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How to manage the 21st-century central bank

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How to manage the 21st-century central bank

John Mendzela sets out the management practices central banks need to succeed in the future, and how to change successfully.

In central banks, internal management practices have typically received limited and sporadic attention from top management. But in a world of rapid change and a global "war for talent", central banks will need to pay much greater attention to internal leadership and management. Why? Because those central banks that actively take up the challenge of internal change are the ones most likely to achieve continued relevance, independence and influence in the 21st century.[1]

John Mendzela

Consider these current challenges in central banking:

- The accountability demands that accompany central bank autonomy;
- Increasing pressures to demonstrate good governance;
- Tighter financial constraints on income and spending;
- Internal dissatisfaction with traditional management practices;
- Problems in attracting, retaining and motivating capable people;
- A growing number of central banks that do not issue their own currency; and
- Globalisation making national economies more interdependent.

Three ages of central banking

The 21st-century central bank will need an information, reporting and communication framework to meet external scrutiny and live within constraints. How to do that from a policy perspective is relatively well understood. But central banks will increasingly need to demonstrate not just how policy is determined and implemented, but also how well management is "running the shop".

How to do that *technically* is increasingly familiar.[2] But what does a "21st-century central bank" look like in terms of management practices? Can we usefully generalise or is each central bank unique?

In working with central banks on change management, I have found it useful to imagine development of a hypothetical central bank through "three ages".[3] In the "first age" the priority is to be effective. Customers and stakeholders seek predictability, consistency and reliability. The central bank is expected, indeed encouraged, to operate as a "bureaucracy" – in the positive sense of that word. To run the shop, senior staff just administer that bureaucracy.

The "second-age" central bank demands a more modern approach. Functions and structures need rethinking. Staff numbers fall substantially to recognise functional and technological change, with remuneration reflecting economic value not length of service. The tools of 20th-century business – measurable objectives, cost accounting, management reporting, stakeholder accountability and systematic performance improvement – are adapted to the specific needs of the central bank. In the second age, senior staff must be genuine managers and not just administrators.

The "third age" of central banking demands a new and more complex method of running the shop. For example:

- Organisational boundaries – both internal and external – become more permeable. People and ideas are exchanged in more flexible ways.
- Increasing specialisation and technological change make it difficult to rotate technical staff and offer managers generalist careers. Senior people need external experience to do their jobs well and move to and from the outside world.
- "Career" progression becomes more of a joint responsibility, jointly funded.
- Succession planning is replaced by capability planning.
- Project sponsorship and management become core skills.
- Staff expect to work in a creative, team-based environment in which they make a substantial and recognised personal contribution.

Uneven development

That all sounds achievable through evolution. Unfortunately, linear development through the three ages no longer applies. Functions from earlier ages continue in new forms even in the most advanced central banks. And in a global economy every central bank is working in the 21st century. So the priority of exploration is added to effectiveness and efficiency for everyone. Indeed, third-age "thought leadership" may be even more important in developing economies where only the central bank can capably lead on many vital issues.

It is however dangerous to devise a one-size-fits-all picture of the 21st-century central bank, or to prescribe "best practice" in central bank management. Each central bank has its own unique features and needs an individual change path to pragmatically blend the management principles of the three ages into its own "right practice". How should that work proceed?

Key features of the three ages are outlined in the table below.

To begin, outline the future FORM of your central bank – its Functions, Organisation structure, Resources and Management systems – in that order. Visualise yourself working on a whiteboard...

First, clarify future functions. List all functions currently performed. Classify them as:

- Core functions sustainable across foreseeable economic development;

Table 1: Key features of the three ages of central banking

	First age	Second age	Third age
Mission			
Functional focus	Mainly operational	Policy and operational	Policy and "advisory"
Priority for delivery to stakeholders	Effectiveness – do the right things	Efficiency – do things right	Exploration – influence new things in new ways
Typical external relationships	Conduct transactions	Consult and communicate	Collaborate and interchange
How to "run the shop"	Administer a bureaucracy	Manage a business	Lead knowledge workers
Structure			
Organisation model	Civil service	Commercial and not-for-profit	Foundation or "R&D" centre
Main way to organise activity	Departments	Processes	Projects
"Career" framework	Lifetime career paths/expectations in all areas	Lifetime careers in core areas, term contracts in others	Individually varying contracts and career expectations
Remuneration type	Time-driven salary scales plus major fringe benefits	"Total cost to employer" packages	Flexible packages tailored around individual paths
Management			
Dominant style of internal interaction	Administration, through hierarchy	Management, through negotiation	Leadership, through facilitation
Main decision type	Quality control	How to do things	What things to do
How management adds most value	Checking and supervision	Planning and quality assurance	Sponsorship and coaching
Staff			
Professional type	Generalists	Specialists	"Contributors"
"Qualification" for direct participation	Individual rank	Individual role	Individual capability
Typical media for direct participation	Memos and papers	Regular or special purpose meetings	Informal forums, e-mail, intranet

