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A dream that turned into a nightmare: The story of a small Bank that aspired to be big

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Abstract

ABC Bank, a small old generation private sector bank established in the 1920s tried in vain to get on to the fast lane during the first decade of the twenty first century. What unfolded during those tumultuous years at ABC Bank is fodder for thought to analysts and management students alike. The Bank's CEO who was of the view that big bang reforms are the way ahead for the Bank stepped on the gas to push things forward. He hired extensively, expanded the branch network and lent aggressively. However, there were many factors that pulled him back: the bank's lethargic culture, aged workforce, vested interests of the trade unions, absence of deep pockets etc. The choices before him were tough: whether to go slow and steady or get propelled ahead? Whether to remain small in a niche market or grow at any cost? Whether to play it safe or take calculated risks? Whether to implement growth strategies that invite the wrath of the employees and the trade unions, or not? Whether to silently tolerate the inefficiencies of the older generation employees or try to squeeze out whatever is possible from them? A little more than 2 years later, the CEO has made an unceremonious exit and a new person has taken charge. He is facing even tougher challenges and has even more difficult decisions to make. The case can be used to teach Strategy, Human Resources Management, Organisational Culture, and Organisational change with special reference to resistance to change.

Key Words: Old generation private sector banks, Wage structures, Labour relations, Organisational change, Psychological contract breach.

JEL classification

J30; J53; L20; M52

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Indian Banks can be broadly classified into three: Public Sector Banks like State Bank of India and Corporation Bank, Old Generation Private Sector Banks like Federal Bank and Jammu and Kashmir Bank, and New Generation Private Sector Banks like ICICI Bank and Axis Bank. They operate alongside foreign Banks like HSBC Bank and Standard Chartered Bank that have their headquarters in a foreign country. As far as HR practices, profile of employees, technology orientation and target customer groups are concerned, Public Sector Banks and Old Generation Private Sector Banks are almost indistinguishable. In this regard, New Generation Private Sector Banks stands closer to the Foreign Banks. They are technologically more advanced, have superior infrastructure including ultra-modern branch outlets at posh localities, are more customer-centered, put emphasis on marketing and sales, hire people from top B schools, pay them handsomely and bring out the best in them by pushing them to the brink.

This case is about ABC Bank, an old generation private sector bank, which wanted to shed its laggard image and metamorphose into a new generation bank, but failed miserably in the process, and found itself stranded at a ‘neither there nor here’ space.

ABC Bank which was incorporated about a century ago in a small town in West India by a group of ambitious and enterprising entrepreneurs was designated a Scheduled Commercial Bank by the Reserve Bank of India in 1977. The branch network touched the 100 mark in 1982, and the total business touched Rs.150 crores in 1987. The Bank went public with a share issue in 1998 and the Bank’s business touched Rs.6000 crores in 2007 and Rs.9000 crores in the year 2008. The Bank opened its 150th branch in 2008.

Mr.Sanjeev Kapoor who joined the Bank in November, 2009 as CEO wanted to make ABC Bank a well-known name in the Indian Banking industry. He knew all too well that something drastic needs to be done to switch to a faster lane and that growth and change would happen only when people strive for excellence. The bank hired 4000 people from foreign banks, new generation banks and prominent Business schools, thus increasing the head count by almost 100% and opened 100 branches during the next 3 years to expand business aggressively. During this period, the business of the 100-year-old bank grew fourfold, a growth which took the market by surprise. The employees who were working with the Bank at the time Mr.Kapoor took charge were being paid salaries in line with the pay structure proposed by the Indian Banks' Association (IBA). The same was being followed by all public sector banks and other old generation private sector banks. Such employees were eligible for pension as well. This compensation structure was more or less similar to that enjoyed by central and state government employees. However, the employees of new generation private sector Banks and foreign banks were being paid much higher salaries. To poach from those Banks, Mr. Kapoor decided to offer higher salaries to newly recruited employees, at par with what the new generation banks were paying. Thus two types of pay structures came into existence in ABC Bank: the IBA pay structure which included post-retirement benefits like pension and the new structure which came to be called the Cost-to-company (CTC) structure that did not include post-retirement benefits.

