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# India's Best Banks

**The foreign banks are there, as are the new private banks, but this year's BT-KPMG Best Banks survey is notable for the comeback of the PSU pack.**

By Roshni Jayakar

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|---|---|
| 1 | HDFC BANK |
| 2 | Corporation Bank |
| 3 | Standard Chartered Bank |
| 4 | State Bank Of Patiala |
| 5 | The Jammu & Kashmir Bank |
| 6 | ABN-Amro Bank N.V. |
| 7 | City Bank N.A. |
| 8 | Oriental Bank Of Commerce |
| 9 | Hongkong & Shanghai Bank |
| 10 | Andhra Bank |

If Indian industry has confidently hit the growth trail, that pick-up in activity is best reflected in the banking sector, which after all is as candid a mirror of a country's economy as you could ever find. And as the 10th BT-KPMG annual list of India's Best Banks reveals, most of India's financial intermediaries have been keeping pace with the deepening market economy, riding the opportunities that come along with reforms even as they brace themselves for increased competition-both foreign and private-by strengthening prudential norms and leveraging technology to ensure that the growth engine hums smoothly along.

Of the 56 banks ranked this year (another 30 with five branches or less have been ranked separately), five of the top 10 have it made it the honors list of top 10 banks for the last three years in a row. Yet, the roster of names isn't exactly predictable. True, you'd expect the superior asset quality of the large foreign banks to polevault them into the top half of the list, but the new private banks as well as some of their good old public sector counterparts are standing up to be counted. What also paints a better picture for the banking industry-more so for the public sector-is the robust retail growth notched up in 2002-03, accompanied by structural reforms in the banking sector, right from branch and manpower rationalisation to foreclosure and asset reconstruction legislations, which have started bearing fruit.

**The big Story**

So what does this year's BT-KPMG Best Banks survey throw up? The biggest story of this year's ranking is the comeback of the PSU banks. For the first time in 12 years, there are all of four PSU banks amongst the top 10. And 12 in the top 20. The corresponding figures last year were three and 10 respectively. Corporation Bank (#2) and Oriental Bank of Commerce (# 8) remain among the top 10, but it's the surge of the relatively smaller PSU banks like Andhra Bank, from #27 last year to #10, and State Bank of Patiala, to #4, that's fascinating. Andhra Bank has shown enormous improvement in its working in the recent past and the bank seems to have taken cognisance of the new market dynamics to renew its strategies. The largest bank, State Bank of India, has slipped to #19 from #10.

The new #1 bank is HDFC Bank, the new private sector bank, climbing up a notch from #2 last year. The bank has made steady progress up the listings, from an inconspicuous #12 in 1996-97 to #1 in 2002-03. The thrust on retail on both sides of the balance sheet continued to gain momentum, thereby allowing the bank to grow as well as to expand margins. Moreover, despite the shift to NPA recognition norms of less than 90 days, the bank's NPAs as a percentage of net advances is 0.4 per cent.

### Slips and Slides

Unsurprisingly, four large foreign banks, Standard Chartered (#3), ABN Amro ( #6), Citibank (#7) and HSBC (#9) are hogging the top slots. A little surprisingly, however, last year's top dog ABN Amro has skidded to #6, and Citibank has slipped three notches.

You will find that though these large foreign banks have better productivity ratios relative to most of the Indian banks, the reason for the slide of these banks is the intense competition from new private sector banks and some of the nimble public sector banks in retail lending. These four large foreign banks with a full service presence across all products account for over 70 per cent of the total assets of all the foreign banks in India.

**Top Ten Banks**

**(Less Than Five Branches)**

**Deutsche Bank AG**
**JP Morgan**
**Bank Of America NT & SA**
**Mashreq Bank PSC**
**Barclays Bank PLC**
**The Bank Of Tokyo-Mitsubishi**
**China Trust Commercial Bank**
**Arab Bangladesh Bank**
**Cho Hung Bank**
**Toronto Dominion Bank**

In a separate listing of 30 foreign banks with five branches or less in the country, Deutsche Bank remains at #1, but there are some smaller foreign banks that have been affected by impaired assets on account of credit concentrations, or reported losses on account of low operating revenues and consequently moved down in the ranking.

Among the old private sector banks, The Jammu & Kashmir Bank stays put at #5, aided by the margin expansion and asset growth that have been driving profits. Improved asset quality is also helping the bank reduce its provisioning requirements. Then there is Karur Vysya Bank (#16), which was started in the textile belt of Karur in the South and has since changed its profile completely, again through a retail thrust. Some of these old private sector banks are likely acquisition targets, as is evident from ING Group's increasing its stake in Vysya Bank from 20 to 44 per cent or the amalgamation of Nedungadi Bank with Punjab National Bank.

Life for the bottom-trawlers continues to be tough. These banks have little hope of finding their way up as long as their sticky assets keep growing year after year. You have Global Trust Bank #50, Dena Bank #52, and Dhanalakshmi Bank #54. Almost all of these banks are faced with serious asset quality problems requiring large amount of provisioning. They have no choice but to shape up or be taken over.