- Complementary functions that have a specific rationale related to the core functions;
- Ancillary (perhaps even unrelated) functions that may have historic origins and that should only be performed by the central bank temporarily; and
- Internal support functions that merely support external functions and so should operate strictly on value-for-money principles.

Core focus

After listing current functions apply focus. A core function is a continuing mandate for the central bank, usually with statutory backing. Complementary functions are trickier. Ask searching questions about why and how the central bank is involved, and the optimal type and level of resources to invest. If there is no clear rationale for the central bank to perform a function, then it shouldn't. Decisions about ancillary and unrelated functions are in principle easy – simply divest them. But realism is needed. Consider other parties and plan a path to discontinue or transfer the function. Determine what attention and resources the central bank will need for this function in the meantime. Divestment thinking will apply to some internal support functions too. Other support functions like information technology and human-resources management will remain part of the future, but how they are performed and resourced may need to change. The whiteboard should now have a list of functions that will continue and functions that will cease. (There may in a few cases even be new functions to begin.) On to organisation!

Having clarified future functions, drawing an organisation structure may seem easy. Identify the outputs that need to be delivered for each function, and group like activities in "departmental" boxes such as:

- Economic research and analysis;
- Financial-market transactions and liaison;
- Operations such as banking, currency and settlement;
- Development and enforcement of regulations;
- Support services (of different types); and
- Internal assurance and audit.

Then just apply the same principle within each box...

Designing the organisation

But organisation design is not an exact science. It may be difficult to design an organisation structure that maps outputs closely to departments and minimises interactions. Some outputs will always straddle departmental boundaries and require inter-departmental collaboration. Changing circumstances will over time undermine any mapping by demanding new interactions.

More fundamentally, a "silo structure" with little interaction can encourage an undesirable "silo culture" in which each department aims to minimise its dependence on others. Blinkered thinking, duplication of activity and inefficient use of resources will emerge. In fact the design of *processes* – the arrows that go back and forth between boxes – may be more important than the departmental design.

The design goal should therefore be an organisation structure that not only efficiently groups like activities, but also recognises processes. Structures and processes should facilitate regular interaction and collaboration between departments. A senior management group of practical size, operating as a genuine management team and not a "committee", is usually a key element of design.

Difficult questions

Other design issues may have particular prominence for central banks, and these are discussed below.

Governance. Governance is not just about formal processes such as risk management, audit and external reporting. Governance should also synthesise work within an organisation to effectively and efficiently deliver core outputs to external parties. How then should the senior management group interact with *top* management: the group of full-time "governors" or "executive board members"? What if the central bank has a non-executive board? Processes to link and differentiate governance and management responsibilities will need careful attention.

Top management responsibilities. If the responsibilities of individuals within top management are defined in terms of departments, it will become easy for department managers to "delegate upwards" operational decisions rather than take responsibility. Should top management instead add value by taking functional responsibilities and sponsoring strategic initiatives?

Corporate coordination. Some central administration point – a "corporate secretary" role or "governor's office" – may be needed. But that administration point could become an alternative power centre that undermines departmental responsibilities. What should its scope be?

Rank or role. Traditionally management jobs had specific ranks attached. Rank-based systems offer advantages such as clear hierarchy and easier rotation of managers. But they also create problems. Managers build empires to justify a higher rank and structures become fragmented, top-heavy and sluggish. In a more specialised and less hierarchical world, role-based systems that individually define, evaluate, recruit for and remunerate each job may deliver better results.

Technical careers. All too often status and remuneration signals encourage capable technical people to become poor managers. Organisational structures should provide valued career paths not only for skilled managers, but also for senior staff who can contribute more effectively in other ways.

Branches. Are they needed? What functions should they perform? How much autonomy should they have? Who should oversee them and how?

Demanding resources

Answering these questions will take time. But finally the future organisation structure is clear, at least in principle. Can we resource it? To plan resources, think from first principles not tradition. For example:

- "What do we need?" is a better first question than "who do we need?"

