppliers builds management awareness and skill in core functions. As the delivery of support services modernises, top management can redirect attention away from peripheral matters to core activities.

Some central banks have already engaged senior business professionals to manage non-core and internal support functions. They have increased effectiveness and efficiency, diversified institutional knowledge and encouraged a more worldly culture.

Why have others not followed this course? Modernising support services can be harder in some environments, for example where few external suppliers exist. But the main obstacles tend to be internal and subjective. For example, "outsourcing" may be challenged on political and ideological grounds, when in reality all central banks obtain some goods and services externally – they rarely manufacture cars, for instance. Sourcing decisions demand objective analysis of benefits, costs and risks – something central banks should do well. Transitions can be planned and managed.

Resistance to modernisation may reflect vested interest, as with uneconomic staff benefits. Or it may just reflect conservatism. Modernisation often involves holistic change to business processes and people skills, threatening those who cannot or will not adapt. For example, the collaborative and informal use of information and communication technology often clashes with traditional administrative practices – it is not unusual to see central bankers receive the same information electronically and by memorandum, with no rationale for that duplication.

Modernising support services should come early in most change programmes.

Conclusion

Those central banks that actively improve their institutional management are more likely to achieve continued relevance, independence and influence. The challenge is no longer "modernisation". Central banks now need to achieve management competence that is high enough to demonstrably support their technical excellence. That goal is eminently feasible.

But it cannot be reached on autopilot. This chapter has outlined practical problems and solutions in particular areas, but isolated initiatives will achieve little. To succeed, institutional change needs a systematic and sustained approach. The key ingredients are twofold: sponsorship, investment and leadership from the very top must be visible at critical junctures and be complemented by skilful implementation of change initiatives.[7]

Notes

1. A comprehensive analysis of management practices and how those practices change across "three ages" can be found in the author's "Leadership in Central Banking" at *www.mendhurst.com/centralbanking.*
2. Sveriges Riksbank Working Paper 221, "Governing the Governors: A Clinical Study of Central Banks" by Lars Frisell, Kasper Roszbach and Giancarlo Spagnolo.
3. See IMF working paper WP/04/226, "Central Bank Governance: A Survey of Boards and Management" by Tonny Lybek and JoAnne Morris.

4. http://en.wikipedia.org/wiki/Delegation. Accessed January 2009.
5. IMF Staff Paper Vol 54 No 3, "Spending Seignorage: Do Central Banks Have a Governance Problem?", by Alain Ize, presents interesting evidence.
6. An accounting framework that separates the expenses of financial operations from true "operating expenses" is essential for internal management and external reporting. See the author's "Good Practice Accounting and Reporting" at *www.mendhurst.com/centralbanking.*
7. The author's "Managing the 21st Century Central Bank" at *www.mendhurst.com/centralbanking* outlines a process for planning institutional change and suggests likely key features of "right practice".