**HDFC**

## Simply The Best

**Quality is a recurring mantra at HDFC Bank, which is evident in its earnings, deposits base, credit profile, and growth rate. That's why it's India's Best Bank.**

By Narendra Nathan

Quality may be one of the more abused buzzwords in the corporate world of product and service delivery, but then when you're talking about India's No 1 bank, it's easy to see the correlation between the top dog status and the quality mantra-which is a recurring theme amongst the bank's executives, whether they're talking quality credit, or quality deposits, or quality earnings or, to sum it all up, quality growth. That's one big reason why the stockmarkets adore this counter, which is evident in the unabashed praise equity analysts are willing to shower on HDFC Bank. "It is a unique bank, in a sense that it is focused not just on growth, but on quality growth," says Rajat Rajgarhia, Head (Research) at Motilal Oswal Securities.

One of HDFC Bank's most notable features is that it's still one of India's fastest growing banks, even after reaching a balance sheet size of Rs 30,000 crore. And there's little reason why this trend won't be maintained. The growth isn't just reflected on the retail side-which grew by 131 per

cent during the quarter-ended September 30, 2003-but is amply visible on the wholesale front as well, which has been growing consistently in the 10-15 per cent range. "With the expected economic recovery that growth rate should accelerate now," points out Aditya Puri, Managing Director, HDFC Bank. As its overall marketshare is still at low levels (around 2 per cent), this optimism seems justified.

If you're still wondering what "quality growth" means, it's just that HDFC Bank has been growing rapidly without compromising on asset quality. To be sure it scores high for its low net NPAs (non-performing assets, and these are expressed as a percentage of net advances) and loan loss cover. This is because of the strict risk control mechanisms in place, one amongst them being an internal rating model. "We have our own rating system based on the S&P 500 rating model and lending is done based on that," explains Samir Bhatia, Country Head (Corporate Banking). Though HDFC Bank decided to adapt the new NPA recognition norm (a reduction in the outstanding period from 180 days to 90 days) from the second quarter of the current year as against the regulatory deadline of March 31, 2004, its net NPAs are still low at 0.37 per cent. "Our general loan loss provisions are also around 0.90 per cent against the regulatory requirement of 0.25 per cent," says Paresh Sukthankar, Head (Credit & Market Risk).

**Quality Of Earnings**

If HDFC Bank has been able to rein in NPAs, it's thanks in no small measure to the quality of its earnings, which are less volatile than many banks. That's because HDFC Bank has well diversified income streams and is not dependent on any one segment for spectacular profits. For example, it has a high and sustainable fee income (as a per cent of total income) and is placed at eighth position (after most foreign banks). And unlike most other banks, HDFC's high profits aren't courtesy treasury income. For example, the security gains are only 7 per cent this year (for the first half) compared to 10 per cent last year. That's conservatism, HDFC style. "We have taken a deliberately less risky strategy and kept our duration (for SLR investments) at two and a half years," points out Sukthankar.

What this essentially means is that HDFC Bank will be less vulnerable if the interest rates start moving up from current levels.

HDFC Bank has also consciously kept its cost of funds low (the bank is ranked No. 3 on this parameter) by focusing more on demand deposits (savings and current accounts) as against time (fixed) deposits. Several initiatives like banking anywhere in India, internet banking, phone banking, and a far-flung ATM network have played their part. "We have changed the notion that only foreign banks could deliver good services. The focus is to show to the retail depositor that we have a better savings/current account and that's helped us acquire high quality customers," says Neeraj Swaroop, Country Head (Retail Banking). That's why HDFC Bank can boast of a customer base of around 35 lakh, of which 25 lakh are demand accounts. "And we are adding around 1 lakh accounts a month," sums up Swaroop.

Another roaring revenue stream for HDFC Bank is a cash management system for stock exchanges and large corporates. In fact, the bank is one of the largest movers of money in the country. Settlements at stock exchanges-where it handles both cash as well as securities-are big business for HDFC Bank. "Now around 65 per cent of NSE and 50 per cent of BSE settlements are happening through us," points out H. Srikrishnan, Country Head (Transactional Banking & Operations).

As HDFC Bank presses hard on the growth throttle, the challenge for Puri is to continuously dig up new revenue streams in a bid to maintain the heady pace of growth.

A year ago, for instance, he flagged off supply chain management for large corporates, a unique technology-backed product that enables HDFC Bank to cater to all customers (from top to bottom) in a supply chain. This product allows for instant money transfer between a company and its clients (vendors or dealers). Thus, by signing up a large manufacturing company, it can

expand its clientele to include the multiple vendors of raw materials to the company, as well as the large number of dealers and distributors. ''Companies benefit from this product and they in turn help us get new customers,'' explains Bhatia.

**Filling The Gap**

If there was one glaring gap in the HDFC Bank portfolio, it was housing finance. For obvious reason: It didn't want to compete with its parent HDFC, the pioneer in home mortgages. That hole, however, has finally been filled up, with the bank marketing HDFC's home loan products, thereby allowing HDFC Bank to offer the customer the entire gamut of products and services.

