CASE 1 :STATE BANK OF INDIA, 1998[1]

Mishra was perturbed. As an AGM of the prestigious State Bank of India Staff College at Hyderabad, he was scheduled to take a session with the young probationers on the benefits of the restructuring as suggested in the McKinsey Report. He was perturbed, not only because the report was something that was not easy to understand, but the portions of the report that he had read and understood, he was not convinced about.

Much had changed since the time when he himself had started his career as a probationer in 1976. Branch expansion had been phenomenal, turnover had increased substantially, the very nature of competition itself had changed. Nevertheless, the nature of decision making had remained the same : banking after all was a serious subject !

Surprisingly, the SBI was not a nationalized bank. It had been created by an Act of Parliament in 1955, a logical successor to the Imperial Bank of India, which in turn had been created merging the four Presidency Banks in the 1930s. Its immediate objective in 1955 was that within the next ten years to create a network of over 500 branches within the length and breadth of the country !. As the only large state sponsored bank in those days, it was given the privileged status of being the treasury bank, and in the places where the RBI did not have any branches, SBI would step in for carrying on the functions, like “presiding over the clearing”. Mishra wistfully recalled the stories of yore when in the absence of the Collector in the District, the next officer that could give the order for firing, was none other than the Agent of the State Bank of India. By the time the 1969 nationalization had come around, all pretensions towards these grandiose existence had fallen by the wayside.

In 1971, SBI was the un-crowned market leader, but the top management had realized that in the increasingly competitive environment, the position that had been assumed as given, was no longer something that could be taken for granted. Other commercial banks, now nationalized since 1969, were asking for their share for government business as also questioning the exclusive subordinate status to the RBI that was bestowed on the State Bank. The banks management also realized that the operating environment had changed totally. With increasing amounts of bank funds being earmarked for the statutory SLR and CRR, operating margins were being reduced. Bank profitability was increasingly dependent on reducing operational logistics time. There was also the danger of expanding beyond a size that could supplement the growth efforts of the organization. Thus in 1971, SBI commissioned IIM-Ahmedabad to suggest a new structure for the organization.

The IIM Team had done a wonderful job of organizing the 3000 odd branches in 1971. The basic unit of the structure continued to be the branch. Some thirty odd branches made up a region, and some 4-5 regions made up a circle, enshrined in the Local Head Office. The LHO was more or less contiguous with states of the Indian Union. Thus the Patna Circle would represent Bihar, Bhopal Circle would represent MP and so on. This was however not a hard and fast rule. Delhi circle would consist of part of UP, Rajasthan, and Punjab.

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Case material has been prepared to serve as a basis for class discussion. Cases are not designed to present illustrations, of either correct or incorrect handling of managerial problems.

[1]This case has been prepared based purely on press reports and an article in Business India, March 2000

Each circle was headed by a Chief General Manager supported by two General Managers, looking after Operations and Planning respectively. Under the GM's would be the Regional Managers and the Branch Managers. Decisions regarding loans would be cleared at the BM, RM or CMC level depending on the amount. [The CMC was the Circle Management Committee consisting of the CGM, GMO and GMP]. Each Circle was also authorized to have a local board, consisting of local representatives of Bureaucrats, eminent personalities etc. Only major decisions would need to be referred to the Central Office in Bombay.

The LHO was the nerve center of the operations. Housing the all powerful CMC, meant that decision were taken fast enough, keeping the local imperatives into account. Posts of Development Managers for the different functional areas like P, Agl, IB, SIB, C&I were created, reporting to the GMP, to develop market intelligence and to perform the planning functions. In the early years, the monopoly positions of the SBI relegated these posts to professional obscurity !

The CGMs reported to Central Office, to their respective Deputy Managing Directors, which were designated on functional basis. Thus for international banking decisions, the DMD, IB would be consulted and so on. The DMDs in turn reported to the Managing Director and the Chairman [Two separate posts]. The board at the central level comprised of representatives from the Ministry of Finance, RBI, industry etc. For administrative purposes the CGM would report to the DMD, Personnel, while his ACR would be written by the MD in consultation with the DMDs.

