MBA

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Executive Summary

This report aims at analyzing the ABC Bank PLC with the view on strategic aspects. First the report entails a review on the banking industry and the bank specifically. Then the report proceeds with understanding the core competencies of the bank, whether they could be proven as sustainable so that the competitive advantage last for long time. Then the current issues faced by ABC Bank PLC had been identified and the immediate and root causes had been identified along with the discussion. Finally, the report entails some recommendations to overcome the issues and to reposition the brand among the customers.

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Task 1
1.1 Introduction

Banking sector plays an important role in the services sector contributing the highest percentage to the Gross Domestic Product. The banking sector is moving towards a consolidation process in order to facilitate the economic growth and development process. The purchase of foreign currency by the Central Bank in 2015 has increased the liquidity levels in the economy. The flow of credit to the needed sectors in the economy is a key concern. The regulatory capital levels were effective and the sector moved towards improving the quality of the service. ABC Bank too recorded positive figures for its performance where its net Return on Assets was 1.33% and the Return on Equity was 13.45%.The overall growth rate was 32.95% in 2015. The Capital Adequacy Ratio was 14.73% and it complied with the regulations on the Statutory Reserve Ratio and BASAL II requirement etc. (ABC Bank PLC, Annual Report, 2014/15)

1.2 Historical review of ABC Bank

ABC Bank was established in the year 1987 as a public limited liability company under the Banking Act. It is listed in the Colombo Stock Exchange. It is a strong bank operating in the local financial system with over Rs. 193.1 Bn in its advances portfolio. Despite the worst time the bank experienced over the last five years' time, it has recovered its market position up to a great extent. LMD recognized the brand "ABC Bank" among the top 20 companies. There are 13 regional offices through which the island wide operations are being managed. Developments in banking services such as internet banking, mobile banking etc. have made the bank to be a pioneer among the other peer banks. The social responsibility initiatives are also a fact for making the bank to be sustainable in the market environment.

ABC Bank has five main operational sections namely Branch Banking, Corporate and Foreign currency Banking, Retail Banking, Treasury Operations, International and Trade operations. These operational sections perform the financial services to each of the target customer categories sing various delivery channels. By 2014, ABC Bank has developed its delivery network with having 157 branches, 177 ATMs and 93 student saving centers all throughout the island. (ABC Bank PLC, Annual Report, 2014/15)

The ABC Bank bank target the middle level to lower level customers, but they are committed to bridge this widening gap between individuals' capacity and their dreams to own a home, by extending unique services to turn their dreams in to reality. Consumer demands are expanding and diversifying and bank wide range of financial solutions address all the aspiring needs of their customers under one roof. ABC bank is playing a major role in transforming lives of people for the better.

ABC Bank expanded with the new developments in technology such as the phone banking facility which is provided at no cost to the customer. The internet payment gateway is one of the advancements in the product portfolio. It enables the use of Master Card as secure credit card payments for purchases. Internet banking is also using updated systems in order to process customer requests for making payments, fund transfers, fund management, bank statements requests, standing order requests, requesting cash advances online etc.

1.3 Vision and Mission of ABC Bank

Vision: "To be the Sri Lanka's best financial services provider as recognized by all of the stakeholders."

Mission: "We provide our customers with the financial services that meet their needs in terms of value, pricing, delivery and service. We will do so through a team of ABC Bankers who are recognized and rewarded for results orientation. We will ensure that our efforts translate to meeting the expectations of our shareholders, whilst always acting as responsible corporate citizens. (ABC Bank PLC, Annual Report, 2014/15)

Task 2

Analyze and discuss the company's main core competencies and competitive advantages over other competitors and discuss if these competitive advantages can guarantee a long term sustainable strategic competitiveness for the chosen company in the market.

There are two types of competencies that an organization could possess. Threshold competencies do not guarantee a competitive advantage and those are the competencies required to ensure survival in the industry. (Franklin, Kanoknart, 2014) Core competencies are the skills and abilities that are unique to the organization that brings competitive advantage to the organization. Rival actions do not permit a competitive advantage even though secured to last long. Hence, ensuring that the core competencies have the characteristics such as non-imitability, uniqueness, rarity, non-substitutability, complexity, causal ambiguity, value etc. is important. And also, continuous monitoring on the competitor actions, changes in the business environment etc. are also very important.