Puri claims it's a win-win proposition. ''We have a good marketing network and HDFC has a good product.'' Here's how it works: Depending on market conditions, HDFC Bank will receive a commission (around 65-70 basis points currently) for originating the transaction. The bank has the right to get back 70 per cent of this housing loan as mortgage-backed securities.

These securities will carry the interest of home loans less 1.50 per cent. But will this arrangement hurt margins, in the light of the prevailing low interest rates for housing loans? "We still have enough margins there. Further, the option to buy or not is also with us," explains Puri.

Another growth area the managing director is chasing is the government business. HDFC Bank was the first private sector bank to get permission to collect direct taxes (income tax) on behalf of government. ''We have improved the collection by reducing the turnaround times from seven to eight days earlier to four days,'' says Puri.

That explains why HDFC Bank is at third position (after SBI and RBI) in this business. Puri adds that with the government allowing HDFC Bank to collect indirect taxes as well, this is one activity with huge growth potential.

What should help HDFC Bank dig its heels further into a nationwide network is the ATM-sharing alliance with SBI that's in the pipeline. Srikrishnan reveals that the interlinking process is under way, and it won't be long before HDFC Bank gets linked to SBI's 2,000-strong ATM network. Without SBI, HDFC Bank currently has 850 ATMs, and it's easy to see what the SBI alliance can do to Puri's reach.

HDFC Bank may have been one of the later entrants into the retail space, but it's playing catch-up pretty well. In credit cards, the bank has clocked 3.40 lakh customers, as against the leader Citibank, which boasts an 18 lakh base. Puri expects the credit card business to break even in the third quarter of 2004-05, but what the HDFC top brass is more enthused about is the credit quality of customers. ''As 70 per cent of our card holders are existing customers, the credit quality here is also very good,'' smiles Sukthankar. That's testimony yet again-if you aren't yet convinced-to the relationship between a tireless quest for quality and HDFC Bank surfacing as India's best bank.

## The Public Sector Strikes Back

**They've come back, and how! Four of the top 10 and 12 of the top 20 in the BT-KPMG best banks' survey are from the much-maligned public sector.**

By Roshni Jayakar

For long, they've been the favourite whipping boys-for analysts, for their private sector rivals, and also for their own customers! A few years ago if anybody was to tell you that India's public sector banks (PSBs) would soon be in a position to match their foreign and private counterparts, you'd probably dismiss them as some loopy relic from pre-liberalisation history. But let's say it loud and

clear: The PSBs have come back-and with a bang. Don't laugh (or worse skip the article), even if you are an ardent admirer of the new private banks like HDFC Bank or ICICI Bank. Just take a look at the numbers. The PSBs have bagged four of the top 10 slots and 12 of the top 20 in this year's BT-KPMG bank ranking, up from one PSBs that made to the top 10 and four to the top 20 in 1999-2000. For the first time in the last 12 years of this survey there are so many PSBs on the top, the territory so far straddled by the foreign and private banks.

At the top of the charts are not the leviathans among the PSBs, but the mid-size PSBs. Corporation Bank has grabbed the second position among the best banks (#6 in 2001-02 and #1 in 1998-99). In terms of size it is the 15th largest bank, and it has clocked a scorching pace in growing business with use of technology, in the process boosting profitability and building quality assets. At #4 is State Bank of Patiala. This State Bank of India associate scores high on operational efficiency and quality of earnings parameters. The Hyderabad-based Andhra Bank has climbed up from #17 last year to #10 by improving the quality of earnings and profitability. The larger ones like Punjab National Bank, Bank of Baroda and Union Bank of India have climbed up a few notches.

Have these banks done something rather extraordinary? Explains K. Cherian Varghese, Chairman and Managing Director (CMD), Corporation Bank: "We have been taking some initiatives over the last few years." By trimming operational costs, upgrading technology and customer service standards as well as increasing the share of non-interest income, most PSB CMDs have succeeded in improving the competitiveness of these banks. Higher treasury gains have also gone a long way in cleaning up their balance sheets, and recovery has become eminently possible thanks to the introduction of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, and a new corporate debt restructuring mechanism.

**The Tech Edge**

One of the favourite buzzwords of PSBs chairmen these days is core banking solutions, which involves centralising the transactions of branches and different banking channels. Several PSBs have been installing core banking software to improve their competitiveness and service levels to match the standards set by the new private sector banks. Says S.S. Kohli, CMD, Punjab National Bank, one of the more technology-savvy PSB honchos: "Besides helping in improving customer service, technology has also facilitated better housekeeping and cost reduction." Punjab National Bank has wired 300 branches and with the implementation of CRM through use of data warehousing the bank expects to add value to the customer as well as maximise opportunities for cross-selling.

At State Bank of India, 1,500 branches are networked and 7,500 branches are computerised. Next part of the plan is to put 3,000 branches on a single window delivery system by March 2004. Says A.K. Purwar, CMD of State Bank of India, the 98th largest bank in the world: "SBI is striving to achieve global benchmarks set by the best international banks and technology will help us achieve this." McKinsey & Co. is advising SBI in setting up new processes, cutting down avoidable processes, reducing costs and improving services. In the next six months, the bank has plans for huge investments in technology. At Corporation Bank, the Chairman admits that computerisation has helped the bank take on voluminous transactions in the retail sector. For instance, early this year, nearly 2.5 lakh new savings accounts were opened in two months.

