Question Paper

Management of Banking Companies (MB3H2B): January 2009

Section A : Basic Concepts (30 Marks)

- This section consists of questions with serial number 1 - 30.
- Answer all questions.
- Each question carries one mark.
- Maximum time for answering Section A is 30 Minutes.

<Answer>

1. Which kind of ‘leadership style’ is required to be adopted when the leader is required to possesses the qualities of vision, motivating of people, and framing tasks for his subordinates

(a) Coercive style
(b) Authoritative style
(c) Affiliative style
(d) Democratic style
(e) Pace setting style.

<Answer>

2. Which of the following statements is relevant to ‘change management risk’?

(a) It is the risk of financial loss arising from the business failure to deliver as per expectations
(b) It is the risk of direct loss resulting from inadequate or failed technology
(c) This risk is the possibility of loss if a borrower fails to meet his financial obligations
(d) It is the risk that arises due to inappropriate human resource policies
(e) It is the risk that arises due to wrong organizational structure.

<Answer>

3. Which of the following statements is **incorrect** with respect to ‘Quality Survey’?

(a) Surveys are usually administered through questionnaires
(b) Dissatisfied and unhappy customers do not respond to surveys
(c) Survey can also be informal
(d) The success of the survey depends on it’s design
(e) The results of quality survey can be positive or negative.

<Answer>

4. The entire ‘supervisory mechanism’ has been modified after 1994 under the directions of

(a) Reserve Bank of India (RBI)
(b) Ministry of Finance, Government Of India (GOI)
(c) Board for Financial Supervision (BFS)
(d) State Bank of India (SBI)
(e) Regulations Review Authority (RRA).

<Answer>

5. A typical ‘balanced scorecard’ can be viewed from different perspectives. Which one of the following is relevant to ‘customer perspective’?

(a) Technology leadership
(b) Employee motivation
(c) Knowledge management
(d) Providing on time delivery
(e) Innovation and Learning.

<Answer>

6. Which of the following ratios measures the operational efficiency of banks?

(a) Return on assets
(b) Return on equity
(c) Business per employee
(d) Profit per employee
(e) Non performing assets to advances.

<Answer>

7. "The form of corporate governance in India is similar to East Asian 'insider model' where in the dominance of promoters in governance is very much prominent." Which of the following committees/groups held this view?

(a) Dr. R.H. Patil's advisory group
(b) SEBI committee headed by Sri K.M. Birla
(c) Dr. A.S. Ganguly' group
(d) Mr. Narayana Murthy's committee of SEBI
(e) Sir Arian Cadbury committee.

<Answer>

8. Which of the following is a 'Transaction risk'?

(a) Credit risk
(b) Liquidity risk
(c) Foreign exchange risk
(d) Risk of loss due to technical failure to execute or settle a transaction
(e) Risk of loss due to adverse changes in the cash flows of transactions.

<Answer>

9. The role of the stakeholders in the banking system was not an issue of concern in the past. Which of the following feature(s) has/have typified the functioning of banking system at present?

I. Customers are more demanding and dynamic; government trading off its social responsibilities against propagation of international best practices and ensuring efficiency.
II. Assured business level typical to an oligopolistic market condition.
III. Accountability only to government.
IV. Vast network of the branches.

(a) Only (I) above
(b) Both (II) and (III) above
(c) Both (III) and (IV) above
(d) (I), (II) and (III) above
(e) All (I), (II), (III) and (IV) above.

<Answer>

10. Which of the following 'leadership qualities' gives the leader working knowledge of and an insight into the operations carried out under his guidance?

(a) Teaching ability
(b) Communication Skills
(c) Objectivity
(d) Emotional stability
(e) Technical competence.

<Answer>

11. Which of the following statements relating to 'Total Quality Management (TQM)' is **correct**?

(a) Companies that are busy warding off competition do not neglect or postpone TQM decisions
(b) TQM can be achieved through employee training alone
(c) TQM can be achieved by simply having as many quality circles as possible
(d) Many firms have not adopted elements of TQM in parts or in isolation
(e) There is a tendency to simply copy TQM as a tool for achieving excellence without providing for necessary organizational preparedness.

<Answer>

12. Which role among the following is the 'interpersonal' role performed by a manager?

(a) Monitor role
(b) Disseminator role
(c) Spokesman role
(d) Leader role
(e) Entrepreneurial role.

<Answer>

13. Which of the following statements is **incorrect** with regard to 'lack of differentiation or low switching costs'?

(a) Banking industry has many players and though customer loyalty exists for few firms, of late the customers are migrating on price terms
(b) The effect of switching costs is identical to what is described for differentiated products
(c) The lower the buyer's switching costs, the easier it is for competitors to attract buyers
(d) High switching costs insulate the firm from the rivals' efforts to attract customers
(e) There is vast scope for product differentiation for banking products.

14. Which of the following statements is **not correct** with regard to 'Sales Force Automation (SFA)'? <Answer>

(a) Sales Force Automation (SFA) is an information system that enables companies to acquire and retain customers
(b) SFA increases the speed of managing or selling the accounts
(c) SFA helps the salespersons to redesign their activities to enable them to provide better services to customers
(d) If there is a large network of agents, bankers can adopt SFA to minimize the activities involved in selling banking products
(e) SFA has different fundamental features depending on the vendor who supplies it.

15. Which 'leadership theory' states that employees (who are virtually wedded to the bank) who develop a sense of ownership and commitment to the organization in which they work will be more dedicated to the goals of the organization? <Answer>

(a) Theory X
(b) Theory Y
(c) Theory Z
(d) The Michigan studies
(e) The Ohio state studies.

16. Which of the following 'leadership qualities' is to be adopted by a banker particularly while dealing with difficult customers who may be either demanding too much or become loan defaulters? <Answer>

(a) Objectivity
(b) Empathy
(c) Courageous outlook
(d) Inspirational ability
(e) Emotional stability.

17. When a new organization is formed, its structure is organic and informal. If the organization is successful, its growth and maturity leads to ____ <Answer>

I. Formalization.
II. Specialization.
III. Standardization.
IV. Complexity and a more mechanistic structure.

(a) Both (I) and (II) above
(b) Both (II) and (III) above
(c) Both (I) and (III) above
(d) (I), (II) and (III) above
(e) All (I), (II), (III) and (IV) above.

18. Which of the following statements relating to 'strategic analysis and choice' is **not correct**? <Answer>

(a) New banks and weak banks that need to comply with prudential norms do not face uncertainty and risk
(b) All the banks in general must develop strategies to cope with uncertainty and risk
(c) The structure of an emerging bank is normally unsettled and keeps changing
(d) The forces of competition also add to the level of uncertainties
(e) A strategy is selected after a thorough comparative study of all the proposed strategies in terms of their strengths, weaknesses, risks and trade-offs against one another.

19. Which role among the following is the 'informational' role performed by a Manager? <Answer>

(a) Entrepreneurial role
(b) Disturbance handler
(c) Resource allocator role
(d) Leader role
(e) Monitor role.

<Answer>

20. A bank might not be able to fund assets or meet obligations at a reasonable price if it faces

(a) Change management risk
(b) Operational risk
(c) Liquidity and Funding risk
(d) Poor governance risk
(e) Credit risk.

