"SUSTAINABILITY IN VOLATILITY" - THE MARKETING PERSPECTIVE

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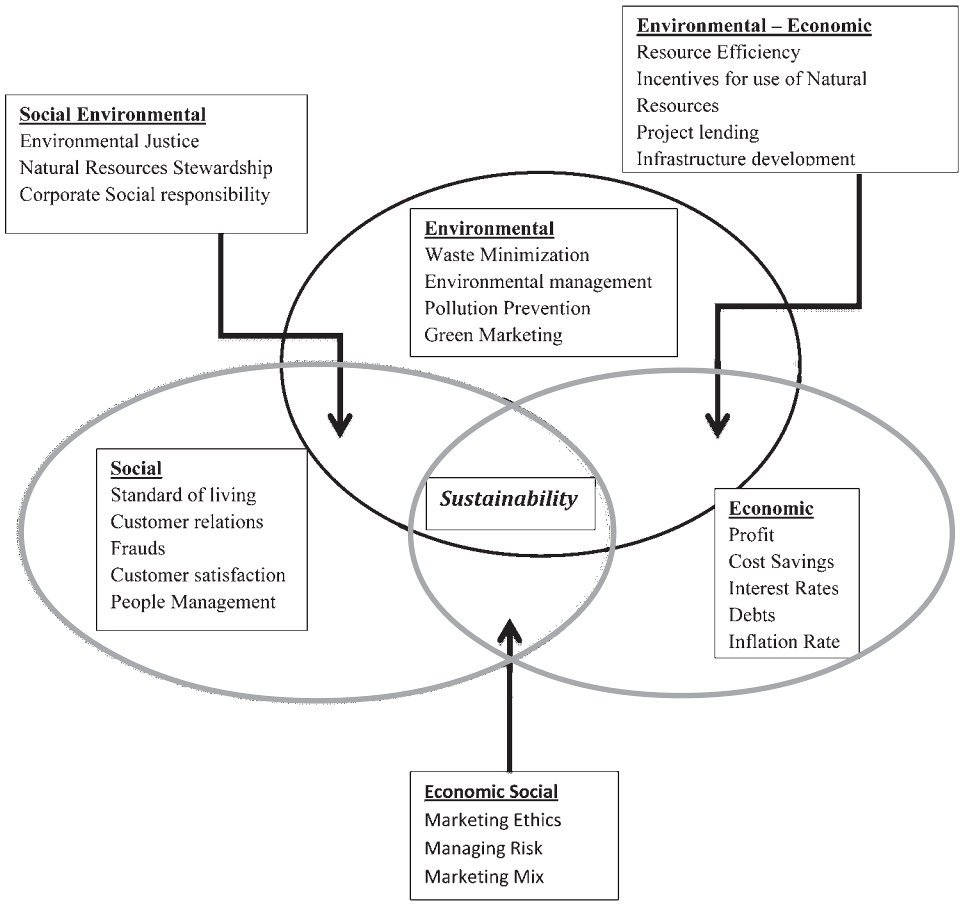
Introduction

Sustainability has become a buzz word among the corporate circles, organizations, chambers and associations, but there is a great amount of confusion regarding what it is? What do we mean by Volatility and Sustainability? Volatility means different things to many people. The volatility is arising from the fluctuations over time of the instability of the market parameters. The term Volatility in financial term indicates how much and how quickly the value of an investment, market/markets, interest rate, currency or any other economic variables changes over time. Volatility goes both ways. It does not necessarily negatively impact on us but it however does make bankers uneasy. Sustainability can be seen as an approach, which is all about enduring the difficult times. This is as much about taking responsibility for preserving planet's resources and societal value as about ensuring the long term survival of the corporate entity itself. It is becoming essential for all types of businesses. Most popular definition for Sustainability from World Commission Environment and Development is "Development that meets the needs of the present without compromising the ability of future generations to meet their own needs". Sustainability stands on the intertwining of environmental, social and economic dimensions often called Triple Bottom Line.