Mr. Kapoor noticed that the Bank's culture is not fit for the modern times and hence he tried to change it, and initially he did not face much resistance as he was able to keep the older employees happy by introducing welfare measures like offering jobs to employees' children. He also gave an option to the officers of the older generation working in Delhi, Mumbai and other metros to come back to their native place, the parent state of the Bank. However, the trade unions accused that Mr. Kapoor's aim was to get rid of the older generation: from the bank, itself (by offering jobs to children who would fit better in Mr. Kapoor's aggressive plans) or at least from the metropolitan centres for which he had grandiose plans of business expansion. But according to Mr.Kapoor's supporters, these measures revealed his humane side: he chose not to tell the older employees bluntly that he wants them replaced by the younger generation. Moreover, adding their children to the Bank's payroll meant that the adverse effect on the financial situation of the family was kept to the bare minimum.

Mr.Kapoor could bring down the average age of the employees from 51 to 32. The new recruits were not allowed to join the trade unions, as Mr. Kapoor believed that trade union, by nature, is a regressive force. The two trade unions that were active in the Bank became restless and turned hostile for fear of losing their importance. Although the economy was in doldrums the bank could grow its business by leaps and bounds. But the Bank was bleeding on the cost front. Expenses on salary and perks shot up by about 4 times, and so did the other expenses. Mr.Kapoor had shifted his office and many other administrative units from the Bank's headquarters at the remote West Indian town to an upmarket locality in Mumbai, and had thereby incurred huge expenses, to improve 'visibility' of the Bank. The unions called it a flawed strategy where too much money was spent for benefits that were too small.

Growth in expenses far outweighed the growth in income and the Bank had to resort to "accounting adjustments" so as to declare profits. Such accounting adjustments were not entirely new to the Indian banking industry. In fact they would have escaped everybody's, probably even RBI's, notice had the trade unions supported Mr.Kapoor. But the unions didn't and it is even being accused that one of the unions persuaded many major depositors not to keep their deposits with the "failing" Bank! When the major depositors became reluctant to renew their deposits, Bank faced a liquidity crunch and found it difficult to extend new loans. When credit growth got affected Bank's income streams got blocked even as the expenses on salaries remained high. This caused a further increase in the cost to income ratio of the Bank.

Mr. Kapoor and Unions at loggerheads

In 2010-11, Mr.Kapoor’s annual compensation was Rs.60 lakhs which was quite high by Indian banking standards. In addition, Mr.Kapoor was also given stock options. The trade unions accused that the new entrants (Mr.Kapoor and his team) are prospering at the expense of the Bank and that it is not fair to have two pay scales within the same organisation. It further accused the bank of window-dressing its balance sheet, an accusation that the Bank was quick to dismiss. The cost-to-income ratio increased to 85 per cent at the end of the financial year 2010-11 from 60 per cent in 2008-09.

In 2010, the management withdrew the conveyance allowance (which was in fact a very meagre amount) enjoyed by officers who were drawing salaries as per the IBA pattern, as a cost cutting measure. The trade unions questioned this action citing the high bonuses enjoyed by the Cost to Company employees. The Bank had changed its name from “ABC Bank” to “The ABC Bank” at the instance of Mr.Kapoor. This apparently simple act entailed incurring of huge expenses to change the name boards, hoardings, advertisement material, pre-printed stationery etc. All these were just for a change of name, which according to the trade unions served absolutely no purpose.

The trade unions accused the management of attempts to make the Bank a new generation bank look alike in the lines of HDFC Bank, Axis Bank and ICICI Bank. And Mr. Kapoor, at least privately, accepted this accusation with pride. Mr.Kapoor overhauled the organisational structure in the Bank and redefined job roles, as the existing structure failed to deliver spectacular results. Many officers were shifted from their operational roles to marketing verticals. Thus, many employees who were previously working from the comfort of their offices were forced to step out of the branch premises and virtually do door-to-door marketing, a job many of them found demeaning! The unions accused that too much emphasis was being put on the marketing aspect of banking, and that things have come to such a point that bank officers were being treated more as salesmen than as anything else. During any promotion process, what was being considered was who canvassed how much business; in other words, what was being judged was who the best ‘salesman’ was. In fact, almost all old generation banks, private and public, were facing the same predicament. With the advent of Core Banking Systems which almost completely automated the accounting procedures followed by Banks, there was no longer any need for experienced accounting professionals in bank branches. Once upon a time, bank officers used to be judged by their proficiency in accountancy. Specialised tasks, like drawing up balance sheets of branches, required special numerical skills, and took weeks and often months to get completed. But, with the modern day accounting systems, any junior officer can spool balance sheets, at one click of the mouse. Thus customer service orientation and marketing skills became one of the important determinants of an employee’s usefulness to the organisation. While other banks were cautious, slow and level headed in dealing with this problem, The ABC Bank management and trade unions took extreme stands, which were poles apart.

