



# BANKING INDUSTRY IS TOTTERING - STORMS OF CHANGE

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Glaciers are melting, the water levels of oceans are rising, earth plates are moving frequently, resulting in tsunamis and earthquakes. Landslides and floods are becoming frequent natural disasters. Weather patterns are changing. Africa is dying with HIV Aids. Asia is threatened by Bird flu, Europe is threatened by Mad Cow disease. Al Qaeda and several terrorist groups are threatening world peace. Russia and China, old communist allies, have joined hands for military exercises; is it a preparation for another cold war? Globalization pushes products and services to a position of Low Price - High Quality without geographical barriers. Key to Industry survival or growth is global communication which has a traffic volume worse than traffic on highly congested roads during peak hours. Everything is unpredictable, volatile, very fast, non-stop and sometimes disastrous.

## **The History:**

The modern banking history began in Lombard Street where the traders and business community entrusted their excess money to respectable, honest, trustworthy merchants for safe custody and return. Then these merchants recognized the time gap between deposit and withdrawal of money and began to lend a part of it. The whole business of banking was based on mutual understanding, trust, moral values etc. and it was a psychological bond among depositors, lenders and borrowers.

## **Marketing orientation of Banking Industry**

The history of the paradigm shift in marketing orientation of the banking industry was begun in the latter part of the 20<sup>th</sup> Century. The scenario was clearly illustrated by the famous marketing guru, Phillip Kotler in his famous book – Marketing Management.

*“Years ago; bankers had little understanding or regard for marketing. Bankers did not have to make a case for checking accounts, savings, loans or safe deposit boxes. The Bank building was created in the image of a GREEK TEMPLE, calculated to impress the public with a bank’s importance and solidity. The Interior was austere and the Tellers rarely smile. One lending officer arranged his office so that a prospective borrower would sit across from his massive desk on a lower chair. The office window was located behind the officer’s back, and the sun would pour in on the helpless client, who tried to explain why he/she needed a loan. This was the Bank’s posture before the Age of Marketing.*”



*Marketing should be in a friendly atmosphere. The Banks learned that attracting people to a Bank is easy; converting them into loyal customers is hard. The Banks began to formulate programmes to please the customers. Bankers learned to smile. The bars were removed from the tellers' windows. The Bank interior was redesigned to produce a warm friendly atmosphere. Even the outside Greek-temple architecture was changed. Competitors quickly launched similar programmes of friendliness training and decor improvement. Soon all banks were so friendly that friendliness lost its decisiveness as a factor in bank choice*

*Segment and innovate: Clearly they began to look alike. They are forced to find a new basis for competition. They began to realize that no bank can offer all products and be the best bank for all the customers. A bank must examine its opportunities and "take a position" in the Market. Positioning goes beyond image making banks which seek to cultivate an image in the customer's mind as a large friendly or efficient bank.*

*Marketing is advertising, sales promotion and publicity, marketing into bank not in the form of the Marketing concept but in the form of advertising and promotion. Banks were facing increased competition for savings. Few Banks started to do heavy advertising sales promotion. They offered umbrellas, radios and other "Come-ons" and attract new customer accounts. Their competitors were forced to adopt the same measures and escurried out to hire advertising agencies, sales promotion experts.*

The process of marketing orientation of banking industry has moved to the areas of publicity, advertising, market intelligence and research, marketing information systems etc developing sub-branches of financial service marketing within the main subject of Marketing.

Someone can raise a simple question. Is it the starting point of storms heading towards the banking industry?

The banking industry has experienced a paradigm shift in the latter part of the 20<sup>th</sup> century which would not be discussed at length in this paper. However the following is the reality:-

1. Entry of rapid development of computer hardware, software with communication and networking to the industry is dominating the industry today.
2. Moving away from Core banking and entering into other areas of financial markets, capital markets, and formation of subsidiary companies and entering into different areas of non financial services.
3. Globalization of industry through global regulatory frameworks.

For a service organization like a bank it is necessary to understand and believe that the "customer is always right". The customer is always right even though he/she is wrong. The customer is always right if he/she thinks that he/she is right. It is the job of the bank personnel to



convince the customer about the rules and the regulations relating to a particular service or situation.

Bankers will be required to educate themselves on customer counselling in the new environment. The bank that is able to provide maximum satisfaction to the majority of customers will be the ultimate winner in the growing and competitive financial markets. In the new millennium, it adds another role to bankers: "Customer advising and customer counselling".