<Answer>

21. 'Transformational Leadership' theory is categorized under

(a) The "Great Man" (Personality) theory
(b) The Trait theories
(c) New Leadership Theories
(d) The Behavioral Theories
(e) The Situational Theories.

<Answer>

22. Identify the **incorrect** statement with respect to 'Total Quality Management (TQM)'.

(a) 'Q' represents product orientation
(b) TQM is a management technique that aims to improve the quality of service provided by an organization
(c) There is difference between Quality and Total Quality
(d) Total Quality is not merely about product quality
(e) Total Quality is performance superiority in delighting customers.

<Answer>

23. Which one of the following is the first phase of development of 'Executive Dashboard'?

(a) Testing
(b) Implementing
(c) Running
(d) Designing
(e) Recalibrating.

<Answer>

24. Which group/committee was appointed by Reserve Bank of India (RBI) with the task of reviewing the supervisory role of Boards of both banks and financial institutions?

(a) Dr. R.H. Patil
(b) Dr. A.S. Ganguly
(c) Mr. K.M. Birla
(d) Mr. Narayana Murthy
(e) Sir Arian Cadbury.

<Answer>

25. Which of the following is the last step in 'Succession Planning'?

(a) Minimizing the Bank's risk
(b) Co- developing the Leader's exit strategy
(c) Building a solid Association foundation
(d) Transitioning the Leadership
(e) Strengthening systems and processes.

<Answer>

26. Which of the following statements is **correct** with respect to 'Innovations' in banking?

(a) Successful banking is impossible without investing in a big way in branch computerization
(b) Process and systems innovations include ATM, SWIFT, V SAT, e-commerce etc.
(c) Technological innovations include credit syndication, securitization, factoring etc.
(d) Public Sector Banks (PSBs) are not facing stiff competition from private and foreign banks
(e) Product innovations include Asset-Liability Management, risk management systems, treasury management etc.

27. Which are the major forces that exert pressure on the organization itself for a change? <Answer>

I. Political and Social events.
II. Increase in the size, complexity and specialization of organizations.
III. The tendency for large organizations and markets to become increasingly global.
IV. Technological revolution.

(a) Both (I) and (II) above
(b) Both (II) and (III) above
(c) (I), (II) and (III) above
(d) (II), (III) and (IV) above
(e) All (I), (II), (III) and (IV) above.

28. Which of the following statements is **not correct** relating to high fixed costs/ storage costs? <Answer>

(a) When fixed costs form a large part in total costs, companies try to minimize the use of their productive capacity
(b) When many firms attempt to maximize their productive capacity, excess capacity is created on an industry- wide basis
(c) To reduce inventories, individual companies typically cut the price of their product and offer discounts to customers
(d) The pattern of excess capacity at the industry level followed by intense rivalry at the firm level is observed frequently in industries with high storage costs
(e) As the inventories of perishable products grow, producers of perishable goods often use pricing strategies to sell products quickly.

29. The Bank for International Settlements (BIS) has proposed worldwide capital requirements for banks related to credit, market and operational risk. However, determining the extent to which the new accord will be adopted is left to <Answer>

(a) Central Bank of a country
(b) World Bank
(c) Central Govt., of a country
(d) Asian Development Bank
(e) European Central Bank (ECB).

30. Which was the first Presidency Bank established in 1806 in India? <Answer>

(a) Bank of Bombay
(b) Bank of Madras
(c) Bank of Calcutta
(d) Bank of Hindustan
(e) General Bank.

END OF SECTION A

Management of Banking Companies (MB3H2B): January 2009

Section B : Caselets (50 Marks)

- This section consists of questions with serial number 1 – 8.
- Answer all questions.
- Marks are indicated against each question.
- Detailed explanations should form part of your answer.
- Do not spend more than 110 - 120 minutes on Section B.

Caselet 1

Read the caselet carefully and answer the following questions:

1. Discuss the changes that have taken place in the Indian Banking Sector from the 1950s till date and the innovative response of the Indian Banking System/ Government during the said period. <Answer>

(8 marks)

2. List out the Technological, Process& Systems and Product Innovations in the Indian Banking Sector. <Answer>

(6 marks)

The banking system in India has created a niche for itself in the current competitive global arena where adoption of new and innovative technological developments carries the key to expansion of business and its future development. The Indian banking system has come a long way from being a player restricted to domestic boundaries to a leading giant in the world of financial services across the globe. Credit for this progress goes to a mix of factors like, the introduction of various economic reforms which gave a boost to the banking sector, adoption of new technology by banks in order to streamline their line of businesses and increasing profits by improving cost efficiency and offering doorstep banking convenience to their customers.

Banking 'Then' and 'Now'

Indian villages were deprived of various financial products like mutual funds, insurance and equity trading hitherto, which are now accessible through proxy banking in the form of Internet kiosks and ATMs. The alias given to banking which is not routed through branches is 'Channel Migration'. Through this route, a bouquet of services is at the customers' disposal in today's banking system.

This is possible because banking transactions are stored in a centrally located server with which all other branches of a bank are connected. The technological systems in India are considered far more advanced than those of Russian and Chinese banking systems but are lagging far behind the UK, USA and Singapore.

Connectivity takes root

Today almost all scheduled commercial banks are connected to all the branches on a real time basis extending the anywhere banking facility to the customers, which means that it is not necessary for a customer now to visit the branch personally in order to conduct transactions. Now a customer has various other options available with him like internet banking, mobile banking, ATMs (automated teller machines), phone banking which offers 24 X 7 banking, etc. Whenever and wherever a transaction is done in a bank account, the updated status is reflected in all the branches, thus making anywhere banking possible. ATMs have revolutionalized the banking sector by making cash and other banking services available to customers at all times.

Future Outlook

The future of Indian banking lies in increased investment in technology plat forms and a greater focus on end-to-end solutions provided by IT majors like core banking products, vertical specific CRM and risk management software.

END OF CASELET 1

Caselet 2

Read the caselet carefully and answer the following questions:

3. Explain the 'Banker's Role' and the role of 'Competitive Environment' in a Customer Life Cycle (CLC). <Answer>

(5 marks)

4. What do you understand by 'Sales Force Automation'? What purposes does it serve? <Answer>

(5 marks)

The Channel Evolution

The technology in banking is leading to a further evolution in relationship management. Internet helps in the reduction of transaction costs and lessens face-to-face interactions. Customer finds it more convenient to carry out transaction through the Internet. There is more technology interface. The relationship manager must possess the knowledge about the channels that his customers use and for which transactions. He has to help them to understand and use technology effectively in this wired world. Educating the customer must be a focal point.

The Financial Advisor

The product array for customers is ever-growing. The relationship manager of the future will have to don the role of a financial guide for his customers. Therefore, his strength and relationship will be based on knowledge. This will lead to customers seeking out their financial guide, their financial planner the new challenge for winning strategies in financial services. Continue to question how close your customers would like you to be.

Stumbling Blocks

Way back in 1999, the Gartner Group cautioned saying, "more than 60% of all CRM initiatives fail." In reality, current CRM programs are complicated with conflicting goals, advice and technology choices that impair banks' ability to adopt a successful CRM approach. Visions of CRM offered by vendors, analysts and experts often fail to offer pragmatic steps in achieving success. The technology infrastructure and capabilities required to share and exploit customer information effectively across corporate boundaries do not yet exist in many banks.