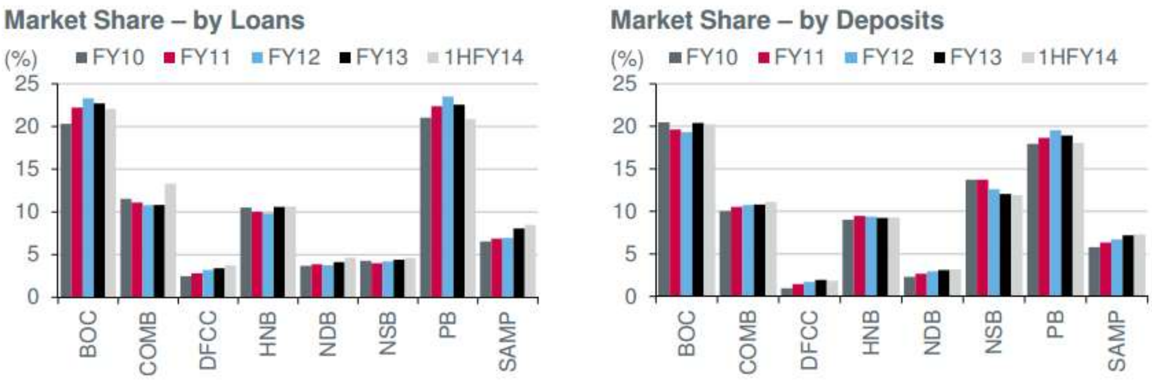

Figure 1 - Competitive Landscape

Source: Fitch Rate

2.1 Characteristics of sustainable core competencies

2.1.1 Value to customers

Those core competencies should be valued by customers. Managers may this idea incorrectly because the thinking that a competency would just be sustainable due to the fact that it is distinctive could be not rewarding as a valued competency. Through the value chain analysis, the valued and less valued competencies could be identified. (Franklin, Kanoknart, 2014)

2.1.2 Rarity

If the core competencies are rare, it will create sustainability. This could be due to the fact that the competencies are linked to the unique resources. Products and services that have taken the patent license could be made rare. Talented employees in a service organization such as ABC Bank is also could be rare. The rarity of competencies could be based on the following three factors.

Ease of transferability – The ownership of the competence and the ability to transfer it may decide its rarity. For example, the competencies related to the talents of employees in ABC Bank could not be transferred to others very easily. Durable advantage would lie in the activities such as recruiting, training, motivating and rewarding such employees within the organization or the culture within the organization could also bring in advantage.

Sustainability – The base of the core competencies should be sustainable because even the unique resources may be a target of competitors. Therefore the base of core competencies should be looked for change.

Core rigidities – Redundancy is another risk associated with the core competencies. There is another danger of redundancy. Overwhelming some bases of core competencies and building of strengths around those bases make them to be core rigidities which would diminish its importance to the customers.

2.1.3 Non Imitability

Core competencies should be non-imitable. If the basis of the competency is common and easily accessed by the competitors this could be imitated. Therefore the competencies should be related to the activities or processes that are valuable to the customers. And the competencies should lead to the performance levels that are superior to the competitors. "Another reason why competences might be difficult to imitate is that competitors find it difficult to discern the causes and effects underpinning an organization's advantage. This is called *causal ambiguity*." (Johnson and Scholes, 2010). The uniqueness of the culture within the organization and the practices could also make the competencies to be non-imitable. Complexity due to internal and external linkages would also be a basis for non-imitability. "Organizations can make it difficult for others to imitate or obtain their bases of competitive advantage by developing activities together with the customer on which the customer is dependent on them. This is sometimes referred to as *co-specialization*". (Johnson and Scholes, 2010).

2.1.4 Non Substitutability

The competency should be difficult to be substituted in terms of the products or services. Despite that fact that the competency is culturally embedded and causally ambiguous, they could be made generic by way of substitution.