While the pace of technology upgradation may be different with PSBs, the underlying trigger for the urgency is competition. That's why technology is the mantra even for mid-size PSBs. Points out A.K. Das, Managing Director, State Bank of Patiala: "We have fully computerised all bank outlets in January this year." According to nasscom, the banking sector spend on information technology was $534 million in 2002-03 and is growing at the rate of 25 per cent per annum. Says Varghese of Corporation Bank: "With technology on a par with new generation banks, we will be a force to reckon with as there is a security association with PSBs."

**Retail Thrust**

From a situation in the nineties when only the large foreign banks were synonymous with retail products like auto loans, credit cards and personal loans, the PSBs have done well to learn the new rules of the game by adopting retail as their new spearhead for growth. With corporate credit off-take sluggish and investment demand almost zilch, PSBs have had to rework their lending strategies. Admits Purwar of SBI: "Most of our credit growth has been driven by retail segment, which is young (and which means that the scope for growth is immense) and NPAs are relatively low." That's a sentiment echoed by Kohli of PNB. "Retail lending leads to a better risk dispersal." PNB has shown a 43 per cent growth in retail lending in September 2003 on a year-on-year basis and it constituted 18 per cent of the total credit.

For a large number of PSBs, home loans are proving to be the key drivers. Nearly 87 per cent of the retail assets of Oriental Bank of Commerce (#8) are home loans and State Bank of Patiala has opened specialised housing cells at select branches for housing loans. That doesn't mean these banks aren't aggressive in marketing other retail products. SBI has been bombarding consumers with more than one new retail product every month.

Tie-ups with auto manufacturers like Maruti and with tractor manufacturers too are being resorted to, thereby expanding the auto loan pie. The SBI Group has been targeting the service sector including healthcare, education, wholesale and retail trade and tourism in an aggressive manner. Products include SBP-Shikshak for teachers, SBP-Vijeta for defence personnel, SBP-Abhiyata for engineers and architects, and SBP-Nyaya for judiciary. Then there is Andhra Bank, which opened its retail book two years ago by launching what it calls "high voltage branches" to focus on consumer loans.

### Better Bottomline

Which so much going for them, the step-up in profitability in 2002-03 was perhaps inevitable. A major contributor to the overall profit growth has been treasury income, fuelled by a steady decline in interest rates and the consequent profits on sale of investments. Nevertheless, according to a study by credit rating agency CRISIL, the increase in the PSBs' core profitability has been driven by the widening of interest spreads on account of the relatively higher decline in deposit costs against the fall in yields, and this trend is likely to come under pressure in the medium-to-long term. The interest on advances would be under pressure due to the difficulties of maintaining yield in the lending business in an increasingly competitive business environment.

The banks' ability to keep re-pricing their deposits to the extent seen in 2002-03 seems muted given the increase in competition and the limited potential for interest rates to fall further relative to yields. Points out Ritesh Maheshwari, analyst, CRISIL: "Banks that are able to find an effective niche in the asset risk spectrum and maintain a tight leash on expense levels would move ahead in the race to maintain and enhance their core profitability."

All said and done it's been a good run for PSBs. But in the longer term, will they be in a position to make the new generation banks sweat? Not all the 26 of them for sure. You still have the likes of Dena Bank (#52), languishing at the bottom of the ranking weighed down by its huge NPAs. Says Purwar of SBI: "Those who invest in technology, look after business processes, are nimble footed and able to expedite the credit recovery process will be able to give some of the new generation banks a run for their money. At SBI, we are preparing strongly to be second to none in this country." Brave words those. And certainly not the last ones in the great battle for a share of the Indian consumer's rapidly-bulging wallet.

## The Thrust on Technology

### State Bank of India

Has networked 1,500 branches and computerised 7,500 branches on intermediate technology. The group has an ATM network of 2,100 ATMs and has engaged McKinsey & Co. for new business processes.

**PLANS:** Will computerise 9,000 branches and put 3,000 on single-window delivery by March 2004.

### Punjab National Bank

Has computerised 3,200 branches and is implementing a core banking solution that provides for anytime, anywhere banking and internet banking in 300 branches. Has installed 300 ATMs and entered into ATM sharing arrangements with four other banks.

**PLANS:** Will network 500 branches by March 2004 and 1,550 branches by March 2005.

### Corporation Bank

Has computerised 476 branches and 77 extension counters. About 93.9 per cent of the bank's business is handled by computerised branches and ECs. Has 350 ATMs and is adding 125 more.