Bringing about the cultural, processes and organizational changes required to execute CRM successfully continues to be a major challenge for most banks.

Future Outlook

It is clear that for surviving and competing in business, retention of customers is a critical factor because the cost of keeping them is less than replacing them. Selling of products or services to them efficiently creates loyalty and, this, in turn, creates more business. But as resources are stretched to new limits, the costs to attract and retain customers will continue to rise and banks will be forced to rethink how they can leverage the investments in CRM capabilities and infrastructure. As technological advances continue, many more applications are expected to emerge. New capabilities are required to capture, store and analyze greater amount of data. And if they make this a part of their future CRM strategies, they will be better positioned to keep pace with their customers' demands and competitors and to grow profitability in the future.

Banks need to be careful when they spend CRM budget on smart, fast and focused initiatives that will satisfy more customers, more of the time. It is a real opportunity to create tailored customer experiences and as a result, competitive differentiation and long-term growth. Leaders are taking careful steps and beginning to identify the varying needs of customers, manage the entire experience, and drive increased loyalty. Others simply can't afford to wait. Once a few players establish significantly differentiated experiences, they will be extremely difficult to catch up with.

END OF CASELET 2

Caselet 3

Read the caselet carefully and answer the following questions:

5. Describe the Features of Knowledge Management. <Answer> **(5 marks)**

6. Give an account of 'Systematic Approach to Knowledge Management'. <Answer> **(5 marks)**

Many refuse to draw the distinction between information and Knowledge. Knowledge Management (KM) expert argue that "If knowledge is not something that is different from data or information, then there is nothing new or interesting in Knowledge Management" Information is available in plenty in books, on websites, in manuals and even in people, whereas knowledge is not. Knowledge is an astounding blend of judgement, insight and inspiration and entails lifelong learning. Through information, people get to know 'what' while knowledge tells them 'how' and 'why'.

Thus, the distinction between information and knowledge emphasizes a fundamentally different approach to working with knowledge in today's organizations. Knowledge has emerged as a new resource contributing to sustainable competitive advantage. Knowledge Management Systems (KMSs) are guided to capture, create, store, organize and disseminate organizational knowledge. It is indisputable that the performance in the capture, creation, codification and allotment of knowledge depends on the implementation of technological platforms capable of supporting an integrated management and thus to reach the stake holder's information needs. Being stored and developed through four essential discrete repositories – people, processes, systems and culture – a functional Knowledge Management System (KMS) should be clearly understood inside the organization for the entire optimized combination of these repositories.

The organization engaged in knowledge sector is looking forward to attain competitive advantage in this fast growing world. The software companies and other knowledge based ones are looking for knowledge to be transferred from one generation to another, to sustain advantages over others. With in a shorter time and cost, the organizations aim to capture and share information among it's employees. The search for the source of knowledge at enterprise or employee level, improves business and productivity. The Knowledge Transfer (KT) can be done and captured from individual, group and enterprises levels in the form of knowledge bank which helps the organization to develop and achieve strategies and objectives. This captured knowledge can be transferred at each functional level to the newly recruited employee. The different KT methods like induction method, counseling method, employee rotation method, training and development method, group learning method equip the organization to transfer knowledge and can be stored and reused at different levels of problem solving in an organization.

END OF CASELET 3

Caselet 4

Read the caselet carefully and answer the following questions:

<Answer>

7. Describe the areas that could pose a challenge to the implementation of Corporate Governance.

(8 marks)

<Answer>

8. Explain the role of Reserve Bank of India (RBI) in Corporate Governance and elucidate the need of corporate Governance in banking sector.

(8 marks)

The role of the Central Bank or the Reserve Bank of India (RBI) is to maintain financial stability in the system, so that each player can discharge its role effectively. By the very nature of the activities being undertaken by the RBI like overseeing payment and settlement system, making of monetary policy, carrying out supervisory role, etc., which becomes, all the more important that a conducive environment for a stable financial system is needed. For ensuring stability in the system, proper policy on governance is required.

The crises and problems in any institution can be attributed to the fundamental weakness in corporate governance's practices such as excessive risk taking, inadequate management of the risk, poor laid down policies, transparency in disclosures, etc.

Corporate Governance encompasses the set of relationships among the corporate entity's management, board of directors, shareholders and other stakeholders. It provides the fundamental structure through which the objectives of an entity are set and the means of attaining those objectives and monitoring performance are determined. Corporate Governance is relevant not only to an individual institution but also to public and private entities dealing with it, as well as supervisory authorities, central banks and governments. Sound governance generates positive externalities and provides the basis for a strong and stable financial system.

The issues in corporate governance crop up from an identifiable process. It all started with the scandals that broke out during 1980s involving the UK listed companies and concerns emanating thereof. The committees such as the Cadbury committee report (December 1992), Greenbury committee report (1995), Hampel committee report (1998), Turnbull committee report (September 1999), and Paul Myness (2001) to name a few have examined various aspects of corporate governance. They have stressed on the need for a good corporate governance in place, and the need for good policies are well-articulated by them. The basic arm of all these committees was to provide guidance and help the listed companies to implement the internal control mechanism in corporate governance and improve their practices in the UKs listed companies.

To begin with the Cadbury committee report, it has echoed to quote "Committee's recommendation is a code of best practices, which will go long way to achieve a high standard of corporate behavior." The emphasis, on board, as a focal decision point, could be said to be led by Cadbury, as could be the emphasis on appropriately constituted board sub committee independent non-executive director and separation of chairman and chief executive position. Subsequently, due to the winding up of large US firms such as Enron Corporation and Worldcom, there has been a renewed interest in the practice of corporate governance in modern corporations since 2001. In view of such failures and intending to restore public confidence in corporate governance, the US federal government in 2002 passed the Sarbanes Oxley Act (SOX), which is better known as Public Accounting Reforms and Investors Protection Act of 2002, Which protects the investors. This act covers the issues such as auditors' independence, internal control assessment and financial disclosures, corporate tax return accountability issues, etc.

Turning to the Indian experiences, the Confederation of Indian Industries (CII), the Associated Chambers of Commerce and Industry (ASSOCHAM) and Securities and Exchange Board of India (SEBI) realized its importance. They reinforced the Cadbury report and stressed on the crucial role of the board of directors, and reiterated the need of it, to observe the code of best practices. Further, at the instance of SEBI, Kumar Mangalam Birla committee has come out with a set of recommendations. At the heart of the Committee's report is the set of recommendations which distinguish the responsibilities and obligations of the boards and the management in instituting the systems-for good corporate governance and emphasizes the rights of shareholders in demanding corporate governance. Some of the recommendations include caliber of nonexecutive directors on the boards who can help bring independent judgment to bear on boards deliberations. This goes to say that corporate governance is now a way of life, on how different entities behave in a system and how most of the forward looking organizations look at the concept of corporate governance.