The Bank recruited four to five sales executives each for rural branches and 12-14 of them each for semi urban and urban branches. Some of them had to be retrenched later as it turned out that the requirements were overestimated. The fact that some of these retrenched sales executives were employed elsewhere before being lured to join the ABC Bank adds an ethical dimension to the matter.

Any Bank is likely to encounter the problem of bad loans a year or two after bouts of aggressive lending. The ABC Bank was no exception. The trade unions accused that the asset quality was poor and that the bank's books had been manipulated. Although RBI could not find anything extremely untoward during its inspection, it did ask the bank to go slow on the lending front, to have an eye on the cost-income ratio and to maintain a higher capital adequacy ratio than the mandatory 9%. Capital being a cushion to absorb unexpected losses (if and when they materialise), an increase in the required level of capital adequacy ratio was, according to the trade unions, virtually a vote of no-confidence by RBI in the Bank's management. Mr.Kapoor's supporters counter this argument by pointing out that, around the same time, RBI cleared the proposal to extend Mr.Kapoor's term for another three years.

There was some discontent among Bank's home grown top executives about the fact that the new recruits at the top level were being paid high salaries and allowances which they thought were disproportionate to the output. Anomalies in industry-wise distribution of wage rates were an accepted fact: even junior professionals in the software industry were being paid salaries higher than those received by seasoned professionals at the executive level (like General Managers) in public sector banks. However, such an anomaly when present within the same organisation and often within the same office became a sore point, for obvious reasons. But, according to Mr.Kapoor, higher levels of pay were a must to attract employees of new generation banks and foreign banks to a small, virtually unknown bank.

The trade unions went on a devastating strike which lasted almost 3 weeks demanding parity in wages. Customers suffered and the image of the Bank took a beating. Finally, the Board had to intervene to get the trade unions withdraw the strike.

It soon became apparent that there were not many people even within the Board who were sharing Mr.Kapoor's optimism regarding Bank's future. Most of the conservative Board members thought that Mr.Kapoor had a one point agenda: growth at any cost; even at the cost of the bottom line. He saw such dents in the profits as a temporary phenomenon. He openly lashed out in one Board meeting that risks need to be taken if the Bank did not want to remain 'eternally small'. To him, expenses incurred on man power and expansion were investments; investments which would pay off in the medium to long term, but not in the short term. But the Board was of the opinion that

Bank did not have such deep pockets as would have allowed it to undertake long gestational strategies.

Matters reach boiling point

The bank was somehow pulling along, when as the proverbial last nail in the coffin, liquidity problems became acute. The long strike had taken its toll and many customers had already shifted their accounts to other more stable banks. Rumours surfaced that the Bank is going to declare a huge net loss for the quarter. There were even talks about the chances of a bank failure. Some Banks took the extreme step of showing reluctance to negotiate “Usance Bills” against Letters of Credit (LC) issued by The ABC Bank. This news spread like forest fire in the market. The public’s trust in the Bank was already at the lowest. When fellow banks started doubting the creditworthiness of The ABC Bank, there was no reason for the depositors to continue trusting it. The management feared a ‘run’ on the Bank. At an operational level, Management began to lose control over the branches as it was busy fire-fighting. Business parameters showed sharp declines in most branches, NPAs mounted and NPA recovery efforts weakened in the absence of strict monitoring at the central level. And then it happened: Proving the detractors true, the Bank declared net losses of Rs.156 crores for the quarter ended 31st December 2011.