**PLANS:** Will spend Rs 250 crore to further enhance customer convenience.

**Interview with Y.V. Reddy Governor/RBI**

## "There Will Soon Be Consolidation In The Financial Sector"

**O***n November 3, 2003,* **Yaga Venugopal Reddy**, *Governor of Reserve Bank of India (RBI), presented his maiden monetary and credit policy. The policy, though not dramatically different from that of his predecessor since interest rates have remained unchanged at 6 per cent, seeks to move the central bank's focus away from merely managing liquidity and emphasises the need to offer special credit delivery mechanisms to small-scale industries and agriculture. The 60-year-old Reddy, who is known to be a man obsessed with details, is only too aware of the limits of the monetary policy in an economy such as India's and is keen to bring the longer-term structural issues to the top of RBI's agenda. Reddy talked to* Business Today's Roshni Jayakar *on the need for continuity and change in the central bank policies. Excerpts:*

**Your policy statement seems to be a continuation of RBI's earlier stance. The decision to maintain status quo on interest rates seems to reflect a wait-and-watch approach on your part to the economy...**

That's right...continuity with change as well as wait and watch. When things are fine, you just wait. At the same time, you watch. You watch to see if things get better when you do something or if there is some new development that calls for re-orienting our approach. In that sense, I would emphasise more on watching than on waiting.

**What developments could make a review of the existing policy necessary?**

As you would have noticed, there are broadly three or four such elements the policy has tried to deal with. One is structural. As far as structural changes are concerned, it is more of a wait till our studies give us more ideas and definite plans to move on. Second, in prudential matters there are the regulatory and supervisory issues pertaining to development financial institutions and preparing banks for the adoption of the New Basel Capital Accord. Our approach here is neither wait nor watch, but to keep working on an ongoing process.

Lastly, there are financial markets, where watching is very important. There can be global or domestic uncertainties. Uncertainties in the financial market may emanate due to non-financial market risk or there could be a shock resulting from non-economic policy risk. So you need to be constantly vigilant. Usually, monetary measures may be linked to unexpected events where watching is important.

And then, you have broad indicators and assumptions for various global and domestic policy parameters like domestic growth rate, inflation, global economic recovery, and global monetary policy stance. Here, we wait and watch in equal measure, to see if anything is going to change. So, on the whole, I would say it is really more of watch than wait.

**The policy emphasises on credit delivery. What are you doing to improve credit pricing transmission of lower interest rates to sectors other than housing? Would the benchmark prime lending rate (PLR) be a step in that direction?**

First, the relationship between price of credit and demand for credit is not one to one. In the past, when price of credit was high, interest rate, both nominal and real, was high and credit still grew. In recent years, real interest has been low, price has been low, and yet credit has not grown. But price of credit is an important factor, an enabling factor, both for credit offtake and competitiveness. Second, anything in excess can be bad. If you price the credit too low, it may then go to places it need not go to. If you price credit too low, then savers may not save. So you are really talking of balance in the aggregate.

Broadly speaking, what this monetary policy is saying is that in terms of overall liquidity and overall price, the current scenario appears to be fine. Having said that, in some sectors where credit should have gone, there are institutional and structural problems that need to be taken care of. Similarly, unless you have administered interest rates, rates will vary.

The benchmark PLR should be treated as a process by which we are encouraging transparency. So if the bank lending the money and the borrower taking the money know on what basis this pricing is done and how different customers are getting different terms, there would be enough information to make the transaction reasonable. That is why I am trying to bring about some systems improvement. Indian Banks' Association has offered to work on PLR and fair trade practices.

**You have revised your estimate for gross domestic product (GDP) growth, how do you see this translating into growth in credit demand?**

Just because GDP is growing, credit need not grow. What we are trying to do is to widen and deepen the financial sector. In a dynamic sense, we want savers to keep more money with banks and banks to give out more money. Contextually, we feel that in the recent past, credit growth did not happen even though liquidity was adequate and the rates reasonable. Mainly because corporates were focussing more on improving productivity than on new investments. We expect credit growth to pick up because corporates who have maximised their productivity gains will hopefully start investing again. We expect infrastructure investment to rise along with increased credit demand from small and medium enterprises. I feel credit growth will pick up very soon.

**The credit policy has asked the banks to ensure that they hedge any forex loans of above $10 million that they make to corporates. How do you plan to enforce this?**

It is not meant to be enforced. We are not saying that everybody who borrows must hedge. When corporates borrow in foreign currency, it may entail risks to their balance sheets if there are major currency fluctuations. Then, to the extent that the banks lend to such corporates, the quality of assets of banks may get affected. So we told the bank boards to ensure hedging of such loans as a matter of policy. On the other hand, if the banks feel that the corporates they are lending to are sophisticated enough and that such fluctuations won't affect their balance sheets, they can ignore our advice and just go ahead.

**Select private banks will now be allowed to provide services to the government. Will this not impact the performance of public sector banks that make good money from this business?**

The question here is once you have accepted in principle that there should be more competition, it should be applied across the board. And since the RBI is banker to the government, it becomes necessary for it to ensure that banking services are provided to the government with maximum efficiency and at minimum cost. Earlier, this was restricted to public sector banks and commission was calculated in a particular way. This had to change as some new private sector banks went ahead and adopted new technology and are now in a position to provide better service.

**Do you see consolidation happening in the banking sector? Could you give us an idea of how many banks we should have?**

It is an evolving situation. Compulsions of competition, compulsions of technology and compulsions of handling innovations in financial sector will soon require some sort of consolidation in the financial sector. In what shape it will come will depend on individual banks and their dominant owners.