Now storms are blowing in from all directions tottering the Banking Industry. Stormy winds are everywhere trapping the banking industry in a maze; how can it find its way back ?

### **Planned changes to unplanned change management**

Change simply means the alteration of the status quo. Even in a most stable organization change is necessary just to maintain the present status. Accordingly, management must continuously monitor the outside environment and be sufficiently innovative and creative to find new and better ways of utilization of organizational and industry resources so that the customer needs are competitively met and customer problems are adequately solved. The term of customer includes both internal customer and the external customer and the stake holders. The change is the demand by external forces and internal forces. External forces are usually generated by the external environment and can be classified broadly in the following manner.

1. Remote external environment (global as well as domestic)

Remote external environment consists of Economic, Political, Mega trends in Customer / Consumer Behaviour, Legal and Regulatory, Social and Cultural, Demographic, Technological and Natural environment. Individuals and institutions cannot influence these variables. Even an industry in a particular country cannot influence them because they are valid globally and that is why these environmental forces are remote and not variable.

2. Operational external environment

It consists of customers of a particular institution / organization, suppliers, labour market, government and competitors. Usually individuals and organizations can influence to some extent subject to given strengths and weaknesses of that organization.

### **Internal Environment**

This includes a large number of strengths and weaknesses of a particular organization, covering many areas.

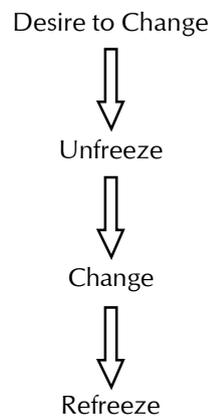
In the banking industry, it covers the image of the bank, quality of the staff, financial strength



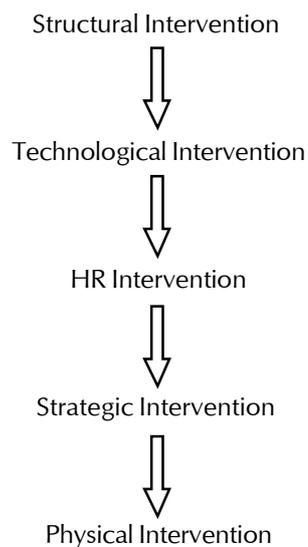
(liquidity, capital, adequacy, profitability, assets base etc.) level of product and service differentiation and innovativeness as well as strategic management competencies, technology productivity level of the staff, quality of machinery and equipment, convenience of locations, refurbishment level of premises, good governance, accounting standards, level of non performing advances and provisioning etc.

The internal environment can be controlled by the management.

Naturally those environmental forces continuously demand changes in the particular industry or institution. The management's solution is to introduce planned changes and development interventions. Kirk Lewis has given a simple model explaining the process.



Organization development aspect requires intervention in key major areas.





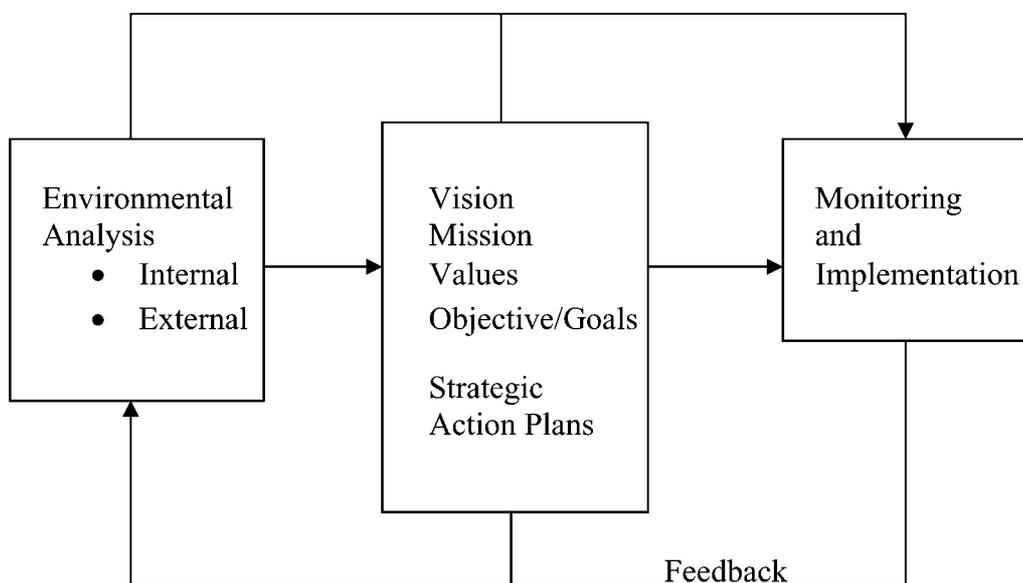
If organization or industry does not introduce planned changes at the appropriate time, external and internal forces will gain entry into the industry or organization and change all the variables for the sake of change and not as expected by the organization or industry, thus creating an unmanageable situation.

