

Rising Profits and Falling Market Share – A Case of National Bank

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Abstract

Banks play the role of intermediary by accepting deposits from the depositors and lending the same to the borrowers. The spread between interest given to depositors and received from borrowers is the source of interest income. The income received from all other sources constitutes non-interest for the banks. The present case is related to National Bank, which has over 6,000 branches across pan India that declared its financial results for the financial year 2020 recently. The financial results of National Bank over the years were exhibiting fall in the main source of income, which is the interest income for the bank. This was coupled with a falling market share for the bank. The consultant hired by the top management identified several issues behind this alarming trend like image, processes, products, and services to name a few. The customers perceived National Bank to be slow and lethargic. Similarly, the customers viewed the processes in the bank to be very cumbersome and not customer-friendly. The bank was considered to be a laggard in digital products, lacking the latest features offered by the competitors. The report from the consultant was an eye-opener for the top management, which realized that it had to work on many fronts to reverse the falling interest income trend. National Bank needs to modify its existing products and adopt innovation concerning products, services, and processes. After identifying the grey areas, the top management is now committed to resolving the issues faced by National Bank.

Keywords : income, profit, profitability, non-interest income (NII) capital, customer service

JEL Classification Codes : G20, G21, G32

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Mr. Venu Srinivasan, CMD (Chairman & Managing Director) of National Bank was going through the early results of the bank, which were declared recently. Having a background in finance, he was minutely observing the figures and simultaneously taking notes in a diary which he always carried with himself. Mr. Srinivasan had recently joined the bank as CMD, six months ago after serving as ED (Executive Director) with Bharat Bank for about 3 years. Mr. Srinivasan joined the banking profession after completing CA and now has over 30 years of experience in this field. Mr. Srinivasan seemed to be perturbed while going through the results of FY 2020 and immediately called his secretary, Ms. Hema to his cabin.

Mr. Srinivasan said to Ms. Hema, “Please call all General Managers at 11 a.m. tomorrow for a meeting, agenda for which would be to discuss the 2020 financial results of the bank.”

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As per the instructions of Mr. Srinivasan, all GMs were present in the conference hall of the bank, which was situated on the fourth floor of the head office, where the cabin of the CMD was situated. The conference hall of the bank was very grand, commensurating with the size of National Bank, which has over 6,000 branches across pan India.

Mr. Srinivasan always sounded business and without withering away from the agenda, addressed the GMs :

I have called this meeting to discuss the financial results of the bank for the financial year 2020 and I seek your feedback on the performance of the bank. I request you all to be candid in expressing your thoughts as it concerns the financial health of our mother organization. Let's start the ball rolling by getting the views of Mr. Anil Bhattacharya, GM - Finance.

Mr. Bhattacharya said :

As it can be seen from the results, not only for this year, but for the last several years, our bank's profit has shown a northward trend, increasing steadily on a Y-o-Y (year on year) basis. As a result of which, our capital adequacy has also improved, and our capital is above the statutory level prescribed by the regulator. Apart from this, a positive aspect is a healthy rise of the non-interest income in every quarter from the last 5 years. We have been able to distribute good dividends to our shareholders.

The performance of our bank in other parameters is in front of you (refer to Figure 1 and Table 1), which according to me are very good considering the prevailing economic environment.

Mr. Rohit Sharma, GM - Marketing said :

Our bank is known for good customer service in the market as we are always in the top five banks

