

Financial and Banking Services Market

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**HUMAN RESOURCE MANAGEMENT
IN UKRAINIAN BANKS:
A STRATEGIC PERSPECTIVE
IN THE CONTEXT OF INCREASED ACTIVITY
IN THE RETAIL BANKING SEGMENT**

Abstract

Banking is a heavily capitalized sector whose investments consist essentially of employees to such an extent that the transformation required can only be affected over time. Strategically, if Ukrainian banks are to be successful, in the near future they will have to redefine the principles of Human Resource Management (HRM) and make it of top priorities. HRM practices are most effective when matched with the strategies of organization. By adapting high-performance workplace practices, banks in Ukraine can create capabilities that will add value to their operations.

Key words

Ukrainian banking sector, Human Resource Management, strategic HRM, retail banking.

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1. Introduction

In the 21st century the Ukrainian banking sector is under substantial pressure to change the way in which it does business. After a decade of economic decline and crisis, the Ukrainian economy has exhibited strong growth and unprecedented macroeconomic stability since 2000. By the end of 2003, official GDP stood 30 percent higher than in 1997. During the same period, industrial output grew by an estimated 56 percent and fixed capital investment doubled. Unemployment has fallen, household incomes increased significantly, and progress in poverty reduction is visible. Inflation has been under control since mid-2000, while credit markets have expanded at a remarkable pace (World Bank 2004). The household real income in Ukraine rose by an average 11.3 percent (Banker 2004).

These conditions provide the banks with an important window of opportunity and challenge to pursue policies and reforms that can ensure the continuation of strong growth and poverty reduction over the medium and longer-term in Ukraine. Rising from negligible levels in the latter 1990s, commercial banking sector appears to be playing a measurable role in supporting Ukrainian economic growth by providing commercial credit to business organizations. Commercial banks have expanded their assets, deposits, and (especially) credit at a pace that far exceeds growth in the economy as a whole. Commercial loans have grown at a particularly rapid rate. The volume of commercial loans in GDP increased from an estimated 12 percent of GDP in 2000 to an estimated 23 percent in 2003 (See Figure 1). By this indicator, Ukraine is now approaching a number of the more advanced Eastern European transition countries (World Bank 2004). Under such a scenario, the banks are facing an increasing competitive environment, replete with threats from various financial institutions operating under different regulated environment.

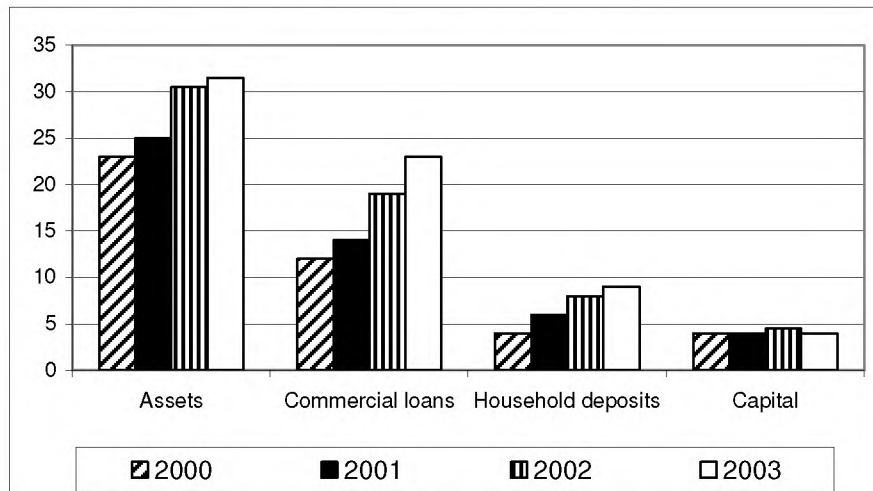
The development of the banking sector in Ukraine has been a complicated process. The instability of the 1990s culminated in the bankruptcy of Bank Ukraine in 2001, which accounted for 10 percent of all bank assets. The number of registered commercial banks in Ukraine has declined from 230 in the year 1995 to 180 in 2003. In recent years, while increases in bank assets, deposits, and (particularly) commercial loans have been extremely rapid, aggregate bank capital has remained virtually unchanged as a share of GDP (Ibid.).