Employing staff may not be the best solution, particularly for temporary needs.

- "We need more resources" is often the first response to problems. But usually the type, quality or motivation of human resources, and not the quantity, constrains achievement.
- Outsourcing should be considered. Modern organisations "buy not make" a widening range of goods and services. Analyse the possibilities systematically and pragmatically, applying economic logic and the practicalities of the local environment.
- Required staff skills and competencies should be prioritised, emphasising what is genuinely mandatory.
- Traditional succession planning (focused on individual development) should be broadened to capability planning (focused on organisational capacity).

Realism is important. There is little point in planning for staff that simply cannot be found in the local marketplace. Yet one frequently finds demanding and unrealistic job descriptions in central banks (financial supervision staff are one common example). Ideal structures that cannot be resourced will achieve little, so it is better to rethink organisation or even functions to ensure the central bank can deliver what it promises.

"Buy not make" can apply to people too. The central bank may lack key technical and managerial capability needed for the future. When "who do we have?" cannot produce effective solutions, external recruitment is essential. Fresh blood often brings other benefits too.

The path to future effectiveness and efficiency is now clear in principle. The whiteboard printouts explain that the central bank will perform specific future functions through specified future organisation structures by employing specified future resources. But what will actually happen will depend on *management* of those resources.

Now manage

Management is a craft – a blend of science and art. Successful management must combine good management systems with the right internal culture. For example even superb management information systems achieve little in a culture that does not stress the importance of acting on information received. How systems should be designed and what organisational culture should be encouraged are pragmatic questions. Sound principles need to be customised to the special features of central banking and to local conditions. Adapt not adopt should be the motto. (A central bank that adopted performance-management systems designed for North American manufacturers had predictably poor results.)

The central bank's planning and management framework should include:

- A vision that is either timeless or specifies a strategic destination;
- A strategic plan with a 3–5 year horizon, including an indicative budget;
- Annual plans and budgets driven from the strategic plan (and budget), for the whole central bank, and for individual departments;
- Systems to plan and manage departmental and cross-departmental projects; and
- Performance appraisal and development plans for individuals.

Developing a vision

The vision should be brief, aspirational and demanding. Avoid statements that could become distracting or make success look like failure. For example the vision might demand that the central bank be "*a* leading national institution" but should not require it to be "*the* leading national institution". Statements about policy success should target optimal results, not perfection. Internal values, few in number and collectively describing the desired culture, may be part of the vision.

The strategic plan should focus on outcomes delivered to external stakeholders. It will establish accountability accordingly and be suitable for external publication. Specific formats will vary, but the plan is likely to state objectives, measures and targets for the central bank as a whole and for each function. Keep the strategic plan concise. Emphasise a few specific priorities and merely summarise "business as usual". More than half a page for each function will detract from focus and communication. Resources need only be specified in terms of total cost, total staff numbers and other key resources.

Annual plans and budgets are primarily internal documents with two distinct purposes. Strategically, they outline how each department will contribute to achieving the strategic plan. Operationally, they set targets for "business as usual", quantify resource allocations and establish accountabilities for each department and unit. Plans and budgets should also indicate likely future developments, particularly responses to strategic priorities. (There are strong arguments for rolling multi-year plans, not annual plans.) Plans for individual organisational units should encompass both ongoing activities and local projects.

From planning …

Because their scope and timeframe falls outside "business as usual", project plans will follow a different pattern. The merits of competing project methodologies are often hotly advocated. But any preferred format should meet key criteria:

- Avoid undue complexity;
- Emphasise project scope, outcomes and benefits;
- Establish clear roles for project sponsors as well as managers; and
- Be common to all projects, even if applied at different levels of rigour.

The annual plans and budget should transparently and simply cascade into individual job descriptions. Modern job descriptions typically have two complementary components. Key result areas describe *what* is to be done by the jobholder, while "competencies" outline skills and attributes that determine *how* work is done. Competencies are especially important for management roles. Key requirements that are crucial to the desired culture such as cross-functional contributions, relationship management, communication and staff development should probably be common to all managerial jobs.

… to performance measurement

Staff performance is the key to organisational performance. Well-designed job descriptions will also be the platform for individual performance appraisal and development plans. But achieving organisational performance demands not just performance-appraisal systems, but also a culture of ongoing feedback and performance measures that are externally oriented. For example "quality" should be defined primarily in terms of value added for customers and stakeholders rather than through internal technical definitions. Performance benchmarks can be drawn from other types of organisation, not just from other central banks.