**KOTAK MAHINDRA BANK**

## Are You Being Served?

**Not only will they keep your money safe, but the new Kotak Mahindra Bank also promises to fetch you a bundle for your Ganesh Pyne tempera.**

By Abir Pal

**S**enior managers huddling over aggressive deposit mobilisation targets, red-eyed managers living out of their suitcases as they embark on yet another whistle-stop branch expansion tour, vice-presidents dashing from one brainstorming session to another, marketing honchos burning the midnight oil as they fine-tune a publicity blitzkrieg... those are some of the vignettes that would be playing in your mind on your way to the headquarters of a six-month-old fledgling bank. You'd expect such a flurry of activity from Kotak Mahindra Bank as it plays catch-up against rivals who are streets ahead on every parameter, be it pedigree, asset base, branch network, or brand equity. You'd also expect to meet a slightly frayed CEO deluged with powerpoint presentations and drained out by a string of countless meetings that go on way beyond dusk. Instead what this

writer encounters is a beaming, relaxed Uday Kotak, basking in the November sun streaming through the second-floor bay windows of Bakhtawar building in Nariman Point, Mumbai's commercial district. Sure there are targets to be met, new branches to be opened, but the 44-year-old Vice Chairman is definitely not losing any sleep over them. That's because by getting a banking licence earlier this year from the Reserve Bank, Kotak's got what he's been yearning for most all these years: Respect.

"A bank spells respectability and credibility in capitals," avers Executive Director Dipak Gupta, who's played a vital role in executing the bank blueprint. What Gupta doesn't spell out but alludes to is that Kotak Mahindra Finance Ltd. (KMFL) was finding the taboo tag of "NBFC" (non-banking finance company) a millstone around its neck. Whilst KMFL might have had an unblemished record, it couldn't avoid being tarnished with the same NBFC brush, as a result of which not just investors but a large portion of the financial community preferred to give Kotak's non-banking conglomerate the go-by.

**Integrated Gameplan**

The first nbfc to be granted a banking licence, Kotak Bank has structured an innovative and non-traditional business model. "Don't forget that rather than positioning ourselves as a new bank, we consider ourselves to be a 20-year-old financial services brand with a new look," elucidates Kotak, attired in regulation-banker grey slacks and a white shirt with a paisley tie. At the heart of Kotak's model is the way the new-kid-on-the-block perceives today's customer. With interest rates on a downward spiral, investors are no longer keen to squirrel away their savings in a dowdy savings account and hope there will be enough to tide them over rainy days. "From being a nation of passive savers we need to become interactive investors," is what Kotak prescribes. His bank's integrated gameplan-akin to and inspired by European banks-thus unsurprisingly aims to meet every investment need of a consumer, straddling the entire gamut from plain vanilla bank accounts to personal loans to mutual funds to insurance to securities trading.

"What's great about that?" you'd probably ask. After all, every bank worth its stripes-be it a private sector player like HDFC Bank or ICICI Bank, or public sector giant SBI-has rolled out an umbrella of products and services to meet every conceivable need of today's retail investor. The crucial difference, explains banking and financial services analyst at Mumbai-based Enam Securities, Punit Srivastava, is that whilst the others have originally been banks that went ahead and acquired a basket of retail assets, KMFL has been in the retail finance business for close to 20 years and today flaunts an enviable portfolio.

What's more, Kotak has the advantage of starting out with a veritable clean slate-those cumbersome irritants called NPAs (non-performing assets), a drag on the balance sheets of most Indian banks are complete strangers to Kotak. And don't forget the benefit of having a compact, nimble and young workforce, something most public sector bankers would trade in their favourite suits for.

**Borrowing Cheap**

Indeed, Kotak might have spent a couple of anxious years waiting for his licence to come in, but the timing couldn't have been better, when interest rates are falling and borrowing was never so cheap.

As any banker will tell you, borrowing cheap is one key to a bank's profitability (the other is the ability to lend at attractive rates). Traditionally, banks have gone the whole hog garnering deposits as that significantly lowers the cost of funds (it could be nil for a current account to a low 4 per cent for a savings account). This money is then deployed in higher-earning retail assets. But in Kotak's "inverted" model or "shirshasan" (inverted yogic pose), as it's referred to internally, it's the other way around. "Our appetite for liabilities will be determined by our appetite for assets," says Gupta, an 11-year-old KMFL veteran, in characteristic banker-speak.

What Gupta means-and that's probably why Kotak Mahindra Bank's top managers are not losing sleep-is that its deposit mobilisation strategy pivots around converting existing customers, at least initially.

It's already found success with its high net worth individual clients, more than half of whom have already opened banking accounts with Kotak. But in order to expand its deposit base to Rs 500 crore-the three-year target-it has to attract new customers. In line with recommendations of consultants McKinsey & Co, only households with annual incomes of over Rs 4,50,000 predominantly in six large cities will be targeted. Delivery channels, presumably to effectively service and retain customers, are being fine-tuned. Says a confident Kotak: "My model for home banking is inspired by nothing less than Domino's Pizza, so we're talking real timely and efficient service here." And service, more than traditional differentiators like safety and geographical location, will play an increasingly important role, feel banking analysts as the entire industry gets commoditised.

