

## **Small Banks Compositional Strategic Transformation Framework and Implementation Measures Composition-Based View**

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**Abstract:** *In view of the status quo of small banks in China, the study put forward a strategic transformation framework for them based on the perspective of Composition-based View which provides a new strategic transformation path. Moreover, the appropriate measures that proposed for the implementation of small banks in transition provide a new way of thinking. Entrepreneur ability and collaboration-oriented are internal drivers of banks to implement the strategy while availability of external resources and customer demand are external drivers. According to the framework of the compositional strategic transformation, compositional strategy can be implemented by banks via compositional-offering and compositional-competition.*

**Keywords:** *Composition-based View, small banks, strategic transformation*

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### **1. INTRODUCTION**

With the globalization of financial markets and the rise of cross-border M & A wave of finance, banks in China facing increasingly fierce competition. The new operating environment brings new challenges to banks', especially small and medium banks' operating capacity, resilience, risk control ability and creativity. Therefore, only a more in-depth thinking about the direction of its strategic transformation, can Chinese small banks gain the upper hand in today's competitive business market.

Reviewing the studies on strategic management, the theory of market structure which represented by Porter (1980) believed that overall cost leadership, differentiation and target concentration strategy are the three basic points of firms in gaining competitive advantage. Nonetheless, the resource-based view (RBV) proposed that enterprise's resource can bring a competitive advantage (Wernerfelt, 1984). However, Prahalad and Hamel (1990) pointed out that organization can obtain a sustainable competitive advantage only when the core competencies meeting unique, idiosyncratic, tacit, and inimitable. On the basis of these studies, Newbert (2008) further emphasized that any organization is a unique combination of resources and capabilities, this uniqueness is the cornerstone of corporate strategy and excess profits. Therefore, we can find that previous studies on strategic management emphasized building core competencies that are heterogeneity and immobility. However, compared with other big banks, small banks do not possess unique, idiosyncratic, tacit, and inimitable resources. Thus, the compositional strategy, which is based on the "Composition-based View", provides a new perspective for the small banks in transformation.

"Composition-based View" was first proposed in 2012 by Professor Lu, it point out that the view of core competencies directly bring competitive advantage is doubtful, because core competencies alone can't compensate for the lack of other capabilities (Lu et al., 2013). Therefore, firms with compositional capability, although with weaker core competencies, have a faster speed of integration, higher productivity, and cost-effective products, finally obtain competitive advantage. In this strategic perspective, small banks can pay more attention on customer needs under limited resources, and compete with powerful opponent with a smaller cost and faster speed.

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## **2. COMPOSITIONAL STRATEGIC TRANSFORMATION FRAMEWORK**

### **2.1. External Driving Factors**

#### *2.1.1. The Liberalization of Interest Rate is Fast*

The liberalization of Interest rate will urge banks to use legal price to compete. However, the rise of irrationality of deposit interest rates will lead to the indiscriminate price war between the financial institutions and then bring a huge shock to medium and small banks (Li et al., 2013).

#### *2.1.2. The Impact of Big Data Era is Huge*

In the age of the Internet, the boundaries of banking and other commercial activities increasingly blurred. Thus, the deeper integration of Internet and banking requires banks have higher IT support and risk management & control capabilities (Tian, 2014).

#### *2.1.3. The Individual Financial Needs are Surge*

Due to increase in personal family income levels, customer financing options are becoming more diverse. The traditional business of small banks has been unable to meet the needs of businesses and individuals, and further require small banks to provide a wider range of financial services (Chang, 2012).

Changes in the external environment for small banks are both challenges and opportunities. On the one hand, the promoting of liberalization of interest rate give a chance to small banks to gain interest rate spreads get through dual-track interest rates. On the other hand, the availability of IT outsourcing can meet the banking needs of IT support. Therefore, accessibility of external resources such as capital and technology, changes in individual (or business) needs are two important external factors that drive small banks adopt composite strategy.

### **2.2. Internal Driving Factors**

#### *2.2.1. Smaller Service Area & Weaker Anti-Risk Ability*

Compared with big banks, small banks' businesses are seriously limited which hindering the development and innovation of banking business. In addition, the smaller service area and the weaker anti-risk ability are limiting factors of small banks (Guo, 2012).

#### *2.2.2. Basic Management is Weak*

With the development of the financial Internet, information technology is more and more widely used in daily business in banks. However, due to the few talents and limited investments in technology, information technology and IT almost become short boards of small banks (Chang, 2012).