Once again certain aspects of management systems and culture may particularly challenge central banks. Several are considered below.

While there are inherent difficulties in evaluating central bank effectiveness, strategic performance measures need to be made specific and objective. Performance measures for organisational units and individuals will probably combine contributions to strategic performance with more traditional output measurements.

Costing systems need to capture all material resource costs. Typically staff costs are the largest element, followed by information technology and premises. (Other costs tend to be material only in specific operations or activities.) So the cost of staff time needs to be attributed to outputs, something few central banks have traditionally done.

Delegations to individual managers should align authority, responsibility and accountability. Delegations need careful design to manage inevitable risks. But effective delegation also demands a culture of mutual trust that accepts occasional imperfection – a manager who never made a mistake has probably never made a decision either.

Focus of senior management

The senior management team should take collective responsibility for bank-wide management decisions. Detailed technical work can be delegated to special-purpose forums, but all senior managers must become familiar with the two key support functions of information technology and human resource management.

For many top and senior managers, a "third-age" management approach may initially seem unfamiliar and challenging. For example they should aim to receive less not more paperwork and make fewer but more important decisions. Unwillingness to "let go" will readily lapse into micromanagement, slow decisions and *ad hoc* interventions that block the intended benefits of delegation.

Central banks cover a wide span of activity, so it is unlikely that systems and culture can be uniformly applied with success. There will be a tension between common principles across the organisation and individual approaches that respond to varying needs. Systems can change quickly but culture is tenacious. Organisational culture is primarily caught not taught. Any required culture change will demand time, leadership and sustained commitment.

By now readers will realise that management of a 21st-century central bank is largely a process of planning and managing internal change. Change management does not naturally appear high on most central bankers' priority list. It is tempting to defer or minimise internal change, and focus on those external challenges instead.

The change path

That would be a bad move. External challenges and internal change are usually interdependent. Failure in internal change is likely to have serious real-world repercussions on performance. Leading internal change can be hard for career central bankers. Those "inside the box" cannot easily step outside it to plan effective change. Common central banker attributes such as "make-no-mistakes" thinking, exhaustive analysis and a preference for longer timeframes may be counter-productive in change management.

But wholesale importation of change-management techniques and resources does not necessarily work well either. The unique features of central banking can confound simplistic thinking. And ultimately only insiders can implement lasting change. The optimal approach is probably to apply mainly internal resources, supplemented by external specialist support.

Embracing change

Each change programme will be unique, but common steps and characteristics can be identified.[4] To change successfully:

- Establish a change program and resource it properly;
- Apply fresh "zero-base" thinking;
- Build a compelling case for change, focused on leadership and values;
- Communicate, communicate, communicate;
- Get as much "buy-in" as possible (but don't allow anyone a veto on change);
- Develop a change plan that includes quick wins;
- Compromise on details if need be, but never on key principles or directions;
- Apply incentives that reward supporters and help neutralise resistance;
- Keep it simple;
- Focus on results; and
- Measure the impact of change.

This article makes the case that the reputation and influence of individual central banks will increasingly reflect their change leadership and management, not just their technical capability. Central banks have unique freedom to plan and manage change more successfully than most organisations. They can use that freedom to become leading and exemplary institutions, for their own good and for the good of others.

To gain enhanced independence and respect, central banks must embrace change. Embracing change means more than just reacting to it, or accepting change when you must. It means getting "ahead of the game" by approaching internal change with the passion and professionalism central banks bring to their technical work. □

John Mendzela specialises in making strategic change successful. He led management transformation work at the Reserve Bank of New Zealand and has advised a number of central banks on their organisation and management change programmes. Comments on this article can be sent to the author at johnm@mendhurst.co.nz.

Notes

1 The proposition "Why Change?" is explored further at www.mendhurst.co.nz/projects-central-banking.html and in chapter 3 of *Central Bank Modernisation*.

2 See "Good Practice Accounting and Reporting" at www.mendhurst.co.nz/projects-central-banking.html and in chapter 2 of *Accounting Standards for Central Banks*.

3 This concept is outlined in more detail in earlier articles for *Central Banking* journal, volume XIII numbers 2 and 3. See "Leadership in Central Banking" at www.mendhurst.co.nz/projects-central-banking.html.

4 See www.mendhurst.co.nz/projects-central-banking.html or chapter 3 of *Central Bank Modernisation* for a more extensive discussion of change programmes.