

# Commercial Banking: Emerging Scenarios

**W**ith the dawn of the new millenium the emerging scenarios in the world of banking and finance all over the world pose massive unprecedented challenges to the players in the market. They also present them with huge opportunities to grab and utilize for their growth and sustainability. The era of traditional commercial banking is fast receding into the oblivion with its several sacred assumptions. As the Information Age unfolds with its diverse dimensions and the world we live in shrinks into a global village radical changes are called for in all spheres of human life whether it is education, entertainment or business. In a chaotic world where intense competition takes place in all fields of human activity each segment is compelled to chalk our strategies for its own survival.

The field of commercial banking was no exception to this global trend. The Banking operations worldwide have been exposed to fundamental changes during the last decade. This situation has arisen due to financial liberalization, technological changes and the introduction of complex financial products. The process and influence of globalization has also become unavoidable and it will further intensify this situation in years to come. Many Asian countries in order to adapt to the fast changing environment implemented massive restructuring programmes to revamp and re-orient their banking and financial systems. Especially, in the aftermath of the East Asian crisis many countries in the region embarked on radical reform processes to revamp and strengthen their commercial banking systems. Indonesian Bank restructuring Agency had merged 4 state banks,

recapitalised 9 banks and taken over 11 and closed 66. Malaysia has established a separate agency to acquire non-performing loans so as to strengthen bank balance sheets. Thailand and Korea have also taken efforts in this direction. Apart from this, forces of competition unleashed by globalization and the technological innovations of the 1990s compelled many countries to initiate restructuring programmes in the banking sector. In this backdrop commercial banking sector of Sri Lanka, which enjoyed a relatively calm and safe environment till the late 1970s encountered massive challenges in protecting their hitherto insulated space in the market place.

This process has thrown up several challenges especially to the state banks, but in its wake, has opened up vast opportunities as well. The state banks have to face challenges of competition from major global players and new domestic private sector banks. Several inherent weaknesses that were the legacies of traditional commercial banking thwarted their efforts at modernization and change. Autocratic attitudes, beauracatic procedures and rigidity displayed by Sri Lankan banks – especially state banks – remained as constraints for their forward march. The customer choice and awareness have increased tremendously due to information technology and also modern media. By technology upgradation and adopting international best practices, banks ensure their survival automatically and the entire global market open for them.

Sri Lankan banking industry picked up its growth momentum in 1980's with several foreign and domestic private banks entering into the scene. This signalled the end of an era in banking and opened the floodgates to the forces of deregulation, competition and

globalisation. Meanwhile, the rapid, unprecedented advances made in the sphere of information communication technology played a major role in improvements of operational efficiency and strategic effectiveness of banking industry in the emerging environment.

The banking industry in general and banking in Sri Lanka in particular has gone through different phases and presently it has come to the reform and restructuring phase. The banking sector reform was implemented since

*Sri Lanka is a country with many commercial banks, savings banks, Regional Development Banks and Rural Banks. Out of the total number of institutions 26 are Commercial Banks which comprise 10 domestic and 16 foreign banks. With the spread of 1346 branch net work of these banks there was a bank branch for every 13,700 people in 2000. While some of the banks concentrate on commercial banking some other banks have a mix banking approach with micro-finance facilities.*

**Table 1.**  
**Distribution of Bank Branches**

Category	2000 (a)
<b>No. of Institutions</b>	<b>30</b>
Commercial Banks	26
Domestic Banks	10
Foreign Banks	16
Savings Banks	01
RDBs (b)	03
<b>No. of Bank Branches (c)</b>	<b>1346</b>
Commercial Banks	1068
Domestic Banks	1026
Main Branches	915
ASC Branches	12
Kachcheri Branches	23
Extension/Pay Offices	72
Overseas Branches	04
Foreign Bank Branches (d)	42
Pawning Centres	185
NSB Branches	100
RDB Branches	178

Source: Central Bank of Sri Lanka.

(a) Provisional  
 (b) Regional Development Banks (RDBs) established under the RDB Act No. 6 of 1997  
 (c) Included Head Offices, but excludes pawning centres  
 (d) Includes sub-branches

1990s with the introduction of the international accounting regulations and capital adequacy norms, permitting private bank functioning, relaxation in reserve requirement and phasing out of refinance facilities. The banks have therefore shifted their focus from growth to profits, from balance sheet size to a transparent and healthy balance sheet. They also recognised the need to improve capital and labour productivity to become competitive in the market. In the light of this move the banks have focussed on different indicators such as return on assets, return on equity, labour productivity, non-performing assets (NPA) provisioning etc., to become competitive in the market.

