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# Business Today lists the best banks in India that braved the headwinds

**Anand Adhikari** November 20, 2013

At a recent event to open a branch of Kotak Mahindra Bank in Mumbai, the lender's founder Uday Kotak summed up the challenges facing the Indian banking sector in the shortest possible way: "In a bank's balance sheet, liabilities are actually assets and assets are liabilities." He then explained his statement. A bank lists the current and savings account deposits as liabilities on its balance sheet. These low-cost deposits are helping banks maintain a healthy margin in the current worsening economic scenario. On the assets side of the balance sheet are corporate and retail loans that earn interest for banks. But, with many borrowers unable to repay, these assets are turning into liabilities.

Indian banks have a lot of things going against them currently, from a slowing economy and rising loan defaults to allegations of money laundering. A few banks have, however, faced the headwinds strongly.

The **Business Today-KPMG Best Bank 2013 study** lists 13 toppers this year.



After a gap of five years, **HDFC Bank has emerged** as the best large bank because of good asset quality, high loan growth, a healthy capital adequacy ratio and an improvement in returns on capital employed. YES Bank remains the best mid-sized bank for the second year running.

For other banks, challenges are only multiplying. The **asset quality of banks** has been deteriorating for the past two years as economic growth slipped to its lowest level in a decade while inflation and interest rates remained high. Gross bad loans have spiked to nearly four per cent of total lending from 2.36 per cent three years ago. The Reserve Bank of India estimates gross bad loans to touch 4.4 per cent by the end of the current fiscal year.

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More debt would have turned sour had banks not restructured stressed corporate loans. The banking system's restructured assets are at an alarmingly high level of more than six per cent. Punjab National Bank (PNB), Central Bank of India and Allahabad Bank all have outstanding restructured assets at more than 10 per cent.

In a recent interview with *Business Today*, **RBI Governor Raghuram Rajan** emphasised on speeding up the loan recovery process through debt recovery tribunals and asset reconstruction companies. "Our institutions dealing with distress are under-developed. That will make it hard for banks to take risks if they have no hope for recovery. We have to improve them," he said.

The deteriorating asset quality is putting tremendous pressure on banks' capital base. The Basel-III regulations require banks to set aside more capital for absorbing future liquidity shocks or any risk arising in the financial system. According to the RBI, Indian banks are likely to raise Rs 2.7 trillion of tier-I equity capital in the next five years. (One trillion equals 100,000 crore).

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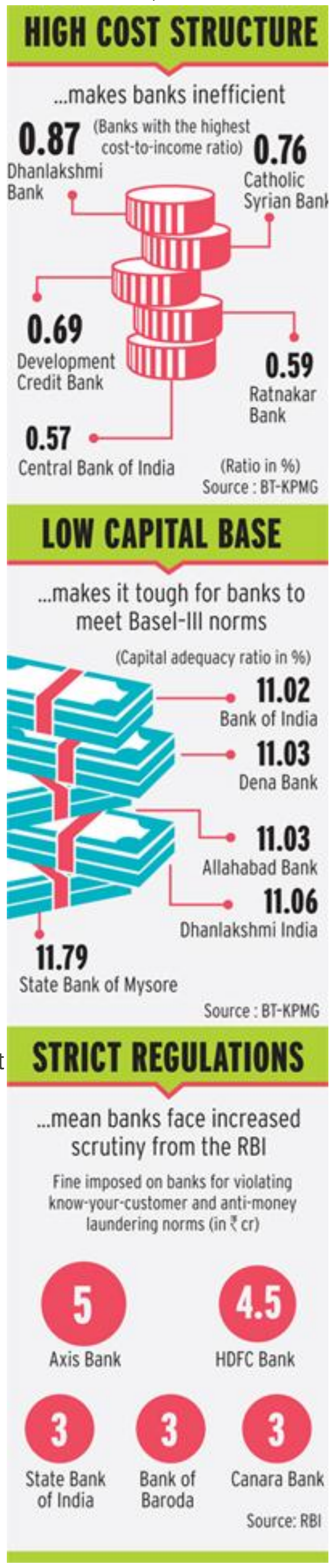
The capital adequacy ratio at many state-run banks such as PNB, Bank of India, Andhra Bank and Union Bank of India is closer to the RBI's minimum norm of nine per cent. This leaves them with little room to breathe easy.