Corporate relationships established for the favor of banking services is a factor bringing in competitive advantage. ABC Bank is providing exceptionally personalized services in order to provide more efficient banking service to the corporate clients. Financial solutions are provided at low rate with promoting cost effectiveness. Therefore the bank had been able to form a competitive advantage over the peers due to competitive prices offered for its services. ABC Bank also introduced the dedicated relationships management concept as an effort to service better. Customer concerns are concerned in order to identify their needs and preferences better. Provision of effective scouting for off shore business opportunities is also another step taken with regard to securing this competitive advantage. ABC Bank has also continued to make visits to the prime and potential trade clients attached to branches in order to strengthen the relationships. The maintenance of good relationships is the most immediate factor behind building a sustainable competitive advantage. Since the customers could be turned to loyal customers so that they would not leave the bank, this fact brings in an opportunity for the bank. By reaching many customers with relatively low interest cost products would result in gaining market share which will ultimately increase profits. It is also superior in exploiting resources and competences such as the branch network and the skilled work force. When focusing on high volumes, it should not compromise quality of services which would create stakeholder resistance to the strategy. Since the markets and demand grows, it creates more opportunities to be exploited. In fact, being limited to the existing market would be unsuitable. (Franklin, Kanoknart, 2014)

Competitive advantage gained through the introduction of new products is also important. ABC Bank introduced its housing loan product by rebranding as “Siri Nivasa” and along with that the delivery channel was modified with establishing a new operational unit for that. Pawning services were expanded in various sides of the country like Eastern and Northern provinces. ABC Scholar is also another new product that targeted at the people who pursue higher education. These products had been launched and brought to the customers by means of various promotional tools and the rigorous advertising made them to contribute fast to the bank’s revenue stream. Providing financial services at a more generic level with high interest costs and other monetary costs could lead to capture no customers especially because ABC bank is not holding a monopoly position.

When analyzing the business environment, it is clear that competitors seek to offer higher perceived value at lower prices. So if ABC Bank pursue a strategy of high prices, it will fail. This strategy would not meet the expectations of shareholders who seek for organizational development and profits because this leads to reduce the market share. If ABC Bank pursue this option, it will probably end up with low margins and hence fail to meet the expected financial performance. It will also fail to meet its social obligations as well. This will not result in an exploration of its strategic capabilities like the service of expert professionals employed at ABC Bank, the innovative ideas etc.

Since the technology is updating day by day and there is almost free access to it, the new products based on technology is vulnerable to competitive actions. Hence building a sustainable competitive advantage in this regard is a very difficult task.

Competitive advantage also established through restructuring the income generating sources. Primarily most banks depend on the interest income which is very vulnerable to the interest rate risk. ABC Bank focused on improving the fee and commission income specially by excelling in trade finance. Bank has offered flexible trade tariff rates and competitive rates for exchanging currencies as a part of trade finance. Bank has also conducted training sessions for the clients with the motive of providing knowledge on the operational aspects of trade finance. There had been negotiations with other banks for securing higher rebates on trade transactions. This core competency has the characteristic that it is valued to customers. But there is a risk that this also could be a generic advantage after some time. In order to make it sustainable, the bank would have to keep on inventing new services for charging fees and commissions and also maintain good relationships with customers with making them as loyal customers to the bank.

Information Technology had been utilized as a source for gaining competitive advantage in order to increase the efficiency and effectiveness of operational activities. The transaction processing system was successfully automated with the aim of improving the effectiveness and efficiency. A new IT portal is also under review for improving the effectiveness and efficiency of individual workers. In this system, the total productive activities and non-productive activities could have been measured through a queue system where the user could choose the task he/she is engaging. The fact is that the technology is changing every minute and new ways of doing things emerge at a fast phase. And there is access to technology too. Therefore the new products based on technology could be imitated by competitors. This fact results in a barrier for building a sustainable competitive advantage in technology related fields.

Competitive advantage gained through engaging in corporate social responsibility is another factor that has proved to be important to outstand among the competitors. ABC Bank is concerned of the social effect of its products too. ABC Bank has recognized education to be one of the important pillars for reducing the level of poverty and improving economic welfare. The 100 libraries project targets at providing library facilities to less privileged children. The annual report states that the "Fervent staff of 10 branches of North West Region II (Kurunegala,Puttalam, Kuliyapitiya, Narammala,Mawathagama, Dummalasuriya,Udappu, Bowatta, Rideegama and Kalpitiya) renovated the community hall of Wellawa Meddagama village,to facilitate social and religious gatherings of the people, furthering community engagement". And also the staff has made attempts to socialize the disabled and differently abled children of Dr. Miranda Hemalatha Kalashramaya by way of donating wide screens, fans, books, stationary, a multimedia projector etc. And also as a point of acknowledging the customers, the digital marketing was utilized in order to promote the bank in digital space. This competency is also could be generic unless the organization keeps on inventing new things in corporate social responsibility activities.