### Marketing Orientation

In this process, banks equipped with modern technology introduced several innovative products and services to their customers to satisfy their ever expanding expectations and needs. Of late, customer satisfaction has emerged as a major component of the bank products. Newly emerged foreign and domestic private banks seized this opportunity and introduced an element of sophistication to the banking service. Modern technology and lean staff were the added advantages to them. These banks realising the importance of customer service – an aspect very much neglected by the state banks - introduced and popularised many technology savvy, tailor made products and services to their discerning customers. Marketing element, which was hitherto neglected in banking, was emphasised and various strategies including personal selling were introduced to attract customers and to grab new business. Many private domestic banks also ventured into the rural areas and carried out massive deposit mobilisation campaigns to mop up surplus funds from those areas. This trend marked a significant shift from reactive selling to proactive selling. Thus in the Sri Lankan banking industry an intense, severe competition was building up during the late 1980s and throughout the 1990s.

### Role of State Banks

Sri Lanka's two state banks, major players in the market in 1960s and 1970s began to feel the heat of competition during this period and realised the threats being faced by them. They felt the sheer inadequacy of their systems and procedures designed some decades ago in fulfilling the new demands of the customers. Hence, heavy investments were made in computerisation and in upgradation of systems. However, state banks had many inherent bottlenecks to grapple with:

- Dwindling profitability
- Rising bad loans
- Low capital base
- Paucity of technically skilled staff

Despite these constraints and obligations towards social banking Sri Lankan state banks continuously responded positively to the forces of disintermediation deregulation, competition and globalisation. Certain advantages of the state banks vis-à-vis their private sector competitors remain a valuable source of strength to them. They include:

- Massive branch network (especially in semi-urban and rural areas which enables them to access sustained resources at cheaper costs,
- Highly educated work-force who is capable of learning any skill required for efficient performance of their duties,
- High level of credibility and customer confidence
- An opportunity exists to re-deploy the excess staff to the hitherto neglected areas of marketing and personal selling.

Mano Tittawella, Chairman, People's Bank in a paper titled "Corporate Governance – The Role of Commercial Banks and Financial Institutions" aptly points out the praiseworthy role played by the State Banks in Sri Lanka's economy. He observes: "Sri Lankan State Banks were called upon to play a different role with a strong mandate towards

social responsibility vis-à-vis their private sector counterparts. In that process these banks implemented several programmes aimed at empowerment of hitherto neglected sections of our society and assisted in many ways to improve their lot in order to accommodate them in the national mainstream. Especially, the architects and pioneering champions of mass banking in Sri Lanka had much broader visions in their minds in respect of banking and rural finance. If they adhered to strict commercial norms in governance of these institutions – especially the People's Bank – many aspects of economic development and rural development would never have been witnessed in this country".

### Quality of Service

In today's sophisticated world of banking quality of service assumes extreme importance. Banks need to provide marketing orientation to their organisations by consciously adopting certain policies and strategies. In Sri Lankan banking industry all players in the market – both state banks and private banks – are offering similar products and services to their clientele. Hardly any difference exists between products offered by various banks. In this context, quality of service makes the difference. Over the years the life style of the customers are fast changing. And so are their expectations. In the emerging environment the role of the banker is also being changed. Today bankers are to play a dual role by being consultants, advisors and advocates of their customers. To attract and serve high value corporate clients banks need to have the financial clout and international network.

### Privatisation: Panacea for all ills?

International as well as local proponents of globalisation and liberalisation strongly argue for the case of total privatisation of the Sri Lankan banking and financial sector. They prescribe privatisation as the panacea for our banking system.

However, in the Sri Lankan context we need to consider the unique historical background of our public/private sector establishments, the distinct role played by them in the economic development and perceptions of our populace towards public/private sector institutions when such sensitive decisions are made. In spite of the fact that globalisation has become universal phenomena one cannot lose sight of local conditions and distinguished characteristics of traditional Asian Societies.

In case of Sri Lanka one needs to appreciate the crucial role-played by our state banks in popularising mass banking in the remote rural areas. These banks allowed the rural masses to enjoy the full benefits of banking first time in their life and made massive contributions to the uplift the rural economy. If a strict norm of private commercial banking was adhered to in this process these salutary developments would never have been achieved. In newly emerging developing nations a real need exists for state sector financial institutions and such institutions are called upon to play specific, distinct roles in the social development and uplift the masses. The mere negation of this reality and pursuance of a policy that advocates total privatisation would only lead to social tensions and distortions in the socio-economic fabrics. The South Asian Crisis of 1997-98 amply demonstrated the fact that

the privatisation alone cannot ensure a pool proof economy in a major crisis.