M.S. Raghavan, Chairman and **Managing Director of IDBI Bank,** says banks will see formidable challenges to expansion when the Basel-III norms are fully implemented by 2018. "We will have to keep generating incremental capital," he says.

The banking sector is also waking up to the challenges of funding infrastructure projects. These projects were earlier the domain of development financial institutions like the Industrial Development Bank of India and Industrial Credit and Investment Corporation of India, the former avatars of IDBI Bank and ICICI Bank respectively.

With the government and private sector looking to invest billions of dollars to build roads, power plants and ports, many banks ramped up their exposure to the sector. Loans to these projects are typically for the long term, say 20 years. But most funds that banks raise are shorter in maturity. This results in a mismatch.

"Banks do not have the ability or the expertise to assess risk in an infrastructure project," says a former chairman of a development finance institution, who does not want to be named. **Shikha Sharma, CEO of Axis Bank,** says banks should be allowed to raise long-duration funds by issuing tax-free bonds.

Banks are tightening their regulatory and governance structures, after a news portal exposed their liberal attitude toward know-your-customer norms and anti-money laundering rules. They must also improve efficiency, especially considering that competition in the sector is about to intensify. The RBI will soon issue new banking licences.

Foreign banks, which curbed retail lending after the 2008 financial crisis, have cleaned their balance sheets and are again looking to expand in India. The RBI has said that if foreign banks shift to a model where they set up wholly owned subsidiaries instead of the current branch structure, it will treat them on nearly equal terms with local lenders.

Rajan had **earlier told *Business Today*** that the RBI will put enough safeguards into the policy so that there is no chance of having a foreign-dominated banking system. "At the same time, let us not be afraid of foreign banks bringing in more innovation capabilities. The system will benefit," he said.

The challenges aside, there have been several welcome developments in the banking sector over the past few years. Private lenders are leveraging social media to engage customers and boost brand visibility. In state-run banks, many women have entered the corner office. Many banks are also looking to offer customised products to those who do not have access to the banking system currently.

Still, the road ahead for banks is a bumpy one. As competition intensifies, the existing banks will have to think of innovative strategies to retain customers. Axis Bank's Sharma says it takes time to build a bank from scratch. "Our job in the meantime is to make sure that our bank is strong, profitable, well capitalised and has a right offering," she adds.

INDIA'S BEST BANKS

## THE 2013 RANKINGS

### GROUP-I LARGE BANKS Balance sheet size more than or equal to ₹100,000 crore

| RANKS 2012/13 | 2011/12 | BANK | GROWTH (%) DEPOSITS 1-year Growth | DEPOSITS 3-year Growth | LOANS & ADVANCES 1-year Growth | LOANS & ADVANCES 3-year Growth | FEE INCOME 1-year Growth | FEE INCOME 3-year Growth | OPERATING PROFIT 1-year Growth | OPERATING PROFIT 3-year Growth | INCREASE IN MARKET SHARE (BASIS POINTS) Deposits | INCREASE IN MARKET SHARE (BASIS POINTS) CASA | SIZE (₹ CR) Deposits | SIZE (₹ CR) Operating Profit | SIZE (₹ CR) Balance Sheet |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | 2 | HDFC Bank | 20.08<br>5 | 20.96<br>6 | 22.67<br>2 | 23.97<br>2 | 15.88<br>8 | 21.77<br>5 | 21.69<br>6 | 21.13<br>9 | 0.17<br>3 | 0.17<br>4 | 2,96,246.98<br>6 | 11,427.63<br>3 | 4,00,331.90<br>7 |
| 2 | 3 | Axis Bank | 14.77<br>16 | 21.37<br>5 | 16.03<br>17 | 23.59<br>3 | 14.01<br>10 | 24.21<br>2 | 25.20<br>4 | 21.08<br>10 | -0.01<br>16 | 0.31<br>2 | 2,52,613.59<br>9 | 9,303.13<br>5 | 3,42,315.67<br>8 |
| 3 | 5 | ICICI Bank | 14.53<br>17 | 13.15<br>22 | 14.39<br>19 | 17.00<br>21 | 0.83<br>20 | 3.10<br>24 | 27.08<br>3 | 10.69<br>21 | -0.02<br>17 | -0.17<br>25 | 2,92,613.63<br>7 | 13,199.23<br>2 | 5,36,794.68<br>3 |
| 4 | 1 | Bank of Baroda | 23.13<br>3 | 25.27<br>1 | 14.20<br>20 | 23.31<br>5 | 3.34<br>18 | 9.22<br>15 | 4.88<br>19 | 22.17<br>8 | 0.42<br>1 | 0.07<br>7 | 4,73,883.34<br>2 | 8,999.15<br>6 | 5,47,135.44<br>2 |