This structure introduced in the early seventies, fitted the organization like a glove. The primary purpose of reducing logistics time, and therefore the cost of transactions was achieved. Also with increased devolution of financial powers, loan applications processing time came down sharply from an average of 6 months to an average of 2 months. However, this was not without a cost. There was a feeling that the cost of this reduction in logistics time was being felt increasingly on the NPA [non-performing assets] figures, which were steadily increasing. Profits were thus further strained.

There was another reason for this. With the changes in the political ideology, which replaced structural reforms with cheap capital intensive techniques of production, loan melas became the order of the day. This was further compounded with the new role of the Lead Development Banker being assigned to the SBI. This meant that profits from the other operations were increasingly under pressure. Nevertheless, the demarcation of circles, on the basis of States helped in within-the-state co-ordination. And the SBI could take full advantage of this. Its recovery of loans granted under the "social" schemes [Mishra shuddered to recall the DIR loans at 4% interest, without any guarantee that were issued to the poorest of the poor] was probably the best among all the commercial banks.

The IIM team had assured that this structure could stand branch expansion till 6000 branches, after which a new structure would have to be introduced. This was proved true, and it was only as late as the early eighties, that minor modifications were felt necessary. This modification came in terms of introducing a new tier of Chief Regional Manager between the RM's and the GMO, with the further devolution of financial power. Thus 3-4 RM's would report to the CRM, who in turn would report to the GMO. This was roughly akin to the Commissioner system of District administration in most of the states, which served as a buffer between the DM and the Home Secretary. The LHO structure was followed at the CRM level, with the planning functions too being replicated in the form of Development Officers, for the different segments. There was also the enlargement of the CMC, with the introduction of a new post called GM, Commercial, looking after specific high volume-high value commercial account branches.

Towards the end of the seventies, there was a major turbulence in the form of the recommendations of the Pillai Committee report. Among its various recommendations was one that was destined to have a major impact on the recruitment policy of the SBI. This was the recommendation to merger the erstwhile OGII [Officer Grade II] with OGI into a new scale called JMGS-1, [Junior Management Grade Scale 1] which would have benefited over 15,000 officers, a substantially large chunk of the 25,000 officers in the SBI. But this merger meant that Probationary Officers, who joined as OG-I's, would now be joining at the JMGS-1 scale, making them junior to all OGII officers.

The start of the nineties saw further changes in the operating environment. The liberalization policy that swept the county saw the coming of a large number of private banks, with state-of-the-art communication technology, with highly specialized segments. This was in response to the fact that the financial services market was getting highly focused, and highly segmented. Specialization had became the order of the day. Competing banks were getting learner and thinner and fighting over margins that were getting reduced further.

The SBI here was at an inherent disadvantage. As an organization that was a logical and moral extension of the state, it could not flout any of the rules that the Finance Ministry introduced. Not only did it have to strictly adhere to the CRR/SLR norms, it also had to strictly follow the rues that 40% of all advances be made to "priority sectors", 25 % be made to the weaker sections etc. This left little money to go around for advances to the Corporate World, which was fast emerging a highly profitable and discerning segment.

Profitability was further affected by the provisioning for the NPA's as suggested by the stringent norms of the Choksey and Narasimhan Committee reports. Computerization which could have helped in reducing costs significantly, was a major issue with the SBI unions. The other banks however were able to leverage this in setting new standards for operational logistics. The HDFC Bank touted that it could process a loan application within 36 hours. The customer too was getting wiser, and smarter, and more choosy. For the SBI this was a major shock. Mishra had wryly commented once that for an organization that never had any problems getting its customers, the very face of the customer was now getting blurred !

Towards the end of the eighties, the very strengths of the SBI seemed to be turning into its weaknesses. The massive branch network, now some 8500 odd branches, was introducing a heavy liability on the profits. Their contribution too in mobilizing deposits was being questioned. In Patna Circle, with over 500 branches it was estimated that 3 branches, Patna Main, Dhanbad, and Jamshedpur, accounted for all the net profits. Some 40 branches supported the losses of the remaining 450. The NPAs, which nevertheless were still above the other commercial banks, were also increasing. There was also a flight of very qualified officers at the middle management level to more lucrative jobs with the burgeoning private sector banks. Thankfully, the basic strength of the SBI, it dominant position in the retail banking [personal] segment had not waned, and its ability to raise large amounts of deposits from the average householder, no doubt leveraging its "government" image continued. This infact provided the very backbone to support the large volume advances that were being sought after by industrial houses. [RBI rules prohibited lending more than a specified percentage of deposits to one borrower. This immediately put a lot of smaller banks out of the reckoning. Alternatively they had to recourse to consortium financing.]