Another aspect of the competitive challenges faced by banks lies in the Human Resources Management (HRM), particularly with regard to the workforce at the lower and middle levels of the organization. In the 21st century, the Ukrainian banks have to adapt radical human resource strategies that would produce higher quality products and services and make organizations more flexible and cost effective¹.

¹ Operating cost in Ukrainian banks is still high and the spread of the banking sector is at 7.5 percent (World Bank 2004 p.52).

Figure 1.

Selected Bank Indicators (as a percentage of GDP)



Source: World Bank (2004), Figure-2.7, p.51.

Due to dynamically changing economic environment, the Ukrainian banking organizations are under constant pressure to manage their labor force in consistency with the organizational strategy. The nature of these changes remains unclear, and questions center around what form the changes will take and around the impact of the changes. With the increased competition in the banking sector, the banking assets are raising at 40 percent a year, while liabilities rise at 45 percent a year (Banker 2004).

This paper provides clear indicator in conceptualizing and investigating the issues with regard to HRM. The paper has two aims. First, it intends to broadly sketch the issues involved with strategy, human resource, and performance in the Ukrainian banking sector. Second, it links strategy and HRM practices to the context of increased competition in the retail segment. Only when we understand these effects and approaches to HRM, the characteristics of a successful banking organization over the next several years can be mapped.

The next section reviews relevant literature on strategic human resources. Section 3 discusses strategies in the Ukrainian banking sector. Linking strategy with human resources is presented in Section 4, and finally Section 5 concludes; where appropriate, policy implications are discussed.

2. Strategic Human Resources

The literature in Strategic Management and organization theory has long argued that the fit between business strategies and organizational characteristics are a key determinant of organizational performance (Chandler 1962). It has been difficult to describe what constitutes a «fit» (Venkatraman 1989). The debate about what constitutes the «fit» has motivated the emergence of what has become known as strategic HRM. Strategic HRM holds that the set of policies and practices used to manage an organization's work force should be considered in the context of organizational strategy. Further, strategic HRM argues that a key criterion for evaluating effectiveness of personnel practices help the organization to meet its goals.

Most of the existing research in HRM considers the effects of HRM practices on individuals and their performance, that is, it takes a «micro» perspective on effectiveness. The strategic HRM requires shift towards a more «macro» perspective (Butler et al. 1991). Strategic HRM begins with the notion that HRM practices are the tools that organizations have at their disposal to achieve goals. Such practices include the following (see Table 1).

The HRM practices described in Table 1 shape the development of employee skills and competence, and they reinforce role behavior. The strategic HRM perspective suggests that practices vary across the organization because different strategies require different employee characteristics related to these behaviors and competencies, in order to be successful.

Table 1.

HRM: A Menu of Practices

S.I. No.	Area of Practice	Same choice available
1	Hiring and Selection	What should be criteria for selection?
2	Staffing	What should be the workforce level? Should there be a mix of full time, part time and contingent employees.
3	Compensation	Rules governing pay and pay raise, Pay level, Wage and Benefit structure.
4	Workplace governance	Extent of involvement of employee in decision making
5	Work organization	Job design, Organization structure

Strategic HRM practices also require that personnel policies and practices be considered as a system. Each individual practices have an effect on the organizational outcome only to the extent of their relationship to a broader set of practices. Strategic HRM is similar to system or configurational approach applied in the industrial relations questions. One of the recent widely used terms is the high performance workplace (Osterman 1994). Its proponent has argued that this system of HRM has the potential to bring competitive advantages to organizations that are able to manage it properly. There exist a number of components for the high performance workplace, and it should be distinguished from the context of high control workplace. Some differences between the two systems exist (see Table 2).

Table 2.