In such situations, trends of other banks in the world are to introduce innovative products and go for off-balance sheet activities. This has resulted in reducing the gap between banks and other financial organisations through changing traditional banking activities. When market is saturated with the new comers no other option was left except mergers, take overs, amalgamations or closures of the institution. However, before these steps need significant consideration of the facts of the market.

The present position in some of the banks facing competition is just changing or adopting banking products with reward systems and renovating banking outlook through Business Process Re-engineering. However, such aggressive approaches used without understanding real causes may further aggravate the crisis. It is therefore necessary to identify profit centres and plan defensively or rationally new programmes rather than haphazard or adhoc treatment. One can select parallel applications with sophisticated banking to some locations and for others the usual much localised practices to cater to the need of different clientele. The local knowledge and experience coupled with international expertise help to achieve these goals.

Tomorrows banking will depend on:

- Market research and business planning

- Reliable accounting system and procedures
- Motivated employees with appropriate skills and customer friendly attitudes.
- Technology strategies

Hence banks will be called upon to allocate considerable resources at their command for skills development, system up-gradation, research and development and technology improvement. They cannot anymore wait for customers at their premises and in future banking the name of the game will be competition. Banks those are adequately equipped with required attitudes and facilities to woo people and win business will survive in this game.

### Conclusion

In sum, Sri Lanka's banking industry which comprises market players belonging to both State and private sector is poised for a take off and exciting growth in the years to come.

During this crucial period all banks irrespective of their nature of ownership will be exposed to the forces of intense competition and disintermediation. In such an environment the success and the very survival of any bank will be very much depend on its ability to rationalise the deployment of staff, curtail the non-interest expenses to a minimum level, effective market penetration and adapting technological innovations to suit the local conditions and ethos.

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## GLOBALIZATION OF FINANCES - WTO VIEW

A recent publications by the WTO and the World Bank "*The Internationalization of Financial Services: Issues and lessons for Developing countries*", offers a comprehensive review of the benefits and risks involved in the globalization of financial services. This publication arose from a World Bank funded research project and its main findings, inter alia include:

Internalization of financial services can help countries build more robust and efficient financial systems by introducing international practices and standards; by improving the quality, efficiency and breadth of financial services; and by allowing more stable sources of funds. Given the present state of institutional development of many developing countries' financial systems, these benefits could be substantial.

Empirical evidence shows that increased competitiveness enhanced through financial sector openness spurs economic growth. Evidence also suggests that it is the number of foreign entrants in the market rather than their market share that has a positive effect on the functioning of national banking custom-

ers gain through reduced net interest margins, lower costs of fee-based services and the availability of a greater variety of services.

Analysis suggests that reasons for foreign entry, as well as the competitive and regulatory conditions found abroad, differ significantly between developed and developing countries.

The extent of the benefits of internationalization depends largely on how it is phased in with other types of financial reform, particularly domestic financial deregulation and capital account liberalization. The experience of the European Union, in particular, shows that internationalization and domestic deregulation can be mutually reinforcing.

The degree of capital account liberalization can determine the potential and benefits of internalization. Internationalization does not, however, require moving to a fully open capital account. Analysis suggests that internationalization of financial service results in less distorted and less volatile capital flows while also promoting financial sector stability.

## CUSTOMER RELATIONSHIP MANAGEMENT IN BANKS

Customer Relationship Management (CRM) remains an important issue for the banking sector because, unlike other retail industries, banks have a poor record of maintaining customer satisfaction.

With increased competition from internet banking start-ups, supermarket chains and telcos who offer financial services, banks are being offered a stark choice; tailor their offerings to their customers' needs or lose their customers, it is unfortunate that there is so much hype surrounding a simple concept such as CRM, because while it is significant, it also has its drawbacks.

The assumption that usually underlies CRM technology is that customers are rigid individuals who express "normal" behaviour all the time. This is not always the case, and banks should not be caught up in all the excitement and disregard some faults in advanced algorithms that ignore erratic behaviour. Time horizons should also be considered, as customer demographics change over time, CRM should be viewed as a long-term business strategy, which, when paired with technology can extract benefits from customers displaying normal behaviour.