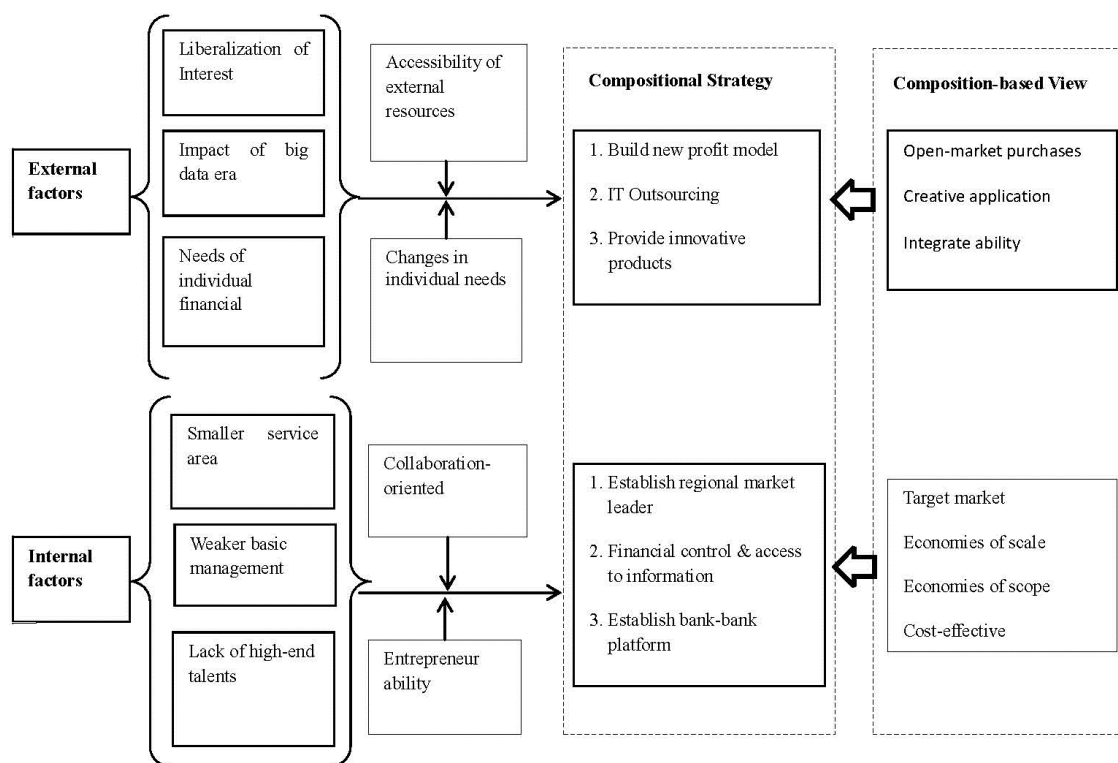
#### *2.2.3. The High-End Talents are Lack*

Small banks need to recruit more creative and complex business talents and improve the internal system that staff can give full play.

Although small banks have some certain problems, there still exist some advantages. Firstly, small banks are flexible enough to satisfy customers, which we called entrepreneur ability. Secondly, in the service area, small banks also can cooperate with other financial institutions. Therefore, entrepreneur ability and collaboration-oriented are two key internal factors that drive small banks adopt composite strategy.

### **2.3. Compositional Strategic Transformation Framework**

In summary, accessibility of external resources and changes in customer demand are two important external drivers of small banks adopt composite strategy. First, small banks can obtain funds through cooperation with big banks and then gain a new profit growth point by lending funds to businesses (open-market purchases, creative application); Second, IT services (such as information systems development and maintenance and so on) can be outsourced by banks (creative application, the unique ability to integrate). In terms of external financial needs, small banks can provide personalized service for target customer groups via imitative innovation (imitative innovation).



**Fig1. Framework of Compositional Strategic Transformation**

Entrepreneur ability and collaboration-oriented are two key internal drivers of small banks to implement the strategy. First, small banks should enhance their innovation capacity and entrepreneur ability, and take appropriate strategy according to the customer needs and market resources (target market). Moreover, banks can play an efficient control on funds by taking advantage of its structural and quick access to information using the geographical environment (economies of scale, economies of scope). Second, banks can achieve integrated management and inter-regional development through cooperation with other banks (economies of scope, cost-effective).

According to the above discussion, the framework of the compositional strategic transformation of small banks can be built as figure 1.

### **3. IMPLEMENTATION MEASURES OF COMPOSITIONAL STRATEGY**

Implementation measures of compositional strategy for small banks to achieve compositional competition are mainly depending on using compositional capability to practice compositional offering. Small banks can achieve their goals through the following measures.

#### **3.1. Compositional Capability—Compositional Offering**

##### *3.1.1. Focus on Retail Business and Integrate their Products and Services*

Retail business is the main business of small banks so that banks they should strengthen the construction of the retail business reputation. Simultaneously, banks should pay attention to provide personalized products and adjust their products according to the preferences of customers.