But the dilemma of the management consultant is how to introduce planned organizational development changes to the banking industry or a particular bank. Because by the time you identify external and internal forces which require such changes and come up with a plan, it may be too late to introduce planned changes because environmental forces are too fast and too powerful like rapidly changing storms.

### **Strategic Plans and real-time strategies**

The owners expect high returns on their investment; the employees try to maximize their benefits; depositors demand safety and high returns on their deposits; borrowers demand competitively lower rates even with weak collateral; the regulators expect high profitability with low risk and high solvency level. The management consultants would give a formula to the corporate management called the Corporate Plan or Strategic Plan to prepare a clear path to direct the bank they manage.

### **Strategic Planning Model**





## Is this the answer to the strategic questions?

The rationale for the existence of a business is provided by the answers to the following:

Where was it?

Where is it now?

Where does it want to go?

How does it go?

When does it go?

What prevents it from going there?

Once management has a corporate plan with set targets, it expects to play a monitoring and controlling role but the problem today is the widening gap between the real situation and the strategic plan itself. The volatile environment variables storming at the banking industry have narrowed the time gap. Three or five year corporate plans have become only a well bound decorative book. Therefore it becomes strategic planning verses real-time strategies. The responsibility of formulating short term real-time strategies has become the responsibility of corporate or senior management. That means no structured decisions. All key decisions are unstructured. Responsibility then passes on to the experience, talents and judgment of the corporate or senior management rather than the external consultant who prepared smart attractive corporate plans. The issue then is - are there specialists or experts in the corporate management? Real time strategies demand more judgmental decisions. Therefore corporate managements should have personnel with multi disciplinary skills, knowledge and experience to cope up with any strategic decision making related to banking industry. Therefore banks should recruit young people with multi disciplinary backgrounds and train them on all aspects of banking industry to enrich their skills on real-time strategic decision making.

## Individual behaviour – Internal and External customers

Psychologist Kurt Levin believes that people are influenced by a number of diversified factors - both genetic and environmental. Influence of these factors determines the pattern of behaviour. He called his conception of these influences "The field theory" and suggested that

$$B = F (P, E)$$

where Behaviour (B) is a Function (F) of the Person (P) and the Environment (E) around him.

The main individual factors influencing human behaviour can be classified into two categories, these are

1. Inherited characteristics
2. Learned characteristics



## **Inherited characteristics**

Inherited characteristics include Physiological aspects, Intelligence, Gender and certain Personality factors, such as the religion observed or philosophy of the family, age and genetic history of the family

Learned characteristics

These characteristics include an individual's attitudes, personality, values, perception, and norms about the environment around him or her

Attitudes:

More precisely, an attitude can be defined as a persistent tendency to feel and believe in a particular way towards some object.



Perception:

Perception is the process by which information is transmitted to our mind and interpreted in order to give some sensible meaning to the world around us. It is the result of a complex interaction of various senses such as feeling, seeing, hearing etc

## **Subjective reality verses objective reality**

Personality:

Personality is a set of traits and characteristics, habit patterns and conditional responses to certain stimuli that formulate the impression that an individual makes upon others.

Values:

Values are assumptions of what is right, good or important to the individual. Values are of great importance to the individual because they guide him\her in their behaviour.

Norms:

Essentially collective values that are usually manifested in the form of explicit rules, laws, codes of practice and implicit group attitudes or culture.

The individuals with Inherited and Acquired characteristics form different behaviour situations



such as Interpersonal behaviour, Small group behaviour, integrated organizational behaviour, Social behaviour, Cross country behaviour.

These behavioural aspects are important to the banking industry in two ways: one is that of the customer - because in the service industry, customer is still expected to enter into the conversation process as the industry has high contact level with the customer. To open an account or to obtain a loan, customer is still expected to visit the bank. That means the individual characteristics of the customer has a major impact on the customer behaviour. The other is that of the employee: employees are internal customers of the bank. Though technology has taken over part of the bank's operations, still the employee or internal customer plays a key role in the industry.