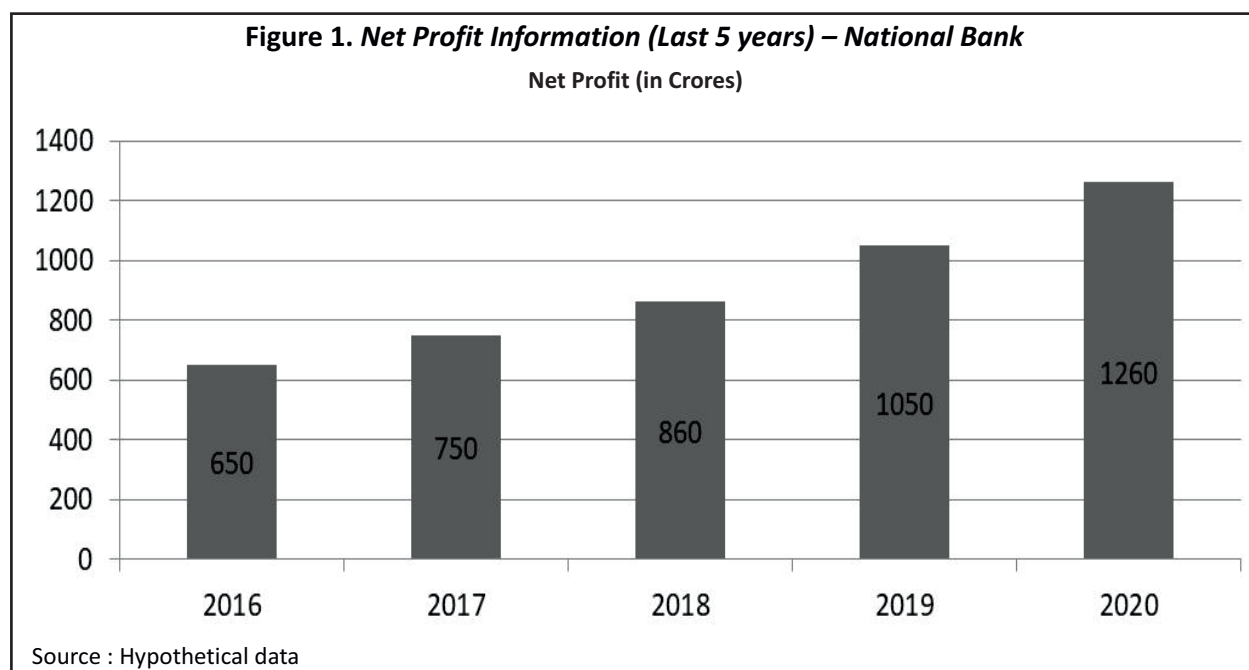


Table 1. Important Financial Ratios (Last 5 Years) of National Bank

Ratios	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20
CASA (%)	25.79	31.82	34	35.84	36.45
Capital Adequacy Ratios (%)	12	13	14	13	15
Return on Networth / Equity (%)	7.88	9.88	12.5	15.8	19.33
Basic EPS (₹)	20.95	31.55	40.55	50.4	75.05

Source : Hypothetical data

in annual customer service by National Bank Association. We have strong brand loyalty and customers are having a long relationship with us, which was indicated in the survey. We also have time tested products catering to the needs of the customers. This is reflected in rising profit as pointed out by Mr. Bhattacharya.

With this, Mr. Sharma concluded his feedback. Next in line, Mr. Deepak Bisoi, GM – Recovery was asked to give his feedback.

Mr. Deepak Bisoi said :

As mentioned by Mr. Bhattacharya, the economy is passing through a tough time, and considering that, there is stress on our asset quality. Economic conditions have impacted the repayment capacity and cash flow affecting the recovery of loans. I would throw light on asset quality indicated by two key ratios that are, GNPA (gross non-performing assets) and NNPA (net non-performing assets). Our GNPA is more or less stable over the years, it has shown an increase of 50 basis points, but is healthy considering our peers, where the spike in the ratio is quite significant. Similarly, our net NPA ratio has increased by 125 basis points during this FY on account of the decrease in PCR (provision coverage ratio). The decision for reduction of which was taken unanimously in the board meeting. Our PCR, which was above the mandated level, is now tuned to the prevailing regulations. Though the two ratios may appear to be on the higher side, but do not demand any grave concern as the financial sector is under stress. That doesn't mean we have lost our focus on recovery – we are in process of setting up a separate vertical for recovery to give impetus for improving asset quality. Since we were told to express a candid opinion, I have put a clear picture before the top management.

With this, Mr. Deepak Bisoi concluded his feedback concerning the results of the bank. Just when Mr. Pradeep Nair, GM - Operations began to speak, Mr. Venu Srinivasan interrupted in between and said :

I appreciate how Mr. Bisoi gave his feedback regarding the bank's result concerning his department. He explained in a manner calling a spade a spade, revealing all vitals on asset quality. But still, no one has touched the grey area which is haunting my thoughts since we declared the results.

After this, he signalled Mr. Pradeep Nair to speak.

Mr. Pradeep Nair, GM - Operations gave his feedback :

I also see many positive aspects in the results, particularly relating to my department. The numbers of frauds, both attempted and occurred, have decreased over the years. The compliance function is also strengthened as we had fewer instances of penalty charged by the regulator as compared to the last year. The grey area, in my opinion, could be rising expenses which are primarily on account of software upgradation undertaken last year for which we incurred the cost of about ₹ 550 crores. We cannot avoid this expense as it has a bearing on the operational efficiency of the bank.