Task 3

3.1 The most recent problems

The crash of the Golden Key Company which was associated with the ABC Bank PLC made a huge impact on the level of trust the customers held on the bank too. The feared customers came in queues asking for their deposits and the refusal to fulfill the withdrawal requests of customers created a reputational damage to the bank. The spreading of the message that the bank lacks enough liquid funds to cater the requests of customers made the situation even more badly.

	31 Dec 14	31 Dec 13
Total assets (USDbn)	1.9	1.6
Total assets (LKRbn)	251.6	217.5
Total equity (LKRbn)	26.3	24.2
Operating profit (LKRbn)	6.0	4.1
Net income (LKRbn)	3.3	2.4
Comprehensive income (LKRbn)	3.2	3.9
Operating ROAA (%)	2.63	2.02
Operating ROAE (%)	24.08	18.76
Internal capital generation (%)	9.33	8.10
Fitch Core Capital ratio (%)	16.14	17.64
Tier 1 ratio (%)	14.04	15.01

Figure 2 - Financial Data –ABC Bank PLC

Source: Fitch Rate

The approach of ABC bank in strategy formulating process is more inclined towards analytical thinking and hence identified to be a strategic planning process. The strategies are more concerned with today's problems rather than exploring opportunities in the future. In the strategy formulation process, ABC bank aims to create a fit between the existing resources and the current environmental opportunities only. Therefore it could be inferred that ABC pursues a Strategic Fit approach in formulating strategies. In order to articulate the future direction, ABC bank pursues a Strategic Planning approach where more analytical thinking is employed as the basis of setting the strategic direction. Managers at ABC bank are using more analytical thinking in formulating and implementing strategies. It is evident from the three year new strategic vision created for the period of 2014-2016 with extensive discussion and the participation of all levels of management with taking a time period of six months.

	2014	2013	2012	2011
I. Profitability level				
1. Net interest margin	5.51	5.42	6.20	5.52
2. Pre-tax profit/total assets (av)	2.43	1.26	1.96	1.03
3. Net income/equity (av)	11.03	6.13	9.29	4.11
4. Net income/total assets (av)	1.25	0.62	0.81	0.28
5. Total non-int. expense (excl.prov)/ net int. rev.+ other operating income	63.63	63.73	54.65	62.86
6. Net int. inc./opp. income	77.57	69.86	70.23	73.82
7. Non int. inc/opp. income	22.43	30.14	29.77	26.18
8. Net interest rev/total assets (av)	4.94	4.88	5.57	4.93
II. Capital adequacy (year end)				
1. Equity/total assets	11.32	11.38	8.74	8.64
2. Equity/loans	15.95	16.75	13.60	13.66
3. Capital/risks - tier 1	14.51	14.02	9.87	11.35
4. Capital/risks - total	14.88	14.67	11.37	13.60
5. Net NPLs/equity	60.14	59.39	109.75	158.00
III. Liquidity (year end)				
1. Liquid assets/customer & short term funding	28.40	29.05	32.81	38.66
2. Loans/customer & short term funding	89.67	89.48	85.63	81.00
IV. Asset quality				
1. Loan loss provisions/loans (av)	-0.19	0.62	1.72	2.22
2. Loan loss reserves/loans	3.53	4.43	6.47	7.45
3. Specific loan loss reserves/NPLs	24.60	28.76	27.41	23.37
4. Loan loss reserves/NPLs	27.15	31.12	30.15	25.37
5. Non performing loans/gross loans	12.99	14.24	21.45	29.38

[a] Annualised where appropriate
Source: Fitch

Figure 3 - Ratio Analysis – ABC Bank Consolidated

Source: Fitch Rate

It is true that there is a contradiction between liquidity and profitability. ABC Bank was compromising the liquidity in lieu of profits. That was the reason for the lack of liquid funds for the payment of customer withdrawals. Liquidity planning is an important facet of risk management framework in banks. Liquidity may be defined as the ability to meet commitments and/or undertake new transactions. The most obvious form of liquidity risk is the inability to honor desired withdrawals and commitments, that is, the risk of cash shortages when it is needed which arises due to maturity mismatch.