The RBI has asked all the listed commercial banks to follow SEBI committee report on corporate governance. Further, these reports can be used as a catalyst for performance improvement in the public and non-profit sectors as well. Thus, looking at definition level, the corporate governance provides the set of processes, customs, policies, laws and institutions affecting the way a corporation is directed, administered or controlled. It also includes the relationships among the players involved (the stakeholders) and the goals for which the corporation is governed. An important theme of corporate governance is to ensure the accountability of certain individuals in an organization through mechanisms that try to reduce or eliminate the principal, agent problem.

END OF CASELET 4

END OF SECTION B

Section C : Applied Theory (20 Marks)

- This section consists of questions with serial number 9-11.
- Answer all questions.
- Marks indicated against each question.
- Do not spend more than 25 - 30 minutes on Section C.

9. Explain the Coercive, Authoritative, Affiliative, Democratic, Pace-setting and Coaching styles of Leadership. <Answer>

(7 marks)

10. Elucidate 'Risk Based Supervision (RBS)'. List out its advantages. **(7 marks)** <Answer>

11. Write Short notes on: <Answer>

a. Recommended Guidelines for Information Gathering. **(3 marks)**

b. Operational Risk. **(3 marks)**

END OF SECTION C

END OF QUESTION PAPER

Suggested Answers
Management of Banking Companies (MB3H2B): January 2009

Section A : Basic Concepts

	Answer	Reason	
1.	B	Right option is (b). The authoritative leader is a visionary who motivates people by making clear to them how their work fits into the larger vision of the organization. He frames tasks for his subordinates and gives both negative and positive feedback to his subordinates.	< TOP >
2.	A	Right option is (a) as Change Management Risk is the risk of financial loss or reputational damage arising from the business failing to deliver as per expectations. Option (b) is relevant to operational risk, Option (c) to Credit risk, and options (d) and (e) to Poor governance risk.	< TOP >
3.	B	It is observed that customers who are happy with the bank's service usually do not respond to surveys but the dissatisfied and unhappy customers usually do. Therefore, it is more important to address the negative comments revealed by the surveys and identify the problems. Banks need to build bridges in their relationships especially with dissatisfied customers. All other options are correct statements relating to Quality survey.	< TOP >
4.	C	Right option is (c) as after 1994, the entire supervisory mechanism has been modified under the directions of BFS.	< TOP >
5.	D	Right option is (d) as it is the only option relevant to customer perspective. All other options are relevant to Learning and Growth perspective.	< TOP >
6.	A	Right option is (a) as it is the only ratio that measures the operational efficiency. Options (b), (c), and (d) are productivity ratios while option (e) is a business ratio.	< TOP >
7.	A	Right option is (a). Dr.R.H. Patil's advisory group on corporate governance for the RBI standing committee on International Financial Standards and Codes held the view that the form of corporate governance in India is similar to the East Asian' insider' model, wherein the dominance of promoters in governance is very much prominent.	< TOP >
8.	A	Right option is (a). Options (b) and (c) are balance sheet risks & (d) and (e) are operating and liquidity risks.	< TOP >
9.	A	Right option is (a) as statements (II) and (III) and (iv) are a thing of the past and relegated to history. Item (I) is a current phenomenon where an increase in the level of competition and market mechanism led to draw lines of distinction between leaders and laggards. Core principles based on acceptable global benchmarks have been adopted to safeguard against the crisis. Customers are more dynamic and demanding with high propensity to switch service providers. Govt., still as a majority stake holder, has been striving hard to trade off it's social responsibilities against propagation of international best practices and ensuring efficiency. The managements in banks are also putting an extra yard to counter the diseconomies of size, make good the inadequacies in IT application and stay afloat in the fiercely competitive market place. All these and frequent cases of regulatory rigors have left the banks at the cross roads.	< TOP >
10.	E	Right option is (e). For example, in matters relating to credit appraisal or maintenance of computer systems, the concerned supervisor must possess the technical competence for taking a decision. Otherwise, it could lead to failure.	< TOP >
11.	E	Right option is (e) and all other statements relating to pitfalls in TQM implementation are wrong because: (a) Companies that are busy warding off competition, often neglect or postpone TQM decisions; (b) & (c) A mistaken belief is that TQM can be achieved through employee training alone or by simply having as many quality circles as possible; (d) Many firms have adopted elements of TQM in parts or in isolation.	< TOP >

12.	D	Right option is (d) as Leader role is the interpersonal role performed by a manager whereas, (a), (b),(c)are informational roles and (e) is a decisional role. As a leader, manager has to coordinate the work of others and lead his subordinates.	< TOP >
13.	E	Right option is (e) as there is little scope for product differentiation for banking products. The only exception would be customized products.	< TOP >
14.	E	Right option is (e) as SFA has the same fundamental features regardless of the vendors who supply it.	< TOP >
15.	C	Right option is(c).Theory Z states that employees who develop a sense of ownership and commitment to the organization in which they work will be more dedicated to the goals of the organization and thus will become more productive. Employees who are virtually wedded to the bank comprise of such category of staff.	< TOP >
16.	E	Right option is (e)Emotional stability refers to leader's ability to deal with subordinates or followers in a confident, calm and empathetic manner .Business matters can create tension and ill-will. Bankers have to maintain poise particularly while dealing with difficult customers who may be demanding too much or who may be a loan- defaulter.	< TOP >
17.	E	When a new organization or sub unit is formed, its structure is organic and informal. If the organization or sub unit is successful, it grows and matures. Maturity leads to formalization, specialization, standardization, complexity and a more mechanistic structure. Hence right option is (e).	< TOP >
18.	A.	Right option is (a). New banks and weak banks that need to comply with prudential norms face uncertainty and risk.	< TOP >
19.	E	Right option is (e) as Managers have net work of contacts and get information by scanning the environment, subordinates, peers and superiors. Managers play the role of monitor by colleting information. Options (a), (b), (c) are Decisional roles and (d) is interpersonal role.	< TOP >
20.	C	Right option is (c) as a bank might not be able to fund assets or meet obligations at a reasonable price in respect of liquidity and funding risk.	< TOP >
21.	C	Right option is (c) as both Super Leadership and Transformational Leadership are categorized under New Leadership Theories being developed.	< TOP >
22.	A	Right option is (a) as "Q" represents Total Quality. It denotes a commitment to Total Quality, not just products. Quality, when represented by 'q' is a symbol of firm's approach to quality that only emphasizes on it's products. This is also referred to as product- orientation.	< TOP >
23.	D	Right option is (d). Designing is the first phase and begins with a thorough analysis of the strategies, goals, and information sources of an organization. Designing is followed by Implementing, Testing, Running and Recalibrating which are the other 4 phases in the development of executive dashboard.	< TOP >
24.	B	Right option is (b).The RBI constituted a consultative group of directors of banks and financial institutions under the chairmanship of Dr. A.S. Ganguly. This group was given the task of reviewing the supervisory role of Boards of both Banks and other financial institutions. In the Indian context, Ganguly committee recommendations can be benchmarked with international best practices as per basal norms. The RBI has also ensured that most recommendations are implemented. As an indication of the follow up measures taken in this regard, the RBI issued a circular dated 25-6-2004 on 'fit and proper' criteria for directors of banks.	< TOP >
25.	D	Right option is (d) as this step identifies the gaps between the required leadership and the existing talent pool.	< TOP >
26.	A	Right option is (a) and all other statements (b), (c), (d) &(e) are incorrect.	< TOP >
27.	E	There are various factors that cause changes in the organization. The fact that either something relevant to the organization has changed or is going to change puts pressure on the organization itself to change. The 4 major forces of change are indicated vide statements (I), (II), (III) and (IV) and hence right option is (e).	< TOP >