With this, he concluded his feedback on the financial results of the bank. The last one to speak,

Ms. Mansi Joshi, GM – Human Resource, said:

The key highlights of results are increasing profits, consolidation on recovery front, and improvement in capital adequacy. Though we are passing through a slowdown, we cannot afford to be complacent, which will offer an opportunity to our competitors for enticing our customers. As regards HR, we have seen a drop in attrition rate, which can be assumed due to higher job satisfaction.

After the feedback of Ms. Joshi, Mr. Srinivasan stood up from his chair and said :

As I have told you to be candid in your feedback, I will also do the same. After listening to all of you, I am utterly disappointed that even after giving a hint, nobody could figure out the area of concern that can impact not only our growth, but survival also.

Please refer to the slide on earnings (signalling his secretary to display the same – Figure 2 and Table 2), the non-interest income contributes a major portion of our profits and adding to that income, the treasury operations is contributing a major chunk of it.

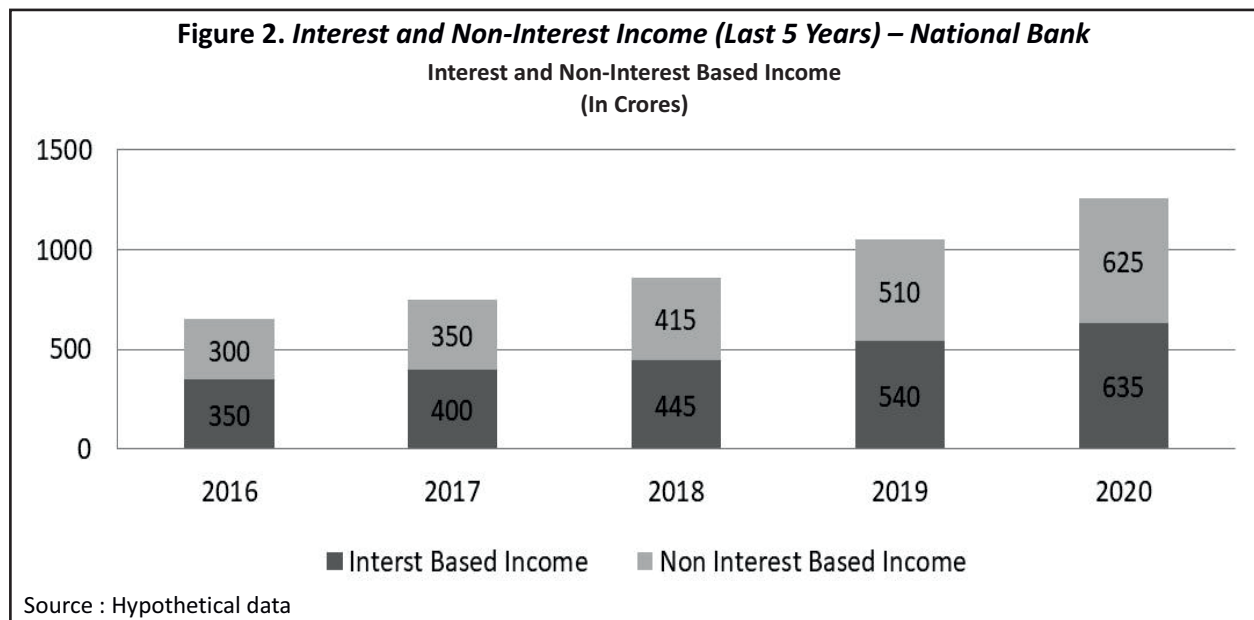


Table 2. Sources of Total Non - Interest Based Income for the Last 5 Years of National Bank (Amt. in Crores)

Particulars	Mar-2016	Mar-017	Mar-2018	Mar-2019	Mar-2020
Treasury Operations	121	141	208	307	440
Other Non-Interest Based Income	179	209	207	203	185
Total Non-Interest Based Income	300	350	415	510	625

Source : Hypothetical Data

All of you have taken a myopic vision, so things are appearing to be rosy to all of you. That means we are sourcing a major portion of our earnings through trading and not our core business of accepting deposits for lending. Rising non-interest income is not a concern if it is coupled with growth in the business, which is not the case with our bank as our advances are contracting on analyzing the trend over the years. If we consider the presents sluggishness and repayment by the borrowers, we can justify our present performance, which would improve with a rise in economic activity. The economic slowdown and repayment could be the reason for the shrinkage of our advances, but that is not the case if we compare the performance of our peers. Our market share in the business is decreasing over the years, but this aspect is camouflaged by our growth in profits, which is coming from our treasury operations.