Difference between High Performance Workplace and High Control Workplace

S.I. No.	Practices	High Performance Workplace	High Control Workplace
1	Hiring and Selection	According to organization goals, mission and purpose	Based on market
2	Staffing	Commitment to employment security and benefit	Hire and fire policy
3	Training	Proactive	Reactive
4	Compensation	Group incentive, High pay	Individual incentive. Low pay
5	Workplace governance	Extensive employee involvement	Little employee involvement
6	Job Design	Flat organization	Tall organization, Narrow job

Strategic HRM suggests that organizations will adopt practices, which give emphasis on high commitment workplace to achieve strategic goals. One systematic question of interest is whether the high performance workplace is likely to help banks in Ukraine to achieve strategic aims. Another area is how to align the high performance workplace practices with strategic issues of the organization. One central problem is that there are large numbers of strategic issues that can be taken into consideration. An organization can have three types of corporate level strategies (Anthony et al. 1994). Organizations may pursue growth, they may seek stability, or they may defend a shrinking market. They

may also engage in some combination of these. Organizations can also have generic strategies based on the line of business they are into. Businesses may seek competitive advantages through cost leadership, product or service differentiation, and market segment focus.

3. Strategies in the Banking Industry

The National Bank of Ukraine has divided the Ukrainian Commercial Banks into four groups according to their asset composition (see Table 3). In the Ukrainian banking sector, the issues that may affect HRM decisions arise at nearly all levels by the various strategic frameworks.

Table 3.

Banking Structure in Ukraine

Group	Assets size (US \$)	Number of Banks
1 st	281-1.28 billion	10
2 nd	110-227 million	12
3 rd	39-97 million	34
4 th	3.7-3.8 million	101

Source: Baranovsky (2003).

At the corporate level, the strategic agenda is usually influenced by the ownership patterns of the banks. The banking sector of Ukraine is highly concentrated, with the top ten banks accounting for half of the total assets, credit and liabilities. Mergers between banks in the fourth group are one area, which is a matter of debate in the Ukraine banking sector. Another area has been the deposit front, the average deposit in Ukraine accounts for 9 percent of the GDP (See Figure 1).

Banks in Ukraine are emphasizing the greater role of the retail banking activity to attract more deposits. Ukrainian banks have started managing retail banking as a strong independent line of business, but this is not always the case. The recent expansion of loans and deposits has occurred on a commercial basis visible in rapidly declining interest rate spreads between loans and deposits (World Bank, 2004). In most of the Ukrainian banks, the role of retail banking operations is chiefly to generate low cost of funds for banks, and the lending activity in the retail segment have not picked up as compared to corporate lending.

Still in Ukraine retail operation is not seen in the same league as corporate and treasury banking activity. There is more activity in corporate and treasury banking area by banks as compared to retail banking activity. In addition to its contribution to a broader corporate aim, a retail banking unit of a bank may also have a competitive strategy of its own. An increasingly dynamic competitive environment can be seen in the retail banking services in Ukraine. Changes in regulations have given rise to an extensive increase in the number of new-generation private banks. New technologies of delivering financial services continue to develop rapidly. Banks in Ukraine are facing a variety of non-bank competitors; increasingly these other institutions are attracting investment funds and other product (e.g. Gold). This new environment will force banks to move to more entrepreneurial sales oriented practices if they are to continue and thrive. While every bank in Ukraine is trying to cut costs, banks in group 1 are doing it more aggressively than do the others. But in the Ukrainian banking sector, none of the banks has an explicit goal of being the lowest cost provider².

Further, there exists a consensus that true differentiation is nearly impossible to achieve in the banking services. There are many reasons to it, but one of them can be that competitors could easily imitate banking services and there are very low barriers to introduction of new products. Some typical initiatives undertaken by the banks in group 1 and group 2 are the following:

- a) Being a «one-stop» financial service provider;
- b) Aggressive selling to new customer;
- c) Aggressive cross selling of new products to existing customers;
- d) Establishment of alternative channels for delivery of banking services;
- e) Development of a reputation for highest quality service.

These sorts of initiatives are not, at least in principle, exclusive. While one organization might pursue none or another may be pursuing many or all of them.

4. Linking Strategy and HRM

Each strategy may in turn imply its own necessary imperatives for human resources. By focusing on individual aspects of organizational strategy, one can ask whether a particular set of HRM practices serve to develop competencies and reinforce behaviors that move an organization towards strategic goals.