Efforts were made to correct the situation and gear up to the market requirement. To get closer to the customer, specialized branches were opened. Thus branches catering specifically to Industrial Finance, Corporate Accounts, International Banking, and Personal Segments were set up. This did help somewhat, but the top management realized that more needed to be done. The IIM structure had outlived its purpose, and in 1996, McKinsey and Co. were brought in to look at the situation afresh and recommend a new structure.

Table : Positioning of Different levels of Officers in State Bank of India

	pre IIM report	**post IIM & Pillai reports**	**pre McKinsey**
Level-10	MD & Chairman	MD & Chairman	MD & Chairman
Level-9	DMD	DMD	DMD
Level-8	Secretary & Registrar	CGM	CGM
Level-7	Dy. Secretary	GMs	GM
Level-6	District Officer	SMGS-6 [CRM]	DGM
Level-5	Staff Officer -1	SMGS-5 [RM]	AGM
Level-4	SO2	SMGS-4	Chief Manager
Level-3	SO3	MMGS-3	Manager
Level-2	OGI*	MMGS-2	Deputy Manager
Officer Level-1	OGII	JMGS-1*	Asst. Manager*
Clerical Levels			

* *indicates direct entry level as Probationary Officer.*

As Mishra read again the brief circulated from Central Office regarding the recommendations of the McKinsey Report that wure being implemented, he was still perturbed. Not entirely convinced that this new structure would fit the existing organization in the same way that the IIM structure had done, he also saw several conflicts in the implementation process, including those with the organizational culture. Not entirely convinced himself, he wondered what sort of job he would do in convincing the young probationers at the lecture.

Issues for Discussion:

1. Discuss the need for organizational change in the SBI in the seventies to the nineties. Why had the IIM structure outlived its purpose ?

2. What are the conflicts that Mishra is worried about ?

3. What are the success and failure factors that you see in the McKinsey report?

Annexure

BRIEF CONTAINING THE PRINCIPLE RECOMMENDATIONS OF THE MCKINSEY REPORT

The Background : The banking industry in India is facing tremendous pressures with respect to profitability. This is not only on account of increased competition but also on account of more stringent banking regulations. With the process of globalization process, banking customers are also looking for products and services which are available internationally. There will thus be a need to create new products to meet the changing customer requirements.

The Diagnostics : The consultants, McKinsey and Co. have observed that the bank enters the era of deregulation with a strong capital base and an expense-to-income ratio, with is comparable with world class banks. However, with an ROA of 0.22% in 1993-94, the SBI is behind private sector banks [1.3%] and the foreign banks operating in India [3.2%]. Market share has slipped from 25% five years ago to 20% now.

The consultants, while devising strategies for the Bank have kept in view the following significant areas for business development. **[1]** to retain and nurture high value corporate clients who contribute substantially to Banks income and profit, **[2]** to avail of new opportunities that have opened up for the Bank for undertaking Leasing and project Finance, **[3]** to develop mid market business, by financing large number of mid sized corporates, **[4]** to focus on opportunities for mortgage lending as well as consumer durable finance, and **[5]** to fully utilize the large network of branches, especially in rural areas for mobilizing deposits.

The Strategy Statements:

Vision : To be a premier Indian Financial Services Group with global perspective, world class standards of efficiency and professionalism and core institutional values. To retain its position in the country as a pioneer in Development Banking. To maximize shareholder value through high sustained earnings per share, and to build an institution with a culture of mutual care and commitment, a satisfying and exciting work environment and continuous learning opportunities.