Despite good profit numbers, our share prices are falling and thus our market capitalization is falling. Market analysts can decipher our weakness, which we are not able to identify among other performance parameters. So, we need to ascertain the reasons for the decrease in business and market share.

Mr. Srinivasan continued his address and highlighted the impact of falling interest earnings and market share on the prospects of the bank. After delving into various aspects of the performance over the years, the management unanimously agreed for ascertaining the reasons for contracting business mix and market share. GM - Finance suggested the name of ABC Consultants, which carried out business process reengineering in Sterling Bank, leading to better performance and productivity in the bank. The need for bringing in an external expert was felt by all and considering the reputation and experience of ABC Consultants in the banking domain, all agreed to hire the agency for finding out the reasons for the problems faced by the bank and measures for mitigating the same.

One week after the meeting, Mr. Srinivasan presented the proposal before members in the board meeting who, after deliberating on various parameters, approved the proposal for hiring ABC Consultants as per mutually agreed terms between the bank and the consultant. The project entrusted to ABC was coined 'Glory' by the bank and involved extensive feedback from customers and staff through surveys and interviews. ABC Consultants had to submit the final report after two months after the launch of the project to the top management of the bank. As envisaged in the project, the team from ABC Consultants carried out extensive surveys across the length and breadth of the country for eliciting feedback and reasons for diminishing market share of National Bank. The top management of the bank was apprised of the progress of the project on a weekly basis. The project could not be completed on the deadline. ABC Consultants got approval for the extension of the project for two weeks from the bank. Finally, after two and a half months of the launch, the agency submitted its report of Project Glory to the top management of the bank.

Findings of Project Glory

The report highlighted several issues leading to a fall in the market share of the bank, which is as under. The consultants categorized the issues into four broad categories.

(1) Image : The customers of National Bank perceived the bank to be slow and lethargic concerning processes and customer service. Though the bank was perceived to be a big bank in the market, but it is lacking in innovativeness. The bank was perceived to be a follower and not a leader concerning products and processes. While conducting the survey, one of the customers of the Kalkaji branch, New Delhi of National Bank said :

The bank, no doubt, has been in existence for over 75 years, which is commendable, but the bank is very conservative. It launches products only when the same are launched by others and the product is accepted by the broader market.

To prove his point, he quoted the case of a mobile banking application that was introduced nearly 2 years after it was launched by other public sector banks. On account of this image, the average age of the clientele of the customers was rising, indicating that the bank was able to retain its loyal customers but was not able to attract the new generation. The new generation being tech-savvy perceived the bank to be a laggard concerning IT products.

(2) Processes : As regard processes, ABC Consultants identified several issues based on the feedback obtained from the customers. The customers felt that documentation in the bank was very cumbersome, involving a lot of paperwork leading to a waste of time and energy. The decision making was perceived to be very slow. Mr. Ashok Verma, a customer of Gomti Nagar branch, Uttar Pradesh said :

I am a customer of this bank since a long time. Last month, I applied for a car loan, and I was told to submit various documents like bank statements, address proof, and a quotation from dealer references details in a piecemeal manner, one at a time. After about 20 days, I was told that I was not eligible for the loan as my deductions were above the permissible limit on account of my other loans in the bank. This could have been told to me at the initial stage only.

The turnaround time is very high, even in months, in the case of commercial loans due to which customers are availing credit facilities from other banks and only maintaining their deposit account with the bank.

(3) Products : In tune with the image, the customers perceived the bank to be a laggard in digital products and service delivery. With no modifications in its products, some of the products were out of tune with the trend. To quote Mr. Deepak Sharma, customer of Banjara Hills branch, Hyderabad, who gave feedback about the home loan by saying :

When I enquired about concession on the rate of interest for a home loan as my CIBIL score was above 800, the branch manager said we have no provision for concessions on ROI (rate of interest) in our bank, which is charged uniformly for all customers. Almost all banks and NBFCs reward customers for having a good credit score by offering concession in ROI and charges, but National Bank has no such provision. The bank should adapt according to the market trends to tap the market, else it will lose good customers like us.