28. A Right option is (a).When fixed costs form a large part in total costs, companies try to maximize the use of their productive capacity. All other options are correct with reference to high fixed/ storage costs. < TOP >

29. A Right option is (a). The Bank of International settlements – under the new basel capital Accord has proposed worldwide capital requirements for banks related to credit, market and operational risk. However, it is up to each country's central bank to determine the extent to which the new accord will be adopted. < TOP >

30. C The first presidency bank was established in Calcutta in 1806 under the name of Bank of Calcutta. Other 2 presidency banks were the Bank of Bombay and the Bank of Madras, established in 1840 and 1843 respectively. They were private shareholders' banks, although the East India company also contributed to their share capital. Hence, right option is (c). < TOP >

Management of Banking Companies (MB3H2B): January 2009

Section B : Caselets

1. Early Innovations < TOP >

Initially, we take a look at the changes that have taken place in the Indian banking sector since the later half of the twentieth century. Such changes reflect the crucial role played by the banking sector in the economic development of country. As we study about these changes, we can also understand the innovative response of the Indian banking system/government during that relevant time-period.

The changes can be described under four phases as given below:

The Foundation Phase

This phase refers to the period from the 1950s till the first round of nationalization of banks in 1969. The priority during this phase was to lay the foundation for a sound banking system. The private banks operated with earning profits as the main motto. These banks were run on purely commercial lines and to a major extent, the aspirations of the common people were disregarded. The security aspect was considered very important and the tendency of these banks was to cater to the financial needs of the elite group/big business houses.

At the same time, the main emphasis of the planners was on the development of the primary sector, i.e., agriculture. However, the bankers were only interested in the development of big industrial and trading houses. As a result, the financial needs of the agriculturists could not be met. During this period a major development took place by way of the transformation of Imperial Bank of India into State Bank of India and the consequent redefinition of its role in the Indian economy.

The Expansion Phase

This phase refers to the period from nationalization in 1969 till 1984. The banking industry made a determined effort to reach to the masses. As a part of this exercise, the then Prime Minister, Mrs. Indira Gandhi nationalized 14 commercial banks in 1969 and another 6 banks in 1980. The emphasis was on branch expansion to cater to the financial and banking needs of the masses. The concept of priority sector evolved during this phase.

This sector comprised small scale industries, small business, agriculture and foreign trade. The banks adopted a need-based approach to assist entrepreneurs in setting up small scale/cottage industries which are labor intensive and also provide employment opportunities to the masses. The nationalized banks also witnessed a large-scale branch expansion during this period. Effectively, the size of population serviced by each branch was reduced. The problems however were that with the uneven branch expansion, the banks became unmanageable, led to the deterioration of customer service, increase in bad and doubtful debts and shrinkage in the spreads and consequent reduction in profitability of the nationalized banks.

The government implemented measures like providing subsidies to the priority sector. On the negative side, many businessmen/industrialists in the garb of entrepreneurs launched their efforts to avail the different facilities offered by the government through banks. They obtained cheaper credits from the banks and financial institutions. However, the growth in industries failed to rise to expectations. Thus, this era also suffered from many cases of sick industries.

Consolidation Phase

The consolidation phase refers to the period from 1984 till May/June, 1991. Undoubtedly the rapid and uneven branch expansion, provided a wide geographical coverage. At the same time, the banks' lines of supervision and control were stretched beyond the optimum level.

A major step taken during this period was the rationalization of the rates of interest on deposits and advances. The concept of disintermediation also emerged as the public was flush with funds. The corporate sector also tapped huge amount of funds directly from the capital market and through various money market instruments.

The burden of bad debts had to be tackled by the government. Various measures were taken to tackle this problem. Efforts were made by the government to help those who were unable to run their ventures effectively due to paucity of funds. Thus, institutions like BIFR and the SICA enactment came into effect.

This phase was marked by a slowdown in the branch expansion. Banks paid a lot of attention towards improving the much deteriorating aspects in the areas of house-keeping, customer service, credit management, staff productivity and profitability. Further steps were taken to rationalize the interest rate structure on bank deposits and loans. More importantly, measures were initiated to reduce the structural constraints, which obstructed the growth of money market.

The Reform Phase

This phase began from June 1991 with the launching of economic reforms, which aimed towards a more open and more competitive market economy. To achieve this objective within the framework of democratic polity is a historical initiative, not only in the economic history of India, but of the entire developing world.

The economic reforms launched in India were under the compulsions of the grave economic crisis faced by the country at that time. These reforms had to be designed and implemented in tandem with the conditionalities agreed with the International Monetary Fund (IMF) under a Standby Loan Facility of 18 months duration (ending March 1993) in support of India's balance of payments needs at that time.

2. Technological Innovations < TOP >

To face the competition, there is an imperative need for the banks to depend heavily on the technological innovations. Ever since the Rangarajan Committee, submitted its recommendations, the banks have been striving hard to implement total-computerization. As a result, today successful banking is almost impossible without investing in a big way in branch computerization. PSBs in particular are facing stiff competition from the private and foreign banks in this regard.

Significant achievements made in the recent past in the area of technological innovations with regard to their applicability in the banking sector are listed below:

a. Full Branch Computerization,
b. Automatic Teller Machine (ATM)
c. Wireless Application Protocol (WAP)
d. Convergence
e. Internet
f. LAN, E-mail and Website
g. SWIFT
h. VSAT
i. Electronic Commerce (e-Commerce)
j. DOTCOM
k. Enterprise Resource Planning (ERP)
l. Data Warehousing and Data Mining.

Process and Systems Innovations

In order to cope with the systems integrity in the process of banking some, innovations have been made in the recent past. A few of such innovations are listed below:

a. Treasury Management
b. Asset-Liability Management
c. Risk Management Systems in Banks.

The types of risks faced by banks are depicted in the following table:

Product Innovations

The various product innovations that have taken place are listed below:

a. Credit syndication
b. Securitization
c. Credit derivatives
d. Factoring
e. Commercial paper
f. Interest rate swaps
g. Currency swaps
h. Currency options
i. Currency futures
j. Gold banking

k. Credit cards.

3. The Banker's Role

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The banking organization undertakes different activities in a CLC. They are:

- **Intrude and engage:** The banker attempts to get the prospect's attention and makes him aware of the bank's products/services. The prospect is kept engaged in a conversation that prompts him or her to know more regarding the CLC. Information is provided to the prospective customer/s through pamphlets; advertisements etc.

Acquire: A prospect that is aware of a banker may not necessarily purchase that banker's product or service. The banker must educate the prospect about its products/services to acquire him as a customer. The art of selling is tested as the banker seeks to explain the relevance and importance of a product to the customer. For instance, in a home loan the provision for Income-tax rebate could serve as a strong point for the banker.

