DE GRUYTER
OPEN

UDC: 336.71
DOI:10.2478/jcbtp-2014-0001

Journal of Central Banking Theory and Practice, 2014, Vol.3 No.1, pp. 5-8
Received: 14 November 2013; accepted: 19 November 2013.

Ichak Kalderon Adizes *

* *Advisory Board of the Central Bank of Montenegro and Adizes Institute*

Email:
ichak@adizes.com

Change and Its Repercussions for the Banking Industry

Abstract: Changes have always existed but their speed and frequency have become rather apparent. Changes are present in all areas of life, but here we focus on those happening in the banking industry. Banks are undergoing revolutionary changes and they must change or perish in their present form. The article explains why banks must change and what are the threats to both asset and liability sides they would face otherwise. Changes result in modifications of strategies, organizations and management. The article concludes that banks that are the most flexible and able to adapt will win the day.

Key words: Change, banking system, strategy, profitability.

Jel code: G21 and G34

Change has been ever-present for millions of years, ever since the Big Bang, and probably before that as well. So, what is new today that we can say about change?

What is new about change in modern life is its speed and frequency. It keeps accelerating without even a pause to let us adapt, adjust or embrace the rapid changes that continue to define us and our society.

Furthermore, change today is different from its earlier forms, not only in velocity but in its very nature. For one thing, it is multifaceted. And multidisciplinary. And very, very much interconnected. The environment itself is becoming increasingly interwoven: technological changes impact our laws which, in turn, affect our social, cultural and economic systems, and not necessarily in the same order or even in ways that coalesce smoothly and naturally.

Instead, change in one institution often topples others like falling dominos. Take the internet, for example, a technological innovation which has had profound economic repercussions.

E-commerce facilitated by the internet has replaced traditional retailing. Bookstores are closing left and right. Amazon now not only sells books, it has broadened into music and films, and beyond popular culture, to the point where it now markets whatever can be retailed, including food. It has revolutionized the retail industry.

But the internet has also had social repercussions. Traditional educational institutions find themselves threatened by new schools of learning and new forms of instruction via the internet which are growing like mushrooms.

And it does not end there. The new forms of communication have also generated popular uprisings and have helped unseat political governments. Facebook and tweeter are credited with contributing to the Arab spring by spreading information instantly, so that citizens have been galvanized into immediate action. And each situational change within the political dynamic is spread directly and at the push of a button to the ever-growing concerned populace. The new communication technology has in effect become the handmaiden of revolution.

What about the banking industry?

The business side of traditional banking has been built around the idea of taking savings and giving loans…. and making a profit on the difference between what it pays for savings and what it charges for loans.

In 1982, when I was consulting for Bank of America we came to the conclusion that this scope of activity was under major threat; that banking was undergoing some important changes and if it remained static, committed exclusively to this product line, it would experience serious challenges to its survival. The prediction was proven right; one example being the bankruptcies running into billions of dollars of the savings and loans institutions a few years later.

Why did banking have to change?

On the liability side, instead of putting its money into a savings account, the public was offered many other financial opportunities to increase its economic holdings. On the asset side, suddenly there was competition from non-banking institutions such as private equity funds and the stock market, which could provide capital in place.

Threatened by both the asset and liability side, banks had to change. They converted from providing only traditional banking services into a more complex financial services corporation. Revenue was now derived from service fees, rather than only from the difference in the margins between loans and savings.

It also became clear that computerization and mobile banking could lend an unexpected flexibility to banking. A bank could now be mobile, located any place where a computer could be installed and an ATM machine made available for transactions.

These changes have had a revolutionary impact on the banking industry over the past thirty years.

For instance, Banco Azteka from Mexico, where I serve as a consultant, has trained and dispatched mobile bankers. They are men and women who come to your home, computer at hand, and offer banking services: extend personal and mortgage loans, open savings or checking accounts, and in effect bring the bank into your home.

It has become possible to place a table with a computer and a banner and establish a branch bank wherever there is traffic and people congregate. So retail chains today rent space to banks so that they can set up tables and/or counters and open for business, especially for consumer credit, in places as different from the old banking structures as large food stores and pharmacies.

Banks used to look like big citadels. They were viewed as a place to safeguard money. No more. An open environment, inviting, friendly, accessible, able to provide services, had to replace the austere guardian structures of the past.

The change in strategy, in what now constitutes the financial services business instead of legacy banking business, has had an impact on the organizational structure of banks: product managers are now needed to manage different product lines and different marketing departments are suddenly necessary to manage the diverse market segments. This has created a matrix organization with all the inevitable accompanying complexities.

There are new managerial problems that need to be addressed. For example, where in the organizational structure should we centre the bank's profit responsibility? It is complicated because there is uncertainty about the loan inventory. How solid and reliable is it? How large are the bad debts? How much of the profits should be viewed as a reserve against future losses?

Banco Azteka has made risk management responsible for the bank's profitability. It is an innovation, and perhaps a daring one. But come to think of it, the idea makes sense. If the risk taken is too high, it will impact profitability in the long run.

The next question is the role of the branches. Where do they belong in the organizational chart? Many branches serve both the small middle market and the larger retail market; and even at times, the corporate market. In that case, where are the branches in the chart? They should not report either to small business or to retailing because they serve both. So, where?

They have to be separate from the market segment and from the product line. They become something like a retail outlet for a myriad of products. But that calls for a retraining of the branch manager. He or she is not the loan officer anymore. He or she manages a "supermarket" of services and the role has been transformed into client relations for whatever product is needed.

The banking industry is going through a revolution of sorts. Technological innovations as well as major changes in the financial industry have given banks little choice They must change or perish in their present form.

Banks that are the most flexible and able to adapt will win the day. This flexibility cannot, of course, be at the cost of violating compliance. The organizational structure of the bank needs, on one hand, strong quality control of operations, and at the same time flexibility to adapt to a fast changing environment. Not an easy assignment.