##### *3.1.2. Seed Up their Business Innovation and Offer a Variety of Products & Services*

On business, small banks can provide financial advisory services and develop new projects (such as Investment Bank, Agent Service etc.). In terms of services, small banks can use compositional offering, such as targeted services and service differentiation for high-end customers.

##### *3.1.3. Initiate New Business and Conduct New Ways of Cooperation*

Banks cooperate with other financial institutions can get more technology, customers, channel resources and management support etc.

### 3.2. Compositional Capability—Compositional Competition

#### 3.2.1. Develop Internet-Enabled Businesses

Small banks can explore business model of Financial Internet to develop business such as Financial Internet, direct bank etc. Banks should ensure time synchronization with information and establish electronic “bank outlets” and “bank counter” expeditiously so that they can provide 24-hour services for customers.

#### 3.2.2. Using Integrated Manage

Not only can integrated management reduce operating costs and operating risk, but also improve the service efficiency and profits. Therefore, In order to achieve compositional competition, banks should focus on the development of business, such as financial lease, bond, insurances, trusts and funds.

#### 3.2.3. Adopt Technology Outsource and Build Wisdom Bank

Through technology outsourcing and building wisdom bank, small banks can reduce operating costs and improve efficiency. In addition, banks can optimize the user interface to achieve compositional competition.

The implementation measures of compositional strategy are showed in figure 2.

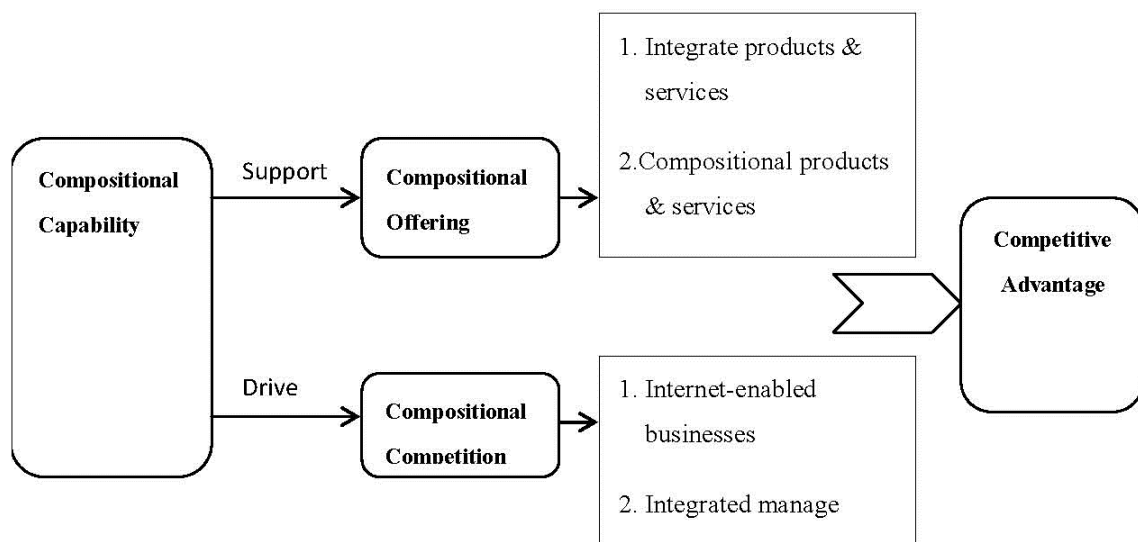


Fig2. Implementation measures of compositional strategy

## 4. IMPLICATIONS AND LIMITATIONS

This paper analyzed the current situation of small banks in China and then built a strategic transformation framework based on the perspective of Composition-based View in order to provide a new strategic transformation path for small banks. In addition, the study put forward some implementation measures of compositional strategy according to the transformation framework. Using compositional capability, small banks can achieve compositional offering through the following measures. Firstly, focus on retail business and integrate their products and services. Secondly, seed up their business innovation and offer a variety of products & services. Thirdly, initiate new business and conduct new ways of cooperation. Finally, Small banks can achieve compositional competition by developing Internet-enabled businesses, using integrated manage, and adopting technology outsource and building wisdom bank.

Both the implications and limitations of the study suggest many topics for future research. For instance, although small banks have similarities in scale and technologies, there are differences for specific banks. Therefore, small banks should take a different approach to implement the compositional strategy according to their own resources, technologies and organizational characteristics. Another limitation is the dynamic external environment. Small banks should adjust their composite resources and methods according to the time and national policy.

Future research could go a step further to perfect compositional strategy. On the one hand, researchers can explore the ways and means to implement compositional strategy in different bank. Research can also expand the strategy to other industries and drawing the boundary conditions suitable. On the other hand, researchers can test the framework by empirical research and put forward the way to implement strategy for specific banks.

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