² This can be due to various reasons like regulatory norms and holding pattern of Banks. Another factor include the extremely low income of prevailing majority of Ukraine (64 US \$ per capita in Dec 2002), low level of public trust in banks and last not the least no reliable system of bank guarantee (only 300 US \$ dollar is guaranteed). These factors make it difficult for banks to attract deposits and, at the same time, reduce cost of operation.

Most of the Ukrainian banks' retail operations are based on the strategies aimed at gaining the market share by selling savings accounts to customers. Here, the strategic HRM perspective suggests that banks will be successful in achieving their goals in this area if their HRM practices are more consistent with the goals.

The banking organization which gives more emphasis on having the right staff training programs, giving emphasis on sales, incentive pay and performance appraisal system, as well as job design which allows for customer satisfaction, ought to be more successful compared to the other banking organizations. This approach also helps to pick out the approaches that are likely to be unsuccessful. Those that generate behavior that would tend to frustrate strategic goals or those that fail to develop the competencies necessary to achieve strategic aims will have negative effects on performance.

Usually organizations do not follow one strategy at a time, they will be following a combination of strategies, at that time deciding on what sort of HRM practices ought to work best is quite confusing. The desired behavior and competencies begin to accumulate and, in some cases, to conflict, resulting in a conflicted jumble of hiring and selection criteria, training program, staffing program, and compensation policy. It is very difficult to suggest a model of strategic human resources in the context of growing importance of the retail banking activities of banks and business strategies for the retail bank activity. Some strategies can be elaborated for banking organizations (see Table 4).

A banking organization can have much possible strategic combinations. For instance, «growth through diversification», where the retail banking activities are the key element (such as selling insurance product to customer) are realized through its high quality delivery. Each banking organization should have few easily identifiable clusters of strategy, which makes them easy to match HRM and banking organization strategy.

Table 4.

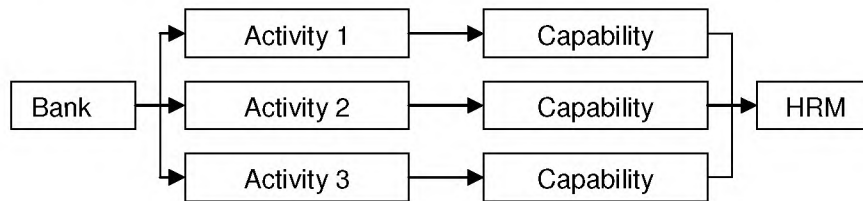
Some Strategic Issues in the Ukrainian Banking Sector

S.I. No.	Corporate Strategy	Role of Retail Banking Activity	Retail Strategic Initiative
1	Growth through acquisition	Independent profit center	High quality service provider
2	Growth through diversification or vertical integration	Generator of funds for corporate activity	Alternative channel of delivery
3	Stability or growth in existing markets	Building trust in customers	Emphasis on sales activity

The multiplicity of possible strategic combinations that the HRM practices might fit suggests that it requires a broader approach to matching HRM to strategic goals. Instead of describing the strategy and fit HRM, the Ukrainian banking organizations have to focus on capabilities with regard to each operating activities and fit HRM (see Figure 2).

Figure 2.

Strategic Approach to HRM in the Ukrainian Banking Organizations



Retail banking activities of the banking organization are highly susceptible to direct influence of managerial practices. The most important activity of retail banking operations is to create value for the customer.

Ukrainian banking organizations have taken many initiatives to create value for the customer in the retail banking operations. Some typical initiatives are:

- a) Banks are seeking to provide customer with convenience, delivering service quickly and in variety of times and places (such as introduction of 24 X 7 days banking and ATMs).
- b) Banks are seeking precision in delivering service and responding to inquiries as accurately as possible (such as opening of call centers).
- c) Cost efficiency to be competitive (not going for extensive branch expansions).
- d) Adaptable to the demand of the market and environment (such as changing ATM cards to debit cards).