Mission : "To retain the Bank's position as the premier Indian financial services group, with world class standards and significant global business, committed to excellence in customer, shareholder and employee satisfaction, and to play a leading role in the expanding and diversifying financial services sector, while continuing emphasis on its development banking role."

Values : Excellence in customer service ; profit orientation ; belonging and commitment to the bank ; fairness in all dealings and relations ; risk taking and innovation ; team playing, learning and renewal ; integrity and transparency; and discipline in policies and systems.

Strategies and Systems : the existing market segmentation was given a re-look in the light of the emerging environmental changes. While in the highly regulated environment, there was limited scope for competitive strategies such as cost leadership, produce differentiation, focusing on customer groups etc., in a competitive situation, focused attention assumes a lot of significance.

The broad strategy has been to create ***SBUs*** to deal with specific customer groups/ business activities requiring focused attention. These customer groups are required to be handled in an integrated manner, i.e. both in respect of planning and operational areas.

The Business Groups and the SBUs under them have been identified as:

1. **Corporate Banking Group** : SBUs include the Corporate Accounts Group, Leasing Group, and Project Finance Group

2. **National Banking Group** : the 13 LHOs constitute the SBUs under the NBG, each LHO having two network of branches to give the business focus : Development and Personal Banking [also referred to as the "retail network"] and Commercial Banking

3. **International Banking** : Foreign offices constitute one SBU and the other SBU being global Merchant Banking and the Link Office

4. **Associates and Subsidiaries** : The SBU's identified under this group are Associate Banks and other Subsidiaries.

A fifth business group has also been identified, viz. **Personal Banking Group**, with three SBU's namely Consumer Finance, Mortgage Finance and Credit Cards under it. For the present, this group has been put under the charge of NBG.

Value Propositions : In deriving the strategy, Value Propositions have been identified for each Group. Broadly speaking, *value proposition is that attribute which the Bank is striving to add to the products/services being offered to the customers* so as to make the offering competitive in the market place and attractive to the customers.

Organizational Structure : The organizing principles are as follows :

1. A lean and integrative ***corporate center***, focusing on long term planning and policy formulation, with no active role in daily operations : center to add value in areas requiring cross business unit perspectives or expertise

2. Targeted business units, each with a distinct profit and loss responsibility for a distinct definable set of customers

3. A senior management team, with common performance aspirations and clear accountability organized on the basis of a simple structure

4. The key processes identified for streamlining are : credit and risk management, improved balance sheet and performance management, progressive and differentiated human resources process an technology management. The inspection and audit systems would need to be realigned with the various changes taking place in the strategies, systems and structures.

The **Apex Management Structure** will have:

1. The Chairman as the CEO

2. Four staff functionaries under the **corporate center**, viz. DMDs with the dual designation of Corporate Development Officer, Chief Financial Officer, Chief Credit Officer, and DMD in charge of Inspection and Audit.

3. The four **business groups** will be headed by:

   (a) MD and Group Executive : Corporate Banking Group

   (b) MD and Group Executive : National Banking Group

   (c) DMD : Associates and Subsidiaries

   (d) DMD : International Banking

4. All the above eight functionaries report directly to Chairman and are independently responsible for matters relating to their group/ staff area.

Revised Structure at the Circles : Salient features of the restructuring are

1. Circle Structure will consist of [a] the LHO, [b] the Network Headquarters, [c] Zonal/ Regional Offices, and [d] Branches

2. Circles are to be divided into two focused networks [a] commercial, and [b] Development and Personal Banking

3. Planning to be integrated with operations. Planning support to be provided by [a] business planners, for network GMs and [b] Sales Planners for AGMs

4. Special re-emphasis on loan recoveries and NPA management by providing support at the various levels in the LHO.

LHO and Network Headquarters : The LHO will be headed by a CGM and supported by three staff functionaries of the rank of DGMs to oversee policy and strategy formulation and policy implementation in the areas of Financial Management, Credit Management and Personnel and Services. The three functionaries are designated as Circle Financial Officer, Circle Credit Officer and Circle Development Officer. Two network headquarters each under a GM have been created to manage the Commercial Banking and Development and Personal Banking network Branches.

Branch Structure : The structure at the branches would be reviewed after the network configuration stabilizes.