Mega trends in lifestyle, economic and cultural variables have changed both inherited and acquired characteristics of individuals. In the good old days almost all of the banks' staff were of high integrity, loyalty, commitment and positive attitudes. They fitted in well with the organization's requirements. They maintained high professional and behavioural standards when interacting with the customers. But today they are foot-loose and planning to jump from one employment opportunity to another. Trainers are busy with improving the attitude of the staff, introducing training programs on behaviour, social etiquette, dress etiquette etc.

### **Outsourcing and HR issues**

The impact of HR aspect and customer behaviour have jolted the industry with the issues involved in maintaining competitive advantages on bank image, customer service, professionalism and stability.

The introduction of outsourcing to manage rising personnel costs has created a storm in the banking industry shaking its original status. Outsourcing has today extended to the global level and it's called global outsourcing, going beyond geographical boundaries. How can a bank fit these outsourced employees to its organizational requirements and culture? How can the discipline required for the industry be maintained? The key problem is how can a bank maintain or improve relationship management with foot-loose, out sourced employees?

Is outsourcing a silent killer or a saviour of the industry?

### **Skilled worker verses Knowledge worker**

20<sup>th</sup> century was the century of skilled workers but the 21<sup>st</sup> century is dominated by the knowledge workers. The skill requirements of arithmetic, book keeping, accounting has transformed to knowledge requirements in software packages, computer based financial analysis etc.

The "New Realities" written by famous management guru Peter F Drucker illustrates this transformation revolutionary manner as follows:-



“A very large number of knowledge workers, perhaps the majority, will still be working in and for businesses. Yet their position is quite different from either that of yesterday’s bosses or that of yesterday’s workers. They are employees but at the same time are the only real capitalists through their pension funds. They do have a “Boss” and are thus “Subordinates” but are themselves “Bosses”.....Knowledge worker is thus a colleague and associate rather than a subordinate. He has to manage as such.

Infiltration of more knowledge workers to the banking industry means more complicated issues in how to manage people?

### **IT Invasion without boundaries**

Today Technology plays a key role in the banking industry and the main outcome has been to reduce customer contact level and time by expediting delivery of the services using network banking and online systems to get a competitive advantage.

The key issue is where the boundary is. The industry started networking its branches and now it has been extended to internet and mobile phones. The call centres are also connected to the network system. The call centres have expanded beyond the geographical boundaries. Banks are now caught up in the IT storm. Recently most banks developed network banking systems using Microsoft Windows XP platform compatible systems. But now Windows Vista has arrived which requires wide screens and high performance PC’s making Windows XP systems outdated.

Time will come to change over to Vista system shedding the currently used System Hardware and Software. Changing system resources, upgrading the system and retraining staff entail heavy costs.

Banking industry has to enhance computer security to safeguard itself against hackers and computer virus. Hence they have to go along with system developers incurring heavy expenditure. Thus banks are caught up in a dual war against risks and safeguards.

IT department becomes a major budget consumer; it adds to transaction cost and makes banking industry very expensive and almost a luxury.

Another issue is that banks are losing relationship with customers due to the intervention of IT. Customers are losing their relationship and loyalty towards a particular bank and due to the competitive environment, they are shopping around to fulfill their banking needs from different banks. The relationship and behaviour of a customer is thus unpredictable and in the long run, the bank has to find new ways of mobilizing deposits.

Data and information which is generated and manipulated by the systems has piled up to a data warehouse, creating a situation where employees and customers do not know which data needs to be mined.



The centralization with IT enables setting up of centralized back offices, credit factories and call centers, weakening valuable customer relationships.

Out sourcing using IT, facilitates outsiders to view most confidential customer and bank data thereby challenging the existing rules and regulation of a bank. This situation becomes more complicated as outsourced employees get access to internal bank data.

The complicated IT environment is invisible to the naked eye and bankers are subject to the mercy of software and hardware engineers who know what type of frauds and sabotage can occur

### **Greek Temple to Mobile Bank**

The early experiments sometimes fizzled out but a new wave of technology has taken mobile phones to the point where they can be of use to financial services such as receiving stock exchange updates, do banking transactions, check account balance etc

Although intended use of the mobile phone is to make phone calls and text messages gradually mobile technology is sneaking into the banking industry. With the latest developments such as Mobile internet technologies (WAP, GPRS, EDGE, Mobile applications) it has become a 'must have device' making it the remote control of modern day life.