The inevitable exit of Mr. Kapoor

The Board, all along, was not very comfortable with Mr.Kapoor’s efforts to shake off complacency and to pull the Bank’s employees out of comfort zone. Finally, the Board lost its patience and it came to a conclusion that the new strategies were taking too long to show tangible results, that whether the strategies will pay off at all is uncertain and that the Bank had had enough. Mr. Kapoor, the man who had worked hard to turn the Bank around became completely disenchanted and he couldn’t think of anything other than moving out. He resigned in February 2012.

Fortunes nose-diving

The Bank never really recovered from the shock. The profit had never been very high. It was in fact a few crores only before Mr.Kapoor joined the Bank. For a century-old Bank, it was a very meagre sum. But in the second half of Mr.Kapoor’s tenure and during the period after his exit the Bank registered huge net losses. Whose fault it was is a question that is open to debate. The markets punished the Bank mercilessly and the share price took a beating.

What does the future hold?

The present CEO Mr.Praful Patel is one who has risen from the ranks within The ABC Bank. He had joined the Bank as an Officer 32 years back, and was a top executive drawing salary under the IBA pay structure while Mr.Kapoor was the CEO. He is definitely having a better rapport with the trade unions although he is no sympathizer of their causes. The trade unions have already put forth their demands: first and foremost, allow the CTC employees to join the trade unions with immediate effect; secondly, bring them under the IBA pay structure thereby eliminating the disparities in compensation; thirdly, appoint the casual workers in permanent positions; and last but not the least, consult the trade unions in all matters related to the management of the Bank since even if the matter does not have a direct bearing on the welfare of the employees, it may indirectly affect them.

It is a troubled legacy that Mr.Patel has inherited. He needs to keep the trade unions happy even as he tries to pull the Bank out of dire straits. He needs to lend but has to also ensure that the loans do not go bad. He needs to maintain a reasonable cost income ratio, but the unions may not take it very kindly if he tries retrenching the excess employees. On top of that, IBA has finalised the bi-partite settlement which will considerably improve the service conditions of the employees, but will make the member Banks poorer by several Crores.

The Board has advised Mr.Patel to consider pulling out of unprofitable businesses, even if that means not realising Mr.Kapoor's vision of becoming a 'financial super market'. For example, Mr.Kapoor had ventured into Card acquiring business (through PoS machines at merchant establishments) knowing fully well that no Bank had made direct profits thus far from that business. But he reasoned that the public increasingly preferred payments through cards over cash payments and no merchant could afford not to have a card accepting machine at his counter. According to Mr.Kapoor, the Bank would have lost its Current Account customers to other Banks and would have found it difficult to canvass new Current Accounts, if the Bank was not capable of offering Card Acquiring services. He went ahead and started this business incurring huge initial expenses for Card Association certifications (by MasterCard and Visa) and recurring expenses by way of fee payments to the service provider and the card associations. Mr.Kapoor had the option to piggy-back on the existing infrastructure of any of the bigger banks, thereby reducing the overheads, although it would have been a less glamorous proposition for a Bank which wanted to make it big in the market.
RBI has raised the Capital Adequacy Ratio to be maintained by The ABC Bank from the mandatory 9% to 9.50%. Basel III norms are round the corner. But how does Mr.Patel raise capital? Internal accruals are simply not there. Investors are not likely to be interested in the Bank anytime soon. The last thing that Mr.Patel would want is the lack of capital affecting his ability to lend. But he is optimistic and is confident of turning the Bank around. But before it can happen, he has to take decisions on several complicated matters: How does he bring the cost to income ratio down? Low cost

deposit base (SB and CD accounts) has eroded, fee based income (non-interest income) is at historic low levels and NPA levels are mounting. Hence income is unlikely to show substantial growth at least in the short term. He has to also deal with the issue of the 'elderly' employees who many in the industry treat as 'liabilities'.
Rumour mills have again started working overtime and it is being suspected that The ABC Bank is a potential target for a takeover by a bigger bank whose presence in West India is comparatively limited. Whether Mr.Patel would consider it a blessing in disguise is anybody's guess.

The fate of a Bank hangs in balance, and along with it the dreams and aspirations of hundreds of employees, thousands of investors and lakhs of depositors.