Liquidity risk in banking is the potential inability of a bank to meet its payment obligations in a timely and cost effective manner. Simply, Liquidity Risk in banking means, the bank is not in a position to make its repayments, withdrawal, and other commitments in time. It arises when the bank is unable to generate cash to cope with a decline in deposits/liabilities or increase in assets.

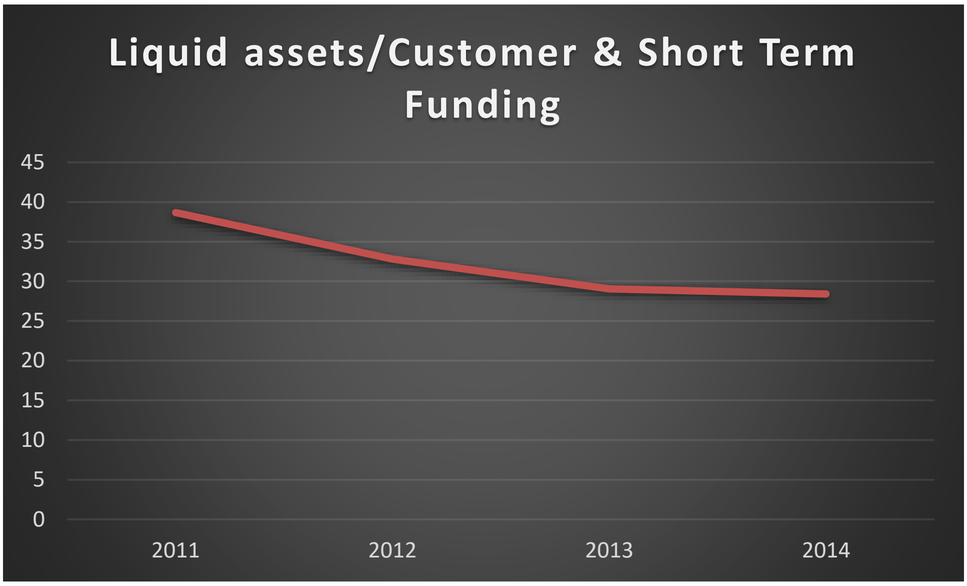

Figure 4 - Liquid assets/Customer & Short Term Funding

The cash flows are placed in different time buckets and banks, lend for a longer period than for which they borrow. Therefore, they generally have a mismatched balance sheet in so far as their short-term liabilities are greater than short-term assets and long-term assets are greater than long term liabilities.

3.2 Liquidity risk consists of Funding Risk, Time Risk, and Call Risk.

- **Funding Risk** – This refers to the requirement to refill the net outflows of funds in the form of unanticipated retail and wholesale withdrawals/non-renewal of deposits.
- **Time Risk** – This refers to the requirement to replace funds due to the non-receipt of expected inflows of funds like the non-repayment of loans etc.

- **Call Risk** – This refers to the tie up of funds for contingent liabilities and therefore the missing of opportunities when they fall due.

The commercial banks operating in Sri Lanka are required to maintain reserves with the Central Bank at rates determined by the Bank. At present, demand, time and savings deposits of commercial banks denominated in rupee terms are subject to the SRR and the applicable ratio is 6% on all deposit liabilities.

The commercial banks in Sri Lanka are required to maintain 20%of liquidity assets on their liabilities, excluding capital funds. Since this ratio is a statutory requirement, non-compliance would result in a penalty for the commercial banks.

The Bank maintains a healthy Statutory Liquid Asset Ratio (SLAR) at Bank level and at Domestic and Foreign Banking Unit levels. The Bank considers Cash balances, Balances with Licensed Commercial Banks, Money at Call in Sri Lanka, Balances with Banks Abroad, Treasury Bills/Bonds and Securities issued or guaranteed by the Government of Sri Lanka, Sri Lanka Development Bonds, Investments in Standing Deposit Facility, Guilt Edged Securities, Approved Commercial Papers, Import Bills, Export Bills, Inland Bills and Items in the Process of Collection as 'Liquid Assets' for the purpose of Statutory Liquid Asset Ratio Calculation. (Franklin, Kanoknart, 2014)

Task 4

Critically discuss how the chosen company can overcome the specific problem which you have addressed in Task 3 by re-strategizing its position in the market or product wise or in any other possible way.

4.1The re-strategizing its position in the market or product wise

Given below are some of the strategies for repositioning the brand among the customer minds. It should also be ensured that the processes and procedures be communicated with various documents and workshops to the employees as well as customers and the general public. There should be rigorous communication because the bank should gain the lost customer confidence and trust with care.