Retain and expand: A banker's real work begins only after the prospect buys its products or services and becomes an actual customer. In this stage, the banker develops several business strategies to increase customer satisfaction and foster customer loyalty. After the prospective customer turns out to become the bank's customer, the bank seeks to expand its services. For instance, the customer may be given the benefit of a credit/debit card at no cost.

To develop, a well-defined CLC, bankers need to map their business processes clearly to the customer needs. The interaction between the banker and the customer depends on the competitive environment. Bankers must prevent their customers from being lured away by their competitors.

Competitive Environment

The whole process of CLC depends on the competitive environment. The severity of competition faced by the banker largely determines whether the prospect can become a customer or not. The prospect can drop out of the CLC in two ways. Firstly, the competitor may capture the prospect before the 'customer moment.' This is known as a "loss" and is not preferred by the bankers. Secondly, there may be erosion in customer loyalty though the prospect may be an actual customer. This erosion in customer loyalty may occur when the customer is dissatisfied with the products/services offered by the organization or when the competitor's products/services are superior. This is known as "attrition."

The inability of a banker to offer acceptable services results in the loss of valuable customers. The banker will have to make more efforts to win back customers.

Bankers may have a tough time with customers who voice their dissatisfaction openly, as they may dissuade other customers from doing business with the banker. As a result, other prospects may enter the competitor's CLC.

4. SALES FORCE AUTOMATION

< TOP >

Sales Force Automation (SFA) is an information system that enables companies to acquire and retain customers. It increases the speed of managing or selling accounts, and helps the salespersons to redesign their activities to enable them to provide better services to customers. Staff members, agents and brokers sell bank's products and act as salespersons for the banker. If there is a large network of agents, bankers can adopt SFA to minimize the activities involved in selling banking products or services to the customers. SFA serves the following purposes:

- **Increased revenue:** It increases revenues as it reduces the costs involved in administrative as well as sales activities.

Reduced cost of sales: The successful implementation of SFA largely depends on the reduction in cost of sales. Field level staff spend more time in making continuous and repetitive data entry. Sometimes, they make unsuccessful attempts to extract and interpret data without having the required tools. The cost of sales is reduced when the time spent on administrative and other non-sales-related efforts is reduced.

Increased mobility for the sales force: The field staff requires increased mobility as they are usually out of the office to meet customers and prospects. Their mobility can be increased by using Personal Digital Assistance (PDA), wireless applications, and converging the web and phone, thereby reducing the frequency of their visits to the headquarters to report their everyday activities. The more customers the salespersons can meet, the more advantageous it is for the organization. As mobility has become an important aspect for gaining a competitive edge,, organizations provide mobile tools such as hand-held sets with Internet connectivity, to their field staff.

Easily available customer with a single view: Bankers have various departments such as the deposits department, the credit department and the accounts department, and so on. The credit department may wish to see the status of the account with regard to the end-usage of the funds lent by the bank, while the accounts department may be interested in seeing the status of the bills that are being negotiated. The staff may be interested in managing the customer accounts. SFA enables each department to view the data individually and simultaneously without any interruption.

5. Features

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Knowledge Management (KM) is defined as the systematic management and use of the knowledge in an organization. In other words it is "the leveraging of collective wisdom to increase responsiveness and innovation." Management discipline promotes a collaborative and integrative approach to the creation, the capturing, the access to and the use of information assets, that includes the tacit, uncaptured knowledge of people. KM is different from information - its close cousin, and data - its most distant relative. Knowledge and information require an understanding of the defined context - their source, their assumptions and their importance and limitations. This is unlike data, which does not require all these details.

An important feature of the KM theory is that it does not advocate downsizing of the employee strength in an organization. By contrast, it believes in imparting on-the-job training to employees, push them towards the goal, and motivate them to get the best out of them. In addition, the employees are also given opportunities to hone their skills, adapt to the changes and improve their efficiency.

The KM concept is applicable to every type of organization. To a great extent, the developed countries are reaping the benefits of KM. This concept seeks to find solutions to organizational problems with a view to continuously improve the working results. The approach adopted for this purpose is human-centric in nature. Undoubtedly it is the human force that forms the biggest asset in any industry/organization. For this reason, it is imperative that its intuitive and tacit knowledge should be harnessed for productive gains. It is not an exaggeration to say that nothing really matters for the organization minus its human force.

The hidden tacit knowledge possessed by every employee of an organization, could be displayed given the right atmosphere and recognition. There are numerous instances of contributions from employees towards cost cutting, enabling companies to post better results.

We can take the example of an employee of South West Airlines who made a suggestion to her management. She advised the company to stop printing the logo with the company's brand legend on the thrash bags, which hang on the back seats of the plane. Her advice, she justified was aimed at cost-reduction by adding that every passenger of South West Airlines in fact is very well aware that the services rendered by the airline are exemplary. Hence, the printing of logo becomes a redundant activity confined to a limited use. The management, in immediate recognition of the employee's suggestion also profusely rewarded her. The company thus saved the expenses on printing that annually ran into lakhs of dollars. Clearly, it is the responsibility of the management to handle the same deftly and to design the infrastructure to be shared among all its employees.

It is now clear that, employees who possess specialized skills in their respective fields are embodiments of knowledge. Naturally, an organization should utilize such skills properly and harness the same. Interestingly, not many organizations have devised systems for this purpose. Apparently, the management gives the right opportunities to only a few individuals who the management thinks are only fit enough. As a result, other deserving cases are ignored.

6. SYSTEMATIC APPROACH TO KNOWLEDGE MANAGEMENT

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A systematic approach to KM helps to retain the traditional faith in providing a rational analysis to the knowledge problem. By following a systematic approach, the existing problems can be solved. However, a new thinking is required to come face to face with new problems. The basic assumptions of this approach are given below:

- The real issue of importance is the achievement of sustainable results. Hence, focus will be on achieving results. Issues such as, the processes or technology or the definition of 'knowledge' are not so important when compared to sustainable results.

A resource must be modeled before it is managed. Hence, various aspects of an organization's knowledge would require to be modeled.

A number of disciplines and technologies provide solutions to a number of problems. Alongside these, traditional methods of analysis could also be used to examine and to solve the problems.

The process of ‘change’ covers not only the employees but also the organization's policies and work practices. The use of technology boosts the awareness and solutions to business knowledge problems. Hence, a systematic evaluation of cultural issues should take place.

Though knowledge management is not an exclusive activity or discipline pertaining to managers, it still remains as an important component of management.

In the light of the above-mentioned information regarding KM, its usefulness for any organization need hardly be over-emphasized. The organizations that have successfully implemented KM have experienced growth in terms of performance and profits and at the same time have improved the employee morale by promptly meeting their genuine needs and also motivating them to perform. The stage is well-set for the leading organizations of our country to start trying out this concept for meeting with better results.

7. Emerging Issues

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There are certain areas that could pose a challenge to the implementation of corporate governance. These are explained below:

Firstly, the financial distress in many countries was due to excessive exposure, concentration, and lending to connected parties, poor credit policy and inadequate management of risk, mainly foreign exchange risk.

Secondly, the boards have to evolve strategies for ensuring strong internal control systems, which include internal and external audit functions and also other checks and balances. The need to set up independent audit committees to help in translating audit reports into meaningful action, both corrective and preventive, is also imperative.