That is not to say corporates will be ignored. Old Kotak Mahindra hand Shanti Ekambaram, after eight years in investment banking, is now working overtime integrating with corporate banking. "We want to leverage our existing investment banking relationships, expand our small and medium enterprises business and basically increase our mindshare and wallet share through providing a range of value-added services," says Ekambaram, Group Head (Corporate & Institutional Banking).

In fact, non-fee based or advisory services are expected to contribute an additional 10 per cent to the consolidated group turnover, from 30 per cent currently. And it's not just advice on financial products that Kotak Mahindra Bank is contemplating; clients will be helped out with their entire investible surplus-gold, real estate and even contemporary art. Clearly, Kotak's banking licence includes for good measure an artistic one too.

## Beyond Numbers

**Banks will need to change the way they measure performance.**

By Anupama Raghunathan, Amar Mehendale, and S. Mahesh

The time for review and introspection found the CEO of a large bank in India deep in thought. The bank had seemingly initiated the 'right' decisions and actions-launched a suite of financial product offerings to its customers, deployed an appropriate operating and governance model, undertaken alliances and joint ventures for related financial services, adopted state-of-the-art technology, and deployed new age distribution channels. All these initiatives were expected to catapult the bank into the 'admired big league'. With the overall numbers better than satisfactory and the regulator satisfied with their results and compliances, the outlook was clearly positive. However, a place in the 'admired big league' still seemed elusive-there seemed to be a missing link to the otherwise perfect picture...

The situation illustrated in the anecdote is definitely not a rarity in the banking industry today. The industry has undergone a rapid transformation in the last decade-banks in India now find themselves competing vigorously for survival by acquiring a 'share of wallet' of their customers. The underlying processes and technologies adopted have created new capabilities and dimensions for 'service' and 'delivery'.

The recent trends of shrinking margins and increasing competitive pressure are forcing most players in the banking and financial services sector to focus on adopting appropriate methods to enhance performance, while improving their quality of service. Also, banks have increasingly become aware of the greater challenge of acquiring new customers while retaining and

expanding relationships with existing customers using a finite set of resources.

This competitive environment makes it imperative to know the performance of individual products and services and determine which of them contribute to profitability. The realisation that, not all products and customer relationships are equally profitable, is leading many banks to define and adopt multiple approaches for service delivery and set appropriate performance measurement techniques.

Against this backdrop, many banks in India have attempted to formulate strategies that enable them to compete in this dynamic business environment. Some of them have made considerable headway in implementing these strategies, while others have not been successful. The differential outcomes experienced by banks have been attributed to a variety of reasons. However, a key enabler for future success is the approach taken by banks to measure the efficacy of their strategies and management of their performance.

## Business Performance Management-Case For Review?

We find that performance management in many banks in India has been largely synonymous with measuring financial performance vis-à-vis the CRAMEL framework or its variants.

**C: Capital Adequacy**
**R: Risk**
**A: Asset Quality**
**M: Management Quality**
**E: Earnings**
**L: Liquidity**

Financial performance parameters have typically been developed along the dimensions of this framework. These are typically used for peer comparison and benchmarking, regulatory reporting, and shareholder reporting purposes. Some banks have also linked these parameters to the individual performance review process and compensation of its employees. However, these financial measures are primarily lag indicators, a post-mortem view of the business, rather than lead indicators that assess the bank's ability to create value in the future.

The erstwhile performance management and measurement system in Indian banks sufficed in the past. The transformed, dynamic environment makes it imperative to review and re-engineer the bank's performance management system.

- The emergence of retail as the business of the future has necessitated almost a complete review of the way Indian banks have traditionally conducted business. Specific segments such as retail assets, fee-based services, and delivery channels require to be managed almost like traditional consumer goods businesses (with focus on active 'customer acquisition' and 'customer retention' rather than passive 'service' that would be more relevant in the erstwhile 'walk-in' business model). These strategies require measurement in a manner that extends beyond CRAMEL and stand-alone non-financial measures.

- There is an increasing need for banks and financial services organisations to focus on methods to increase income, improve quality of service, and reduce cost of operations. Computation of risk parameters, for example, Funds Transfer Pricing (ftp), capital allocation or risk-adjusted performance would be incomplete without recognising appropriate recognition of non-interest overheads and 'delivery costs'.

- Technological developments and business pressures have enabled new business models such as outsourcing, alliance etc. These have necessitated building newer capabilities by banks. The performance measurement system needs to accommodate evaluation of these new business models and capabilities.

Some banks have deployed performance measurement systems with management dashboards that incorporate financial and non-financial measures (staff productivity, customer satisfaction etc.). However, in many instances, it is found that these non-financial measures and lead indicators are viewed stand-alone, without adequately linking them to overall strategic objectives. In such cases, the 'standard' financial measures continue to remain the foundation for the individual performance review process and executive compensation. Therefore, these banks, while espousing strategies focused on building customer relationships, core competencies, and organisation capabilities, tend to actually motivate and measure performance only with financial measures.