In figures: How India's top banks performed (Click to enlarge)

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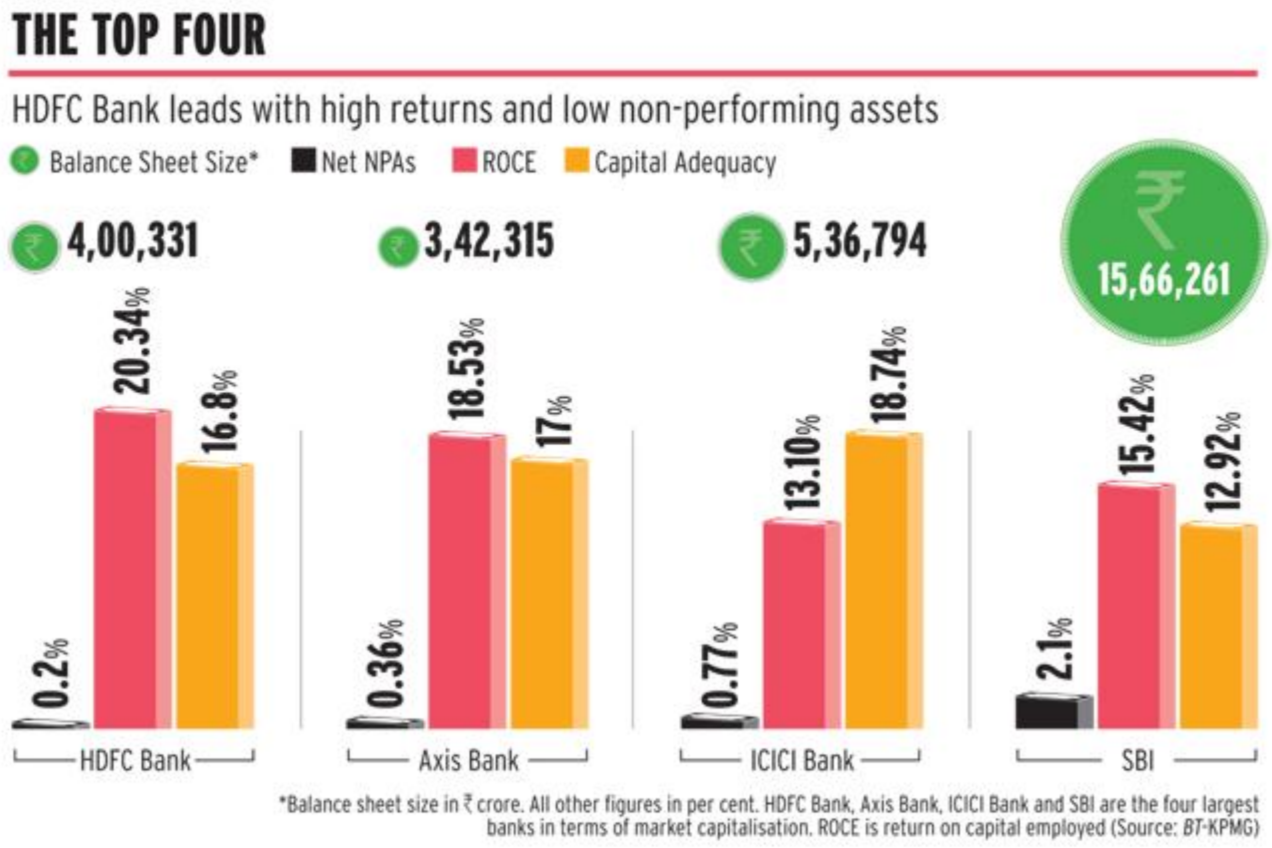
http://businesstoday.intoday.in/story/best-banks-2013-india-banking-sector-intro/1/200612.html

# HDFC Bank tops Business Today's Best Banks listing after five years

**Mahesh Nayak** November 22, 2013