Current vigorous risk management techniques will continue together with advanced measures to monitor the impact on the Bank. Front level employees' engagement with elevated efficient and effective methods will be one of the main characteristics of future risk mitigating methods of the Bank. Prominence should be given for improved measurements in the risk management activities like risk identification, assessment etc. and also new knowledge on risk management techniques etc. should be priority areas for investment.

The Bank stresses the importance of maintaining an adequate deposit base as sources of funds to finance lending to customers. They are monitored using the advances to deposit ratio, which compares loans and advances to customers (excluding receivables) as a percentage of customer deposits. Cheques and drafts purchased which are deemed to be liquid, are excluded from the advances to deposit ratio. ABC Bank could improve their Advance to Deposit Ratio (ADR) considerably compared to crisis years with the aggressive deposit mobilization compaigns.

An adequate level of trade-off between profitability and liquidity is to be maintained by the bank by taking suitable actions in order to ensure they keep satisfactory level of liquidity through various fund providers at an agreed level of confidence. In order to ensure that they have sufficient liquidity at all times and their financial obligations can be met without any stress, ABC Bank maintains a well- articulated liquidity risk management policy.

There should be proper risk management education and thereby improve risk communication which would be effective. The bank has the top management attention to the risk management function after the crisis period and thus the practices and policies should have to be continued to the future in order to be successful and be strong enough to face the risky situations.

Amendments are needed to the structure of the loan portfolio of the ABC Bank in order to ensure adequate credit management. Fitch Ratings stresses the importance of maintaining proper customer files and branch level credit administration. Therefore the ABC Bank needs to ensure proper procedures are in place for managing its loan portfolio. This heightens the credit risk of ABC Bank by compromising ABC Bank's ability to monitor credits and enforce security. ABC Bank must be prudent in lending and it should balance the loan concentrations over many sectors in the economy. Therefore there is a possibility to extend credit to the retail and trade finance categories more and reduce the existing concentrations in the credit portfolio.

However, most banks have targeted these segments to maintain margins in their corporate banking portfolio. Hence, competition will intensify. Further, lending to middle market segments will present a higher credit risk, thus ABC Bank must decide its risk appetite and display reasonably good credit risk selection and management where the bank should have kept the Non-Performing Loan ratio at a reasonable level.

It could be recommended to carry out a comprehensive Liquidity Contingency Funding Plan (LCFP) linked to the Business Continuity Plan which is in line with regulatory guidelines to ensure they are well-aware the responsibilities of liquidity management team and ensure the business continuity through close monitoring the liquidity position against the predefined liquidity risk trigger points.

Departments like departments like procurement, treasury, and supply chain should be managed properly in order to face the commodity price risk in an effective manner. Its effective recognition could minimize the potential loss of earnings or economic values arising principally from customer-driven transactions and the banks relevant investments.

ABC Bank has created its business strategies and financial strategies to support the overall corporate strategy. Financial strategy should have been designed to complement the business risk. The level of business risk faced by ABC Bank is moderately high because of the risks involved in operating activities, demand and price volatility in financial markets, risk of failure to adapt to the changes in the technological environment and the fierce competition. This higher level of business risk should have to be balanced by the moderately low level of financial risk. Reduced interest rates and leverage could reduce the financial risk and total risk. To allow total risk to increase in response to a change in business risk, the financial risk have to be adjusted. ABC Bank should have taken a conservative approach in balancing the two risks where it has not compromised its high business risk in order to take a very low financial risk. But the level of financial risk is assumed to generate a fair level of returns which is neither very low nor high. The financial strategies should be fair enough to be not so aggressive but to earn sufficient returns.

Conclusion

As the report recommends, there should be many initiatives taken by the bank in order to reposition its brand in the customer minds. Since the financial sector is one of the most sensitive industries that is vulnerable to the reputational damage, ABC Bank has to rebuild the lost customer confidence. There should be processes and procedures in order to ensure proper liquidity and profitability match, risk management education, balancing financial and business risk etc. Creation of employee awareness on these matters could be done through the organizing of workshops, events, documentation and distribution etc. The emerging strategy formulation and thinking process should have to be adopted with replacing the rational strategy formulation approach and the traditional thinking. These solutions would help the ABC Bank to reposition within customer minds in the safest mode again.

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