New technology has provided banks with two major problems: It has allowed new entrants into the market and decreased face-to-face interaction between customer and bank staff due to automation and the emergence of new electronic channels. This can be partially rectified by "e-CRM" – at least there is contact of some form, CRM related technology such as (relational) databases, accounting package and credit scoring systems has always been used by banks for risk mitigating purposes but it has only been recently used for cross-selling and tailoring initiatives that aim to attract customers and retain existing ones. Thus advanced predictive technology is now used to ascertain future buying behaviour of customers.

The concept of e-CRM suggests that banks should integrate all their electronic channels (web-ATMs/ATMs kiosks, mobile phone banking, call centres, telephone banking, PC banking and Internet banking) on to a single enterprise wide platform in the back-office so that a single view of customers can be achieved.

When customers interact with one of the "touch points" the data from each transaction can be

filtered to large data warehouses in the bank-office where data mining and other sophisticated algorithms can purge the data-base for any type of trends or correlation that may be useful for front-office staff for cross-selling purposes. For example on a banking portal, a customer's previous audit or "click" trail can automatically generate a tailored offering of another service to the customer.

Whether the offering is relevant to the customer is questionable but, assuming the customer displays "normal" buying behaviour patterns, e-CRM technology can be very powerful. No longer are banks dictating the types of product that will be sold to customers but rather, customer behaviour is breaking the traditional "product silos" way of doing business. There is a plethora of technology vendors that have products that facilitate CRM.

Statistically, some predictive technology assumes a normal distribution of the market segment that has a particular behaviour and that this behaviour falls within a specified confidence interval. This means that most of the time customer who take on a mortgage will also perhaps buy house insurance, and it assumes they will repetitively act in this manner. For example, the customer takes on a further mortgage to refinance another house and therefore buys another house insurance policy. But what happens if the second house is used for student rental, and insurance is the students' responsibility? This is a general example, but some people have erratic buying behaviour and these types of social nuances are prevalent. "Normal" behaviour does not necessarily apply all the time.

The often quoted "80-20" rule, which states that 80 per cent of a bank's customers are not profitable and only 20 percent of customers are profitable, is also misleading. The underlying assumption is that customer behaviour does not change over time. But even if future research suggests that over time this rule is robust or accurate, it does not guarantee the demographics of each individual in each of the percentage category remain the same. A customer in the 20 percent group can move to the 80 percent group over time, and vice versa. Unexpected changes in income level gained from promotion or a change of job can also move individuals to a new grouping.

Incomplete or inaccurate information of customers and the increased automation and digitalisation of markets give rise to "the customer in the machine" or "virtual customer" concept. This refers to defining the customer only with the attributes recorded in a database. The virtual customer is usually different

from the real customer. A limited set of attributes in entity fields in a database is only the part of the whole person.

The success of CRM techniques will depend on the nature of the product/service being offered. For commodity or inelastic products such as milk or cereal, predictive technology is useful because 99 per cent of the time, customers will want these products every time they step into a supermarket, but for high-end or elastic products, it is harder to predict because of the increased value and decision making time of the purchase.

Similarly, risk-averse investors' buying behaviour can be easily predicted because they are likely to buy blue-chip stocks but a risk-taking investor may have a large portfolio of risky products that is hard to predict accurately. Even for a high correlation between two products, that is attached to a specific customer and not necessarily to a whole segment, it will be inelastic products that are attributed to normal behaviour. An example of normal behaviour can be demonstrated by the usual high correlation between buying cereal followed by milk.

Given the assumption that there is a robust predictive method/technology that can define and tailor a product to a customer will buy the product? It is likely that not just the product will increase customer satisfaction and retention but the overall care/support that is provided will be bought. CRM is so general and broad that it probably involves business practices and procedures that transcends technology.

New competitors entering the banking market will increase pressure for banks to be more customer-centric. CRM will play a more important role in the financial services industry as bankers look for ways to cross-sell new products and retain customers. But CRM is not a cure-all; it can service normal behaviour quite well but erratic behaviour should also be factored into decision making. Technology should be taken in the overall context of an organisation. CRM looks like a glorious concept but a sustainable return or investment on CRM technology is yet to be reported in the banking world.

Courtesy: *The Banker*, September 2000



However, the sustainable growth and success of the banking industry will depend on the general performance of the national economy. The constraints, which were part and parcel

of our economy during the last few years such as huge defense expenditures, interest rate fluctuations and absence of massive development programmes due to paucity of resources, seemed to have

brought adverse impact on our banking systems as well ■

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