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Bank privatisation and Marketing in Financial Intermediation

Point of view

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Financial intermediation is the exchange of money between borrowers and lenders accomplished through a financial institution. Financial intermediary is the go-between in the exchange process and brings together the borrower and lender. Banks, savings and loan institutions are examples of intermediaries.

The advantages of financial intermediation to an economy are many. Under conditions of dis-intermediation, transaction costs, increase and deficit and surplus units are not synchronised.

The borrower and lender will have conflicting objectives on long-term and short-term transactions, as well as maturity period and collateral requirements.

The development of an economy will depend on the efficiency of the intermediaries, comprising banks and other institutions comprising the financial industry of the country.

This economic concept of financial intermediation is based on empirical observations.

There are certain limitations in this notion, which arises out of philosophical considerations that led to the concept. An examination of this philosophical trend will reveal the reliability of the models that are offered by economists.

Therefore, let us begin a philosophical exploration of economics.

Economics

The subject, economics originated in United Kingdom where, empiricism, as a trend in modern philosophy developed.

The test of truth untrammelled by experience of humanity was the basis of this philosophical trend. Scientific experiments that supported empirical hypotheses brought great advances in natural sciences.

Yet, this philosophical trend has been challenged because it does not have a universal application. For example, in quantum physics empirical observations has been questioned to arrive at scientific conclusions.

However, in some branches of sciences the concept is applied. Practice of Western medicine relies on empirical observations to this day.

That is why most of innovations in medicine are attributed to other branches of sciences and not to physicians themselves.

Another weakness of the school of Empiricism is it assumes that outside one's experience a model world exists. In other words perfectly managed banks, savings institutions are available and they act as model intermediaries. This assumption is not realistic. The performance of Pramuka Bank is just one example that contradicts the notion.

History

In Sri Lanka, the attempts of policy makers and economists for the last twenty-five years were the history of a failure to improve the process of financial intermediation.

Consequent to the liberalisation of the economy in 1978, reformation of liberal monetary policies were initiated. These increasingly included market oriented measures and deregulation of the financial market.

However, the informal financial sector still dominates the economy and comprises the principle financial intermediaries.

They control more than 60% of the loans given to consumers.

The market has not been penetrated by the formal sector. Penetration of a market is a subject in marketing and not economics.

Therefore, the key to efficient financial intermediation lies in effective marketing of banking services. Marketing brought pragmatic solutions to questions unattended by empirical economics.

Pragmatism was the first independently developed American philosophy.

State banks

What role have the state banks played in financial intermediation of the economy? Out of the mentioned 40% of the financial market served by formal financial service providers, the two state banks still control a formidable 60% share even after 25 years of competition by foreign and domestic banks.

Private banks have not effectively reduced the market share of the state banks.

Among the reasons given is state patronage.

This writer is of the view that private banks are equally market efficient or inefficient as the state Bank. In terms of financial intermediation, private banks have not shown any innovative marketing efforts.

One reason could be the fiduciary dilemma faced by bankers in this country who have been exposed to British banking systems.

Another reason is that our banks are organised as operational entities and not as marketing organisations.

Reformation

Government after government tried to find answers to reform the banking system to, make them more 'market efficient'.

These have been limited to privatisation attempts of state banks or starting new state sponsored banks like 'Samasa'. The philosophy behind these attempts was structural changes or 're-structuring' attempts.

These attempts started with the institutions and not the market. Therefore, the large market-share served by the non-institutions has not been penetrated.

A major sector in the economy, paddy cultivation, is entirely financed by the informal sector at usury interest rates.

This has led to a state of uneven development in the economy and has raised the price of rice.

Let us ask the question, to what extent will privatisation of state banks facilitate financial intermediation?

Privatisation will not enhance the managerial capacities of state banks because both private and public banks depend on the products of our sterile education system for managerial talents.

The education system of the country kills creativity and innovativeness. These two attributes are needed for innovative new products and improved customer care.

Privatisation means self-interest and not larger social interests. There is every possibility that when thousands of refugees return to their former habitats they will find the privatised state bank branch closed.

The status quo of the rural economy-uneven development will be accentuated under privatisation.

One has to bear in mind that the imbalance in the rural economy led to two armed youth uprisings.