Thirdly, more steps need to be taken for improving transparency through more information disclosures regarding corporate governance. In this regard, the banks should examine the annual reports on corporate governance of such companies wherein appropriate disclosures have been made.

Fourthly, there are increasing concerns about the conflict of interests. Four areas of the financial sector carry high risk for such conflicts. These are: underwriting and research in investment banks, auditing and consulting in accounting firms, credit assessment and consulting in rating agencies and universal banks.

Fifthly, there is a need for a strong culture of compliance at the top management level in the organization. The top management will be tested in its response to ethical or reputational concerns.

Sixthly, there is a need for establishing a consultative process aiming towards harmonizing the approaches as per the Ganguly Committee's and the Narayana Murthy Committee's (of SEBI) recommendations.

And lastly, the exercise of corporate governance should not end with commercial banks. There is a greater need today to extend these principles of good corporate governance practices to cooperatives, PDs, NBFCs and other financial institutions.

The above mentioned failures in basic risk management are also a reflection of the failure of corporate governance. The RBI has laid down prudential guidelines, and has also been emphasizing the need on the part of the Board for better understanding and oversight of key banking risks. Boards of respective banks will have to take into consideration solvency and other risks while making decisions. The Basel II proposals also lay emphasis on the interaction between sound risk management and corporate governance, The RBI also has listed out the requirements for sound risk assessment processes, robust controls and transparency. The responsibility for a bank's overall risk management and performance lies with the board and senior executives who should understand and guide the bank staff. Further, the RBI has to ensure that good governance practices are adopted by all banks.

8. The RBI'S Role in Corporate Governance < TOP >

The corporate sector in India received the Cadbury Report with great interest. The RBI, the SEBI, the Confederation of Indian Industry (CII), and Associated Chamber of Commerce and Industry (ASSOCHAM), studied this issue in depth. Consequent to the interest shown and the studies made by these institutions, the issues related to focus on the crucial role of the Board of directors and the need for a Code of Best Practices to be followed by them was reinforced. The RBI has taken the initiative for various steps to be implemented for the sake of corporate governance in the Indian Banking System. These initiatives can be classified under three broad categories: (i) Transparency (ii) Off-site surveillance (iii) Prompt corrective action.

In any sound corporate governance mechanism, the aspects of transparency and disclosure standards comprise as its important constituents. These standards have been improved to be equated with international best practices. There are, however, many gaps as well. The disclosures in the areas of risk management strategies, risk parameters, risk concentrations, performance measures, component of capital structure, etc., in India do not match with the international standards as yet. There is a need to further broad base the disclosure standards coinciding with the level of improvement in banks' abilities in analyzing the information objectively.

The off-site surveillance mechanism facilitates the monitoring in the movement of assets, the impact on capital adequacy and the overall efficiency and adequacy of managerial practices in banks. "Peer Group Comparison" introduced by the RBI also reveals periodically data relating to critical ratios. The RBI thus seeks to put peer pressure on banks for better performance and governance.

The RBI adopted prompt corrective action, comprising a part of core principles for effective banking supervision. In addition to the trigger of capital adequacy norms, the RBI introduced two more trigger points: Non-Performing Assets (NPA) and Return on Assets (ROA) as a measure for asset quality and profitability. These three trigger points will enable the RBI to intervene and enforce a set of mandatory actions to check any deterioration in the health of banks.

Section C: Applied Theory

9. The Coercive Style < TOP >

A coercive leader demands immediate compliance with his diktats. He expects each of his directions to be followed in an exact manner specified by him. His style is 'Do what I tell you.' To get the work done he could create terror, bully employees or treat them in a demeaning manner. Such a leader would make his displeasure public for even the smallest mistakes committed by his employees.

Coercive leadership is the least effective of the six styles, because it follows a top-down approach, throttling the ideas and creativity of employees. This also erodes the performance of employees whose sole motivation is not money.

Some research studies show that coercive leadership works well on certain occasions: like during extreme or emergency situations as an earthquake or a fire, or when a company is undergoing a turnaround or when there is the threat of a hostile takeover.

The Authoritative Style

The authoritative leader is a visionary who motivates people by making clear to them how their work fits into the larger vision of the organization. Such a style maximizes employee commitment to the organization goals and strategy. An authoritative leader frames tasks for his subordinates by defining standards that can help achieve the organization's vision. He gives both negative and positive feedback to his subordinates who are evaluated for their consonance with the vision.

The authoritative style is suitable for almost all businesses, and is especially useful when a business is not performing well. But this style has a few limitations: when an authoritative leader works with a team of experts or peers who are more experienced than him, he may face ego problems in getting along with them.

The Affiliative Style

The affiliative leadership style focuses on people. It lays more emphasis on individuals and their emotions than on their tasks and goals. An affiliative leader keeps his employees happy and creates harmony among them. This style promotes camaraderie through better communication and sharing of ideas. The employees also have more flexibility in doing their work.

An affiliative leader motivates subordinates through positive and continuous feedback. He also expresses his emotions openly, thus building relationships naturally, without conscious effort on his part.

The affiliative style also has its limitations: Its concern for relationships can allow the poor performance of some employees to go unchecked or uncorrected. Excellence suffers as employees begin to feel that mediocrity will be tolerated. This style works best if used in conjunction with the authoritative style.

The Democratic Style

A democratic leader listens to the opinion of his subordinates to win their trust. He gains their respect and commitment by spending time with them, getting new ideas from them and building consensus on issues.

When subordinates participate in the decision-making effort and know that their opinion is valued, their motivation to achieve goals increases. A democratic leader creates a work culture in which followers are aware of the realities of the situation and know what can or cannot be accomplished.

Democratic leadership is ideal when the leader needs to have more information, ideas and guidance. A democratic style may signal a leader who is unsure of himself, or may be the hallmark of a very competent leader. This style too has its limitations: frequent meetings, opinion gathering session and diverse opinions may lead to situations where consensus may not be achieved. The effectiveness of the style depends on the competence of the subordinates and the leader's ability to accurately assess the value of their opinions.

The Pace-setting Style

As the word pace-setting indicates, a pace-setting leader sets the pace for doing work. He sets an example for high performance by doing his own work at a high pace. Invariably, a pace-setting leader is obsessed with working 'better and faster.' He expects his subordinates to emulate him. He identifies employees who perform below his standards of-work and demands better performance from them. He may even terminate their services if they do not come up to his expectations.

This kind of style can vitiate the working environment. Many employees will feel threatened by the pace-setting leader's hire and fire attitude and demand for excellence. This kind of leader does not give any feedback to employees. As a result, when the leader leaves, the followers are at a loss as to what they should do. This is not a desirable situation for any organization.

This style works well with self-motivated professionals who are highly competent and need little direction and coordination.

The Coaching Style

A coaching leader helps his employees identify their unique strengths and weaknesses. He helps them identify their personal and career aspirations and encourages them to establish long-term development goals. He also helps them achieve these goals.

Such leaders give constant feedback to their subordinates. Coaching leaders delegate power to a large extent, because they believe in the inherent strengths of their subordinates. They also teach their employees in the way a coach or teacher would.

This style works well when the employees are aware of their limitations and are willing to learn. Since leaders are usually hard pressed for time, this style is seldom used. The effectiveness of the style is limited by the leader's ability to teach and the employees' desire to learn.