The bank lacks innovativeness in launching its digital products which are not up to the mark. Being conservative in culture, the bank emphasizes more on security features than on operating convenience. The digital initiatives like internet banking, mobile banking, and wallet are not user-friendly as per the feedback given by the customers. The customers have to fill separate forms for each digital product and visit branches for each request like activation of the facility, regeneration of facility, setting of transaction limit, etc. Though these were taken to ensure safety, but were very inconvenient to the customers. This aspect defeated the very purpose of offering convenience to customers through the use of the digital platform in banking.

(4) Human Resource : ABC Consultants interacted with about 20% of the bank's staff in the officer as well as clerical cadre. The staff was very open in giving their feedback as they were assured of anonymity. Despite having an employee-centric human resource policy, it was not implemented in spirit. During such a feedback session, Mr. Mohit Gupta of Malda Town branch, West Bengal said :

As per the HR policy of the bank, an employee is transferred only after completing at least 2 years at a particular centre, but I have been transferred thrice during the last 2 years. Not only I am facing physical and mental hardship, my family is also suffering now and then. They have to adjust to the new environment in terms of city, locality, school, etc. What is the use of a well-crafted policy if it is not implemented by the management ?

The management was not sensitive about other aspects like appraisal, leaves, promotion, etc. This had a bearing on the morale of the employees.

After getting feedback from the staff, ABC Consultants identified several issues concerning human resources in the bank. The staff in the bank developed credit shyness on account of the management's attitude towards the default by the customers. Punitive action is taken against the staff for credit decisions taken by the staff if the account turned to be NPA (non-performing asset). The staff was very cautious about credit decisions for avoiding such disciplinary action by the bank. Branch managers insisted on liquid security by the borrowers for ensuring that the account remains a performing asset. In many cases, they avoided taking decisions by turning away the customers.

After two and a half months, including an extension of 15 days, ABC Consultants submitted the report, which enumerated the issues and suggested various strategies for implementation to overcome the problems faced by the bank. Mr. Srinivasan called the meeting of all General Managers to discuss the submitted report.

Mr. Srinivasan set the ball rolling and said :

As all of you have gone through the report, we shall discuss each of the strategies suggested by the consultant and decide our course of action. As I believe in collective decision making, I shall elicit feedback from each one of you.

After which, he invited the other GMs to present their views on the report, starting with GM - Finance.

Managerial Implications

Banks offer deposits for savers and lending for borrowers. In the present times, their earnings are not limited to traditional sources. Due to that, banks are supposed to utilize their financial resources in a better way and keep a

close eye on different sources of earning. Sometimes, banks are unable to analyze the factors affecting their performance and if leadership permits, some external consultant support can do magic for banks.

Teaching Notes

Teaching Objectives

This case focuses on the functioning and various challenges faced by a hypothetical public sector bank, that is, National Bank and the reasons for fall in market share with the help ABC Consultants. At the end of the case exercise, participants should have an understanding of the following issues :

- ⇒ Challenges faced by the public sector bank.
- ⇒ Sources of income of the bank.
- ⇒ Importance of profit in the bank.
- ⇒ Various types of risks in banks.
- ⇒ Top management functioning.
- ⇒ Leadership role.

Potential Audience

Graduate and post graduate students, executives, and anyone interested in business process reengineering in public sector banks are the potential audience.

Relevant programmes – Graduates and post graduates of management, commerce, banking, and finance.

Number of Teaching Sessions Needed : Four lectures of 50 minutes.

Authors' Analysis of Each Question Raised

(1) According to you, what are the challenges faced by National Bank ?

(i) Dwindling Market Share : The biggest challenge before National Bank is of falling market share, having multiple ramifications in terms of product acceptance, customer service, turnaround time, etc. Customers being the primary source of earning, falling market share is a grave concern for the bank.

(ii) Income Imbalance : Another big challenge is income imbalance with regard to non-interest income, which is contributing handsomely to the overall performance of National Bank. The skewness towards non-interest income is exposing the portfolio to market risk. Any adverse movement in the market may wipe out the profits generated by the treasury operations.

(iii) Outdated Products and Processes : Increased competition and sophistication of customers require that banks rethink and design processes, procedures, products, and services that are cost-efficient and effective with the aid of technology to remain competitive and profitable. Even though National Bank's current account saving account ratio (CASA ratio), earnings per share, return on equity, and capital adequacy ratio have increased, but due to high

dependency on treasury operations, slow processes, outdated working model, National Bank's loans and advances have declined.