IT

The protocols of Information Technology are antithetical to the existence of a banking bureaucracy because the use of IT presupposes sharing of information.

IT negates the hierarchical organisational structure as the computer has taken over the operational functions of banks.

There is no necessity to have a layer of officials who supervise others. Information Technology can be used to negate a situation of asymmetric information in financial intermediation.

Most domestic banks are organised as kachcheris, which served as revenue collection centres to the British. They are hierarchical, bureaucratic and resist change.

Any restructuring of state banks has to start with liquidating the bureaucracy.

A thick bureaucratic foliage hides talented and innovative young bankers in the undergrowth.

The offices of DGMs and AGMs in these banks are mini *kovils* in a relationship regime.

They are pockets of resistance against changes needed to enhance customer care.

This can be done by replacing such officials with team leaders in a reduced span of control with a diminished salary gap. The Japanese model is the ideal for our needs.

Pricing

The present Chairperson of Bank of Ceylon has suggested a pricing policy' for the bank.

This may be an attempt to market-orient the bank.

This is relevant because domestic banks have no pricing policies.

They have what can be called a 'rates policy'. Banks have assets and liability committee (ALCO) but no pricing committees.

A pricing policy may give impetus to develop new products. For instance within the current regime of low interest rates the senior citizens of the country are looking for new products to sustain themselves, as per letters to editors of newspapers.

The two state banks can develop such products through a marginal pricing policy because of their market share and the sizes.

However, a pricing policy itself will not develop new products without product management, branding and consideration for the balance elements of marketing mix. Innovative marketing is needed here. It is suggested that the two state banks should share the market instead of competing with each other for effective financial intermediation. The strengths of the banks should be directed towards market segments that can exploit them.

Ideally, Bank of Ceylon may concentrate on the corporate sector and People's Bank could take over the micro finance, agriculture and poverty alleviation etc. This may rationalise the branch network on a strategy of market penetration.

Products

Under the re-structuring of the two state banks the important aspect of marketing which facilitates, financial intermediation has been neglected. The banks have adopted FMCG formulas for marketing of financial services. These methods are not applicable in financial marketing.

One has to take into consideration unique features in financial marketing, the risk factor, government controls affecting the industry, complicated nature of financial products, the need for effective personal selling and the use of IT.

The two banks have not introduced marketing planning formats to the branches and they are still functioning under the budgetary system of the kachcheris.

A bank, which does not know the difference between budgeting and marketing planning, is not marketing oriented.

Modern banking is based on fee-based products and not on interest bearing products.

Development of new financial products needs enormous efforts in research and innovative thinking.

A banker attached to People's Bank told this writer that a Pettah trader known to him has no stores or stocks; only a telephone and a desk in a corner. He trades and accepts dated cheques from his clients and a third of them bounces.

However, he does as enormous amount of business every month. It can be seen that the trader has worked certain profitability ratios in his head taking into consideration pricing of his ware and the cash flow of his clients.

In his calculations, he has taken into consideration the amount of cheques that bounce. I told the banker that it seems to be an aspect of corporate consumer behaviour and asked him wether the bank researched the phenomenon and recorded it. It has not been done.

The normal banker in this country is a balance-sheet lender and anything outside it is beyond his imagination. Development of consumer based new products is outside his scope.

Pettah trading runs the economy. The Pettah traders also have the 'chit' system which is a form of commercial paper much more efficient than products offered by the formal banks.

It is a possible fee-bearing product. Enormous quantities of produce change hands daily on the 'chit' system. The informal sector has very innovative products that run the economy but banks have rarely researched on them. Both state banks have economic research units but pragmatic marketing research is not being given attention. The difference between marketing and publicity is not established within the banks. Fee based products can be developed only if the bankers become aware how the informal market runs.

Marketing

The subject marketing pre-supposes that an organization has to accommodate the changing needs and wants of a market.

The market will not change to accommodate outdated organisating charts.

Apparently, under the present re-structuring of banks, marketing, the vital link in financial intermediation is missing.

Restructuring seems to be another bureaucratic effort that strengthens the ancient regime.

Pragmatic methods should replaced empirical speculations to find new answers to the problem of financial dis-intermediation.

One irony is that economic problems have no answers in economics.

Managerial effort makes the difference in effective intermediation. A good authority told this writer that the local banking industry needs a revolution. It is urgently needed.

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