Banks should assign different weights to goals and use different combination of strategies. In general, banking organizations in Ukraine have to reshape HRM initiatives by using the following:

- a) Control Model

- b) High Performance Workplace
- c) Practices based on strategy and environment

(a). Control Model

The basic aim is to reduce cost jobs; also jobs and hierarchy are well defined. Here, emphasis is given to accountability. Banks have the advantage of keeping tight control over labor cost, which satisfies one of the fundamental strategies in retail banking segment.

(b). High Performance Workplace

One of the key elements in the retail banking activity is to serve the customer more effectively by emphasizing on customer service delivery process. HRM is the key element in improving the performance of the delivery process in the retail banking. The organization has to train and commit workers of the retail banking activity, so that workers can seize opportunities to cross-sell services to customers: Banks have to train workers to adapt quickly to new technology and organizational change. In the end, the bank has to invest heavily in human resources in order to improve the performance of the retail banking activity.

(c). Practices Based on Strategy and Environment

Here, a banking organization has to derive HRM practices on the basis of values derived from capability that is the outcome generated by the practices. Suppose, for example, certain customers in Ukraine retail banking are highly sensitive to inconvenience and imprecision, but are willing to pay a higher cost. So banks have to align its HRM practices with outcomes of this activity. For the retail banking, as the service industry, the best practices are those that generate high level of convenience and precision.

Each approach has its own benefit; in the Control Model, the banks can vary the workforce size of retail segment operations to meet cost consideration and customer expectation. Though High Performance Workplace strategy is too costly, it would be no more costly, perhaps less costly, than the Control model as savings would be realized through fewer mistakes and rework, better teamwork and cooperation, higher productivity per employee. The last approach (HRM practices based on strategy and environment) has an important implication. If different systems produce different outcomes, then an organization should follow the HRM system that best suits organization's strategy and environment. For instance, maintaining tight control over cost while seeking opportunities to cross sell.

Ukrainian banking organizations need to understand this aspect of fit between organization strategy and HRM practices in the context of increased competition because of the two reasons. First, the extent of how different HRM systems affect different outcomes is not clear. Second, there is a lack of consensus on what the customer value in retail banking is, how much the customers are willing to pay for it, and the value an additional customer is adding to banking

organization. Banks in Ukraine, in fact, are in the middle of developing different retail strategies based on their benefits about the answer to these questions.

5. Conclusion

Generally, the key question is the relationship of HRM to performance outcome. This needs to be investigated both with respect to detailed strategic goals in the context of capabilities that are important to the organization. In banking, the uncertainty lies both in understanding the potential value of business strategy and in quantifying what sort of outcomes different HRM systems will produce. The first goal of strategic HRM research must be to understand different capabilities and its outcomes that are associated with different clusters of HRM practices. Further empirical study has to be undertaken in Ukraine in the context of understanding the link between strategy, HRM and performance. It remains important to consider the practices in the context of the system rather than the individual.

Everybody understands how the jobs are designed, how the pay systems are structured, and the like. The real issue here is: can an organization follow a hybrid of high-performance and control-based practices that contribute to its performance? Successful organizations in the future have to maintain multiple systems governing different employees within job families. Corporate strategic issues may also influence the time horizon available to retail banking activity. High performance workplaces require investment in human resources but do not immediately generate corresponding valuable capabilities. It seems possible that in a less turbulent climate we might see more investment in human resources. Current pressure to contain costs in the immediate short run however leaves retail banking operations in a difficult position. Even if organizations find their strategic needs best served by the capabilities generated through investment in their workforces, they may not be able to make such investment.

HRM must not only be considered in relationship to corporate and business strategy but also to technology and service delivery processes. Information Technology and intelligently designed (or reengineered) processes have potentially enormous effects on the ability for banks in retail segment to meet consumer needs at lower cost. Do certain links of HRM suit different technologies? Put another way, does the effectiveness of technologies and processes in driving performance depend at all on HRM? This is one of the core issues that banking organizations need to address.

Finally, it is worth remembering that HRM practices do not function solely to serve strategic goals. The choices of particular HRM practices may reflect organizational power, politics and institutionalized norms of best practices as much as they reflect the strategic goals or performance imperatives.

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