A few banks are also in different stages of implementing a holistic performance management system based on methodologies such as the Balanced Scorecard that drill-down corporate strategic objectives down to the grass-roots level and measure performance across multiple perspectives (i.e., financial, customer, internal process, learning, and growth). These banks have experienced varied degrees of success-while some can boast commendable progress and successful implementations, others have encountered roadblocks due to 'design' and 'implementation approach' inadequacies.

## Approach To Business Performance Management

This dynamic growth of the Indian banking industry over the last few years, rapidly changing and innovative product portfolios and business activities, differing risk profiles and adoption of varied business models, have made performance assessment and identification of drivers of its value, increasingly complex.

The bank's performance management will need to be a process that synchronises the institution's strategy with day-to-day operations and translates the same into measurable results. The ultimate goal of business performance management is to ensure that the organisation and all of its subsystems (processes, departments, teams, employees, etc.) are working together in an optimum fashion to achieve the results desired by the organisation. It should be a top-down process that extends beyond financial metrics, key performance indicators, and performance incentives.

There is a wide range of aspects that need to be addressed for effective performance management (See Managing For Effectiveness).

While there may be multiple approaches and tools to adoption of appropriate performance measurement systems in an institution, there are some basic underlying guiding principles:

- A clear articulation and communication of the institution's strategy is essential to set the direction for defining organisational performance. A shared understanding of the strategic direction of the organisation subsequently forms the basis for defining performance metrics, which are at the heart of a robust performance management system.

- Appropriate performance measures that take a balanced view across various parameters need to be developed. These include:

**Financial** parameters that assess the changes in financial position, future potential to repay, how shareholder wealth is being increased, performance contribution to capital growth;

**Customer** satisfaction, customer response time, customer profitability, marketshare, complaints;

**Processes** like service levels, cost income ratio to productivity, quality of service delivery to internal and/or external customers;

**Learning and Innovation** like market innovation, reduction in the number of errors and/or complaints in service delivery, training investments and returns

- Appropriate processes that allow for capture and utilisation of information need to be established. This may require investment in appropriate systems that capture and disseminate information at a granular level and manage risks. The future will require increasing investments in analytical tools as part of an integrated framework to support the bank's decision-making and performance measurement process. As banks move along the learning curve, they could buy or develop more sophisticated systems that require expertise and organisation maturity apart from accurate meaningful data.

- Introduction of mechanisms to 'influence' achievement of the desired objectives will further enhance the efficacy of the organisation's performance management system.

- Linking the balanced scorecard to the rewards and incentives is a good way of ensuring the systems' robustness.

- An appropriate governance structure supported by a robust monitoring mechanism needs to be deployed. This would assist in effective institutionalisation of the process. Visible top management involvement is a necessary condition for smooth and successful roll-out.

## Likely Hurdles In Performance Measurement

Currently, the approach adopted and current levels of sophistication of various banks in India today, identify a number of challenges for successful deployment of the 'right' performance measurement system. Our prior experience indicates that some well-intentioned performance management initiatives have had limited success. This may be due to any of the following reasons:

**Design inadequacies:**

- Development of inappropriate metrics (metrics that are not result-oriented, measurable or actionable);

- Incorrect or a lack of linkages of metrics to strategic objectives. Stand-alone or inappropriate metrics may not elicit the desired behaviour from people and systems within the organisation;

- Introduction of complicated or a high number of metrics;

- Limited identification and definition of information needs; and

- Level of information currently captured by the existing systems of financial institutions may give an incomplete picture of a bank's performance. Historically, banks and financial services organisations in India have deployed multiple software applications for varying business models and/or have limited it support. This leads to the challenge of identifying, extracting, cleansing and aggregation of data from multiple applications.

**Implementation approach inadequacies:**

- A lack of sponsorship and buy-in across the organisation;
- Inadequate education and communication efforts;
- Failure to manage expectations from the performance management system;
- Aspiring for implementation deadlines and timelines that are too 'aggressive', the pressures of which may jeopardise the entire initiative;
- Inability to introduce effective 'incentive' and 'penalty' mechanisms. Some categories of Indian banks have a cultural legacy that hampers their ability to effectively influence performance through incentives or suitable penalties.

Banks need to drive change in a number of areas to move towards a more transparent organisation, while working with regulators and market participants to create the necessary conditions for greater transparency at reasonable cost.

**Conclusion**

Deployment of an appropriate performance measurement framework along with a supporting governance model is central to the institution's long-term success. In order to move towards a more effective organisation, banks need to drive change in a number of areas and strongly influence the behaviour of its stakeholders, processes, and systems within and outside the organisation.

Therefore, an appropriate performance measurement system will be most meaningful when they are cascaded top-down and linked to distinct, organisation-wide strategic objectives. While it is important for banks to address possible design and implementational approach inadequacies in future performance management initiatives, sustained benefits can be achieved only if banks view performance management as a continuous process, rather than as a 'one-time' initiative. Getting the 'appropriate framework' right now will enable banks to take full advantage of the opportunities waiting around the corner.

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