10. RISK BASED SUPERVISION (RBS)

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The Reserve Bank of India is moving towards Risk Based Supervision. In this process, supervisory resources are allocated initially and later on supervisory attention is focused as per the risk profile of each institution. The major instruments of RBS comprise on-site examination and off-site monitoring supplemented by market intelligence mechanism. In recent times, globally, off-site surveillance has gained primacy, given the ease and promptness of monitoring.

Given the objectives of RBS, what needs to be done is an exercise of proper allocation of scarce supervisory resources in accordance with the risk profile of the concerned institution. It is expected that this approach will lead to an optimal utilization of supervisory resources while at the same time minimizing the impact of crisis situation in the financial system. Essentially, the RBS process involves continuous monitoring and evaluation of the risk profiles of the target institutions that are supervised in relation to their business strategy and exposure. Apart from strengthening the risk modeling capabilities based on off-site data and associated research for 'predictive supervision', it would rationalize the overall compliance burden.

The major elements of RBS approach comprise:

a. Risk profiling of banks,
b. Supervisory cycle,
c. Supervisory program,
d. Inspection process,
e. Review, evaluation and follow-up,
f. Monitorable action plan,
g. Supervisory organization,
h. Enforcement process and incentive framework,
i. Role of external auditors, and
j. Change management implications.

The central function for RBS would be the risk profiling of banks, which, in essence, would document the various financial and non-financial risks confronting the bank. The risk profile of each bank, in turn, would entail drawing up of a supervisory program for the concerned institution, which would be flexible enough to permit amendments warranted by subsequent major developments. The supervisory follow-up process will seek to ensure that banks take timely corrective action to remedy or mitigate any significant risks that have been identified in course of supervision. This would be implemented through the Monitorable Action Plan (MAP) that would not only outline remedial actions, but also link these to the areas of high risk identified in the risk profiling and supervisory process. In order to make the framework incentive compatible, banks with better compliance record and good risk management and control system could be subjected to a longer supervisory cycle and lesser supervisory intervention. In case banks fail to show improvements in response to the MAP, they would be targets of a disincentive package comprising more frequent supervisory examination and higher supervisory intervention such as directions, sanctions and penalties, including the mandatory and discretionary actions as enshrined in the Prompt Corrective Action (PCA) framework. This process would be supplanted by widening the range of tasks and activities performed by the external auditors. Since the success of the entire process depends upon the pro-active response of banks, it is essential that banks should have well-defined standards of corporate governance and documented policies and practices in place to clearly demarcate the lines of responsibility and accountability.

The following are the several advantages of RBS:

i. It enables supervisors to gain a better understanding of the quality of management, characteristics of the business and the risks that a bank faces.
ii. It enables supervisory authorities to display more consistency in carrying out supervisory responsibilities and establish best practices in the supervision of banks.
iii. Explicit linking of tools of supervision to areas of risk or concern helps the banks' management to understand why a particular supervisory tool is used.
iv. The transaction costs are high in on-site supervision and having obtained a better understanding of the bank's risk profile process, RBS will be of help to decide the intensity of the future supervision. The intensity of supervision and the amount and focus of supervisory action will be commensurate with the perceived risk profile of the bank.

11. a. **Recommended Guidelines for Information Gathering** < TOP >

Considering the sensitivities involved both in information gathering by the banks and need for privacy of the customer, there are certain guidelines for information gathering. The recommended guidelines for information gathering can be broadly categorized under:

- Information relevance
- Information accuracy
- Notification of information gathering purposes, techniques and sources
- Consent of the applicant.

Information Relevance: It is immaterial whether the government views the information as relevant or not. However, the applicant is entitled to know the need for information collection. If the bank cannot justify the need for information collection, then it has to forgo its information request.

Information Accuracy: Banks must ensure that accurate information is gathered. This criterion applies not only to the bank that gathers information but also to other banks/agencies who wish to share this information. On an average, it is estimated that in the US annually about 3 million people request organizations to change their credit reports that already contain wrong or outdated information.

The problem of erroneous records is attributed to five sources that give rise to the same. These are:

- Inaccuracy: The primary data may contain erroneous information. If the erroneous data is not verified before use, it leads to increase in the extent of inaccuracies.
- Imperfect Rationalization: This happens when an individual has to choose his response from a limited set of choices and is not given an opportunity to explain the reason for his choice.
- Bias: Bias occurs due to concealment of certain unfavorable facts concerning individuals.
- Error: Computer and clerical errors in data handling could create erroneous records.
- Incompleteness: Records created with missing facts are said to be incomplete records.

Though regulations are not clear regarding storing and transmitting inaccurate non-credit related information, banks must exercise care with respect to the erroneous records. This may make them liable for defamation suits. In order to avoid the risk of maintaining inaccurate information, many banks update and correct their customers' data files.

Notification of Information Gathering Purposes, Techniques and Sources: Individuals, information about whom is collected, must be informed about the purpose, technique and sources of information gathering. Though application forms used by banks contain these disclosures, sometimes the language is ambiguous and confusing. The individual concerned should be informed about the disclosures so that information can be elicited willingly that would be useful to the bank.

Consent of the Applicant: The applicants must be informed about the information collection and the purpose of exercise. Banks must obtain the individual's consent before information about his background is collected. Some persons, however, are concerned with a view that when a person seeks banking facilities, such a person makes himself vulnerable by signing 'a search warrant without due process'.

b. **Operational Risk**

Operational risk is the risk of direct or indirect loss resulting from inadequate or failed technology, human performance, processes or external events. Major operational risk categories can be identified under five heads namely, organizational, policy/process, technology, human and external. Banks themselves are primarily responsible for identifying and managing their operational risks. They should employ internal control techniques to reduce their likelihood or impact. Where appropriate, risk has to be mitigated by way of insurance.

Banks initiated the setting up of a risk management team and developed specific operational risk management tools beginning with the definition of risk indicators in all segments to serve as early warning signals. The risk management team's responsibilities in relation to operational risks are:

- Defining high-level operational risk policies to ensure a comprehensive and consistent approach to the identification and management of operational risk.
- Implementing a group-wise standard methodology to ensure consistency in operational risk management.
- Communicating and providing general guidance on operational risk related issues, including regulatory changes and developments, to promote best practices.
- Reviewing and improving various aspects of operational risk management to reflect industry's best practices and regulatory requirements.
- Approving, from a risk perspective, that all the new products and services that are launched and ensuring that risks are understood by the organization and managed appropriately.
- Identifying risk through formal risk reviews, covering specific risks, activities, business sectors or products, and encouraging pre-emptive action.

Operational risks can be minimized by ensuring that effective infrastructure, controls, systems, and individuals are in place throughout the organization. Periodic, group-wise meetings may be held to promote a common understanding of priorities and to foster a dialogue between the corporate center and the segments. Knowledge and experience would have to be shared throughout the group with the goal of maintaining a coordinated approach. All segments shall own the primary responsibility for managing their operational risks. A bank should collate loss data and initiate self-assessment of risks in different departments/branches. The state of operations and their inherent risks should be regularly reviewed, based on extensive audits and follow-up reviews. Audit data can serve as an early-warning signal for potential trouble spots.

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