The crucial question related to IT supported banking industry is - "Is it supported by IT or dominated by IT?"

### **Regulators, on whose side?**

The regulators are very busy protecting customers and introducing risk management in many areas. Basel 1 introduced capital adequacy and credit risk management in 1990s; for year 2008 onwards it has an expanded the risk areas creating three pillars of risk

Credit risk

Operations risk

Market risk

Today most bankers are busy developing business continuity and disaster recovery plans to minimize operational risks which demand extra cost and idle assets. Credit risk management narrowed down the risk and profitability game played by the bank through relationship management. The bank for international settlement (BIS) is planning to enforce more regulations in the future such as Disclosure of off balance sheet items, bringing in additional Accounting standards etc. International terrorism and illegal businesses force bankers to play a detective role to detect and



prevent money laundering and terrorist activities and thereby necessitate bringing in “Know Your Customer” concept (KYC).

Opportunities for corporate crimes in these areas were not previously known to the banking industry because the industry was well managed by professional bankers with ethics, simple products and operational procedures. When the industry expanded and the competition increased beyond ethical levels, avenues began to open for corporate crimes. The Pramuka Bank incident itself gives a good example of corporate crimes related to the banking industry. Then where is the trust and the faith in bankers who developed this industry from London Lombard Street who collected others’ money and returned it with utmost safety while lending to very good borrowers.

While society demands good governance is Corporate Crime another silent killer in society?

### **Conglomerates entering into banking industry**

While storms are blowing from all over and continue, another storm in the form of the large conglomerates is entering the banking industry. These institutions will play a competitive role taking advantage of the companies of such conglomerates. Then competition will not be fair to all players.

Corporates began to avoid the banking sector by operating through monetary instruments like commercial papers, capital instruments, debentures, share issues and issuing of different type of globalized instruments such as Global depository receipts. Then banks turned to retail and SME sector with the concept of “small is beautiful” but with globalization, small is getting smaller and their survival time is shortened.

Supermarkets and Shopping Malls force small retailers to put up shutters, eliminating competition and depriving relevant shoppers of their choice. Product differentiation of small companies are quickly captured by the bigger ones. The herbal toothpaste products of small producers being captured by Signal Herbal toothpaste in Sri Lanka and India is a case in point.

### **Banks and their Core Business**

The bankers have moved to capture markets such as personal and vehicle loan markets and to look at other income avenues such as credit card, leasing and factoring business. What therefore is the core business of banks today?

In this scenario one wonders whether banks are in the banking business or in the facilitating business.

The storms continue to blow with rapid development of internet based payments with the expansion of e-commerce via internet payment gateways, Real-time gross settlements deprive



the banks of the benefit of the Float. What is the future of documentary based international trade or cheque payment systems?

### **Banks are searching for new channels**

The expansion of non banking financial institutions such as finance companies and specialized saving banks into all commercial banking activities, other than demand deposits, cause commercial banks to lose part of their business volumes. But on the flip side of the coin, banks now hit back by venturing into the leasing business at rates that non-banks cannot afford and also use the capital allowances under leasing to reduce the tax burden on their other interest income.

Due to narrowing margins banks cannot afford castle type buildings to house their branch-offices. Instead they resort to small front offices or super market banking centres with a single employee at a terminal connected to the main network.

The banking industry is tottering with powerful storms blowing from all directions. Customers and investors seem to be watching while corporate management teams are busy with formulating real time strategies for survival or growth. What are the solutions? Formulation of strategies and business alliances, shared technology with competitors, mergers and acquisitions, moving away from core-business (core-banking) are the order of the day. But still there should be someone to look after collection of money, keeping it in safe custody and lending part of it, as it is the root of sustainability and growth of the economy.

To quote **Theodore Levitt in "Management Myopia – Innovation in marketing new prospective for profits and growth"**

***Every major industry was once a growth industry. But some that are now riding a wave of growth enthusiasm are very much in the shadow of decline. Others that are thought of as seasonal growth industries have actually stopped growing. In every case the reason growth is threatened, slowed or stopped is not because the market is saturated. It is because there has been a failure of management.***

According to Theodore Levitt it is natural to experience different business cycles in industries. Sometimes existing industries can vanish and new industries may emerge.

For any industry to survive there must be a united and professional approach to safe guard the industry from strong storms in spite of competition, by improving profits, market share and maximizing investment returns to the share holders.



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