(iv) Customer Service : Banking being a part of services, good customer service plays an important role in survival and growth of an individual bank. National Bank is facing customer service issues on account of various factors. On account of cut throat competition in banking, good customer service can be a big differentiator for customer acquisition and retention.

(2) What are the possible solutions suggested by the ABC Consultants according to you ?

(i) Emphasis on Innovative Products and Services : Owing to globalization, it is essential to have innovative products and services in order to stay profitable and competitive. National Bank needs to rethink about its available products and services. Out of the available options, some can be updated, some can be discontinued, and some new products & services can be introduced.

(ii) Modifying Existing Products According to the Market Demand : Mere innovative services won't help in regular growth ; due to the dynamic environment, the products and services need to be updated on a regular basis. This updation can be done on an annual basis after considering all the suggestions of the in-house committee for updation. Looking into the current scenario, more emphasis should be given to online products and services. Customization of loans and advances will give National Bank an edge over its peers where they can be flexible in the rate of interest if a customer is having good creditworthiness.

(iii) Recording Customers' Feedback : The bank should get the customers' feedback and their experience related to services. The feedback can be collected in a numeric value between 1 to 10. Higher the number, better the experience and vice-versa.

(iv) Adoption of a New Processing System : National Bank has 6,000 plus branches all across India. The turnaround time in the bank is quite high, causing great inconvenience to the customers, particularly in case of loans. The existing processing time can be reduced if the bank provides a chatbot option on their website and application for checking the eligibility of the loan, etc. The bank can go for centralization of its loan processing through specialized branches which cater to particular category of customers like retail, SME (small and medium enterprises), and agriculture, to name a few.

(v) Realigning Income Sources : The bank needs to create a balance between the various sources of its income. High dependence on treasury operation will limit the growth of the bank, which alternatively can be achieved through acquisition of new customers and increase in digital transactions. National Bank can augment its commission income through sale of third-party products and services. This will result in improving the bank valuation in the market and hence will increase the market share and price of shares.

(vi) Proper Implementation of Human Resource Policies : National Bank has HR policies, but it lacks in proper implementation of the same. The bank needs to be more empathetic, while considering genuine requests of its employees. This will keep employees motivated and increase the belongingness to the bank.

(vii) No Compromises with the Quality of Assets : Due to pressure of sales and targets, sometimes the quality of loans and advances are compromises which lead to another problem of the possibility of an increase in non-performing assets in the future. National Bank can leverage its large branch network for achieving its targets.

(viii) More Focus on Customer Services : For any financial institution, retaining existing customers is as important as having new customers. The retention of customers will be on the higher side if the bank has good customer services. Better customer services boost customer motivation to stay with the bank and also increase their loyalty toward the bank. Due to the nature of services provided by the banks, customers' data need to be collected and updated on a real time basis. If National Bank improves upon its digital services, it will save the time for existing customers and will also attract young customers to have a long term relationship with the bank.

(3) What Problems will National Bank Face in Maintaining the Status Quo ?

If National Bank continues to work without any changes, then it can be exposed to market risk. Any dependence on a major single source for revenue may lead to another type of risk, that is, concentration risk. Presently, the bank is earning profits but any adverse movement in market conditions will drain away all the profits of the bank. High dependence on treasury operations is not sustainable for the bank and ultimately it will have to return to its basic sources of earning. But that will erode too due to dwindling customer base, outdated working model, and slow processing. The imbalance in income may threaten the viability of the bank on account of adverse returns from its investments.

Authors' Contribution

Mr. Girish Mainrai conceived the idea and wrote the case study considering different aspects of the case. Dr. Sarvesh Mohania reframed the case and wrote the teaching notes in the case. Both authors reviewed the final manuscript.

Conflict of Interest

The first author, Mr. Girish Mainrai, is associated with a bank, but the present case study is written from the banking industry perspective, and not any individual bank. Furthermore, the case study is fictitious, written only for aiding management teaching. The second author, Dr. Sarvesh Mohania, certifies that he has no affiliations with or involvement in any organization or entity with any financial interest, or non-financial interest in the subject matter, or materials discussed in this manuscript.

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Disclaimer

This case was prepared by the authors for the sole purpose of aiding classroom discussion. Cases are not intended to serve as endorsements, or sources of data, or illustrations of effective or ineffective management.

Suggestions for Further Reading

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