Marketing can be defined as a business philosophy, and a collection of management techniques, oriented towards providing value to customers, organizations and society. While there are ranges of views on the domain of marketing, all would agree that it is a broader management concept which focuses on achieving the triple bottom line through creating, producing and delivering sustainable solutions with higher net sustainable value whilst continuously satisfying all stakeholders. Sensitivity to these three dimensions, especially under volatile environment, in which a bank operates, is simply good business and certainly a pre-requisite for long term legitimacy and survival. Banks must integrate these three dimensional issues into their strategic thinking by adopting a triple bottom line approach rather than purely focusing on growth in market share, deposits and profitability.

This article attempts to address the marketing aspects of some key interfaces of three dimensions, which have particular interest to practitioners of banks on sustainability in a volatile environment. (Please see the following diagram for issues relevant in the interfaces)



The Three Dimension of Sustainability (Marketing Perspective)

Economic Dimension

The economy is a complex open system and the marketer who can master the diagnosis of current economic problems and anticipate the direction of policy changes, will process an edge over rivals. The economic dimension discusses the key economic variables behavior in volatile market and its impact on economic sustainability.

Interest rate

The all important and most controversial issue in the volatile market is the interest rates. As a result of rapid credit growth, lower market liquidity and devaluation of rupee, market interest rates started to increase from last quarter of 2011 and this trend has been continuing. Since the Central Bank of Sri Lanka has strengthened the credit growth, we could expect interest rates to rise further. As we are aware that the vigilant customers are well aware of the rising trend of the interest rate and they prefer short term to long term deposits. Under this high interest rate regime, Bank Marketers' must concentrate on introducing long term product or annuity products with attractive terms and benefits.

It is noted that pawn broking emerged as a key credit growth area due to the increasing gold value along with the convenience with their form of borrowing, low credit rules, higher margins etc. The risk of declining gold prices in any volatile market is possible and it is a challenge for bankers. This is mitigated by banks granting 70-80% of gold value and as a marketing tactic, bank tend to lend more advances in shorter period of redemption.

If the regulators restrict the lending by not allowing to take place any credit bubbles in Sri Lanka, which crippled banks in USA, banks can practice de-marketing of loans. It is the new marketing concept that encourages people to consume less. Whilst doing so, banks may prioritize SME loans, developments based project loans and export led loans. However this needs to be handled carefully from the marketing point of view that curtailing the consumer loans in a way that is believed to go unnoticed by the customer and otherwise, this action may lead to punish the bank by the customers through in appropriate ways.

Inflation rate

When the market players are uncertain about future inflationary control measures, they tend to raise the premium on long term lending. Under such circumstances bank look possibilities of introducing index linked bonds. The primary justification for issuing index linked bonds is the existence of a positive inflation risk premia, which means that over the long run, it will be cost effective supplement to conventional bonds. There are other benefits for introducing index linked bonds namely, to manage the cost of borrowings by covering inflation risk, to minimize the inflation risk premia by providing inflation protection to investors, and develop the bond market by lengthening the yield curve.

Public Debt

A high level of public debt and high debt servicing costs have several adverse implications on the economy. The present study showed that the country's debt issue has reached a critical situation. As we all are aware that the current balance of payments difficulties owing to the large trade deficit and large external repayment of debt and its servicing costs (Estimated over US$ 1500 in 2012), are needed to be financed by foreign borrowings due to the inadequacy of foreign reserves / earnings. How does a bank marketer address this debt sustainability?

Firstly, to Increase the inflow of foreign remittances, this could be done easily under the situation of high interest and rupee depreciation environment. Banks need actively to chase remittance from migrant workers. In Sri Lanka the total value of worker remittances is a major source of external financing which amounted to US$ 5145 M in 2011, which is 8.7 percentage of GDP. This is sufficient to cover over 60 to 70 percent of trade deficit. It is difficult to estimate the exact total value of remittances through informal channel but definitely a large portion (50 %) not captured by banks.

According to the new exchange procedures introduced by the Central Bank, in its "Road Map 2012 and beyond", with effect from 11/07/2012, would contribute to greater efficiency, convenience, improve investor confidence and most importantly apart from many operational measures of exchange transactions. Noteworthy feature is children will now be given permission to open foreign currency account. Banks need to take advantage of this by introducing new NRFC/RFC children savings account or embedded to their existing children account with value additions. Banks usually consider such accounts as low cost long term products.

Secondly, by identifying various exclusions such as Access, Condition, Price, Marketing and Self exclusions. These exclusions often act as barriers, particularly to low income remitter to enter into the banking stream. Banks have to offer the right mix of innovative financial products tailored to their needs, with awareness programmes and effective outreach programmes.

Thirdly, by encouraging Public Private Partnership (PPP) in major infrastructure development projects, the banks could arrange syndicated loans /project loans to private sector for PPP's. Banks have played a pivotal role in the Sri Lankan economy by contributing to the economic development through financing of various short term and long term projects in line with national plans. In this aspect, banks must take initiatives in assisting the business ideas rather than merely looking for conventional type of loans/projects.

Profits

A general perception among many is that banks enjoy super profits. Banks as commercial business entities need to generate profits for their survival, expansion, growth and to increase shareholder value.

However some traditional routes to higher profitability may, no longer available to banks specially under volatile scenario because,

- Increasing capital levels and risk weightings to meet the regulators' requirement, Basal II / III levels would depress profit
- Competitors and customers may be more efficiently aware of the market conditions, interest rates etc
- Since the majority of the banks' cost base lies in distribution, they need to address the cost of serving their customers
- The income is being challenged not just by still competitors and regulatory interventions
- Unfavourable stock market situations
- The allocation of share of profit for delinquent borrowers

While the country is taking measures to reduce its negative gap of balance of payment, a recent study shows that Sri Lanka can cut its import bills by 31%, under such environment banks may loose the fee-based income of foreign trade. It affects the profitability.

Usually Volatility drives up/down net interest margins and therefore need to boost the fee income. The factoring is a useful instrument which is not much popular among borrowers especially for business, which sells product or services on credit. Factoring basically improves customer's cash flow and speed up working capital cycle allowing better and quicker business growth. Factoring provides specialized services like, invoice discounting, cheque discounting, sales ledger management and collection of receivables. It creates new business opportunities for both customers and banks.

Cost Savings

One of the largest categories of profits share of banks has been the employees. Banks which have excess staff will erode the profit share. Under volatile situations bank need to identify the minimum required staff level and suggest various lay-off packages. However banks also need quality, right-skill of people to carryout their business operations. Due to the fact that limited credit expansion, the staff of Credit Division could be utilized for loan recovery. Volatility could be used by banks to improve operational efficiency and thereby increase employee productivity.

Major portion of bank's income is also allocated to suppliers and utility providers. Usually at tough times the natural tendency is to cut cost in this area.

In order to establish base lines for the measurement of bank's effort to reduce environmental impact, bank could introduce a tracking system for resource usage. The results could be recorded under respective headings below and will be used to benchmark for future performance.

- Paper usage
- Energy consumption / Water consumption
- Business travel

Bank could employ a full time Economic Officer to coordinate cost savings activities and monitor performances.

In today's environment, accountability and high return on marketing investments are paramount importance. This is becoming a challenge within many organizations, especially under volatile environment. Banks invest millions of rupees in internet based transaction system, whereas spend smaller portion for on-line marketing. Internet access today is increasing from 3-10% (2.5 million internet users) and could be considered as competitive and cost effective vehicles for financial products. Social media can be a major contributor to bank's on going efforts, especially as they pertain to service, sales and marketing. For instance, banks can use social media as a low cost channel to distribute messages, host conversations, provide customer service, identify dissatisfied customer and increase the impact and reach of traditional media efforts.

Social Dimension

The bank needs to manage the impact of its activities on society in which we operate and an inclusive perspective on our stakeholders. Following areas are considered under social sustainability.

Customer Relations

In many developed urban markets and more affluent segments of many growth markets, the majority of potential customers are within the banking system, and are well provided for in terms of their financial needs. Opportunities to grow through new customers acquisitions in these markets or segments are increasingly limited and expensive with compared to rural market. However the opportunities to grow existing relationship are often not fully tapped. With many banks in each market all trying to compete for more business from their most valuable customers, the goal of developing an effective customer centric model is becoming ever more challenging. Not only do banks need to maintain high levels of service and access, quality products, but also face competition that is becoming ever more innovative.

Those that succeed do so by exhibiting the ability to build an intimate understanding of their customers, and then to use this knowledge to engage their customers and tailor propositions around their needs to be in the minds of the customers to win the market share.

Developing a successful service model is important in volatile market in order to be effectively optimized the customer value proposition. Customer Value Proposition (CVP) is a socio economic concept that expresses the value that a purchaser perceives that they will receive from buying bank services. Typically customers will try to maximize the utility from their expenditure. This utility/ value concept is explored in great depth under customer value proposition and is a central tenet of good an effective marketing and selling. Successful marketing, indeed selling about and getting the customer to purchase your offering in preference to everybody else. Understanding what the customer values and therefore getting CVP right is the difference between success and failure.

Traditionally, strong customer knowledge and empathy have often been associated with the "Local Branch Manager" model that has all but disappeared from most banking markets. The banks that are excelling at building deep customer relationships today are trying to maintain that vital human connection between staff and customers, but are increasingly employing technology and advanced business processes to enable them to do so.

Following characteristics are needed to be adhered by banks during volatility

- A clear view of who their customers are, and to develop, and use of differentiated propositions, and service models to meet different customer need
- Effective relationship management strategies in place that incorporate not only staff culture and training, but also the underlying systems to support these interactions
- Different business units collaborating to meet the targeted range of customers needs, which leads and opportunities being passed seamlessly to the right part of the organization
- Product and services designed around customer needs
- A strong focus on ensuring that the bank's distributions system and processes are easy-to-use and highly accessible to customers
- A multi-channel architecture that enables a consistent quality of service experience across all the various customer contact points, and which is connected with the bank's Customer Relationship Management (CRM) systems
- A strong set of analytical and marketing capabilities, which are increasingly industrialized into a marketing ' factory' that supports management of relationships with customers across all their interactions with the bank
- Digital marketing capabilities that make online and mobile channels more relevant to customers, and which increasingly incorporate social media elements into the bank's customer interactions
- A strong customer-focused culture that permeates both sales and service activities

Possible frauds

During volatile periods, there is a tendency to increase frauds. Fraud is a subject that needs attention of everybody. Frauds can be internal or external. Bank card skimming / or copying of card data, security issues in internet banking, theft of credit card details, ATM misused, credit frauds, cheque frauds, frauds in deposit accounts are some of the common frauds. The costs of frauds include direct monetary loss, fines from regulators, loss of customers/ potential existing reputation cost, social media further can amplify the issues. Much of the frauds that happened went unreported and perhaps some of them seen as an acceptable loss. Sometimes it covered under insurance. Many banks still do not have enough measures to tackle frauds which cost heavily to banks.

Marketing Ethics

'Ethics' as defined in the Oxford dictionary, is a set of moral principles that distinguishes between right and wrong. Business ethics is a branch of ethics that examines moral rules and principles within a commercial control. More often than not business activities are carried out with the central aim of profit maximization. On the contrary, ethical behavior tends to restrict this main aim of doing business. When business enterprises strictly follow their business objectives of profit maximization, they may tend to ignore the interest of others. The ethics comes into play, is that there can sometimes be conflict between the objectives of the different Stake holders.

Ethics needs to be considered under lending, when we analyze the purpose of the loan, we have to consider whether it is a legal or moral. Although that is subjective judgment, what constitutes the best advice to a customer's fairness in the financial promotion is how many of banks give deferential interest rates for different customers - Price discriminations

The largest recipient of income of banks has been the depositor. However the small percentage of customers earns fairly a large percentage of depositors' profits because of the bargaining power they had on their large deposit base. How ethical this is?

The consumer sovereignty Test (CST) could be used to decide the morality of a decision. It is based on an analysis of whether consumers can exercise informed choice. It basically looks at three dimensions consumer capability, information available and choice.

Managing Risk

One can cite the managing risk, as one of the biggest challenges, facing his/her business. Expanding on this, bank can note a number of factors contributing to a heightened risk agenda, including market volatility and the increasingly complex regulatory environment. Boards want risk managements to be embedded in the business and in the culture of the organization. Most banks have a greater focus on risk management than they did few years ago. The risk environment has heightened, with economic weakening, and regulatory requirements. Some banks believe their current risk management processes will not cope-up with the rate of changes in this volatile business conditions. Risk management is heightened in the Chief Risk Officer's mind because it is top of mind for the Board and other governance committees. In times of uncertainty, the danger is that banks will focus on minimizing risk and fail to take advantage of market opportunities. Marketers have a leadership role here, to play in addressing this balance, by explicitly focusing on the upside, not just the downside. In order to sustain in the volatile market, speed to market is critical.

People Management

The talent life cycle is very expensive whenever people walk out the door, knowledge goes with them and the replacement costs are significant. In this volatile environment, banks will need to address their immediate talent shortage as well as develop strategies to address the supply gap. Banks will need to develop innovative approaches to secure and develop the talents. It is important to provide with knowledge, skills and competencies that are required from the human resource to meet the emerging challenges of volatility.

Environmental Dimension

The natural environment forms the backdrop to our social and economic lives. As such a growing economy must draw part of its necessary input from the life supporting system. Greener marketing reflects the emergence of significant changes to traditional consumption patterns. There has been a growth in customers and businesses, using environment criteria within at least some of their buying decisions. Banks that recognize this and offer greener choice may provide opportunities for differentiation. Customers do not just only buy products or brands, but also consider company philosophies and policies. Increasingly, customers will vote on environmental issues with their purchases and investment decisions.

All institutions will bear significant financial costs for climate change mitigations and adaptations. In this aspect, the companies need to analyze by themselves, answering to the questions of on what eco system services do we depend upon, and how will the decision taken, affect the eco system services etc.,

There are two main areas of environmental concern for financial organizations. Firstly that they give due regards to the environmental impacts of their customers' business and secondly they ensure that their own operations are conducted in an environmentally aware manner.

Banks could ensure that green issues are analyzed by way of reviewing their existing portfolio for potential problems, ensure green issues form part of the normal credit assessment process, developing green activity plan and ensuring insurance is in place with sufficient coverage.

According to the Swiss Re's talent sigma study, in 2012, the total economic losses to society due to natural disasters and man made reached an estimated USD 370 billion during 2011, compared to USD 226 billion in 2010. This staggering USD 370 billion in economic damage due to natural environmental issues will be shouldered by corporations, government and ultimately individuals.

Conclusion

The term Sustainability came from the realization of the earth's limited resources that are being depleted at a fast pace by human activities. In an increasingly uncertain and competitive business environment, bank marketers are taking on for more strategic roles in steering their banks safety through tight volatile market conditions and how banks are responding to market volatility.

If Sri Lanka's banking industry tempted to beat the stiff competition under volatile environment by providing low quality credit, liquidity mismatches, not adhering to regulations/ compliances, not doing business in ethical manner will be the root causes for financial meltdown.

Developing sustainable practices, within the bank build the competencies in sustainability initiatives. Sustainability should never be considered merely as a compliance view, but as an opportunity to drive the organization forward.

> *"Society is demanding safer and fair financial systems. The view that financial markets were big casinos, where the betting was done with other people's money and gamblers walked away unpunished, is quit common around the world. Public opinion has been dominated by that sentiment, which has also affected policymaking."*
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> ***- Jose de Gregorio, former Governor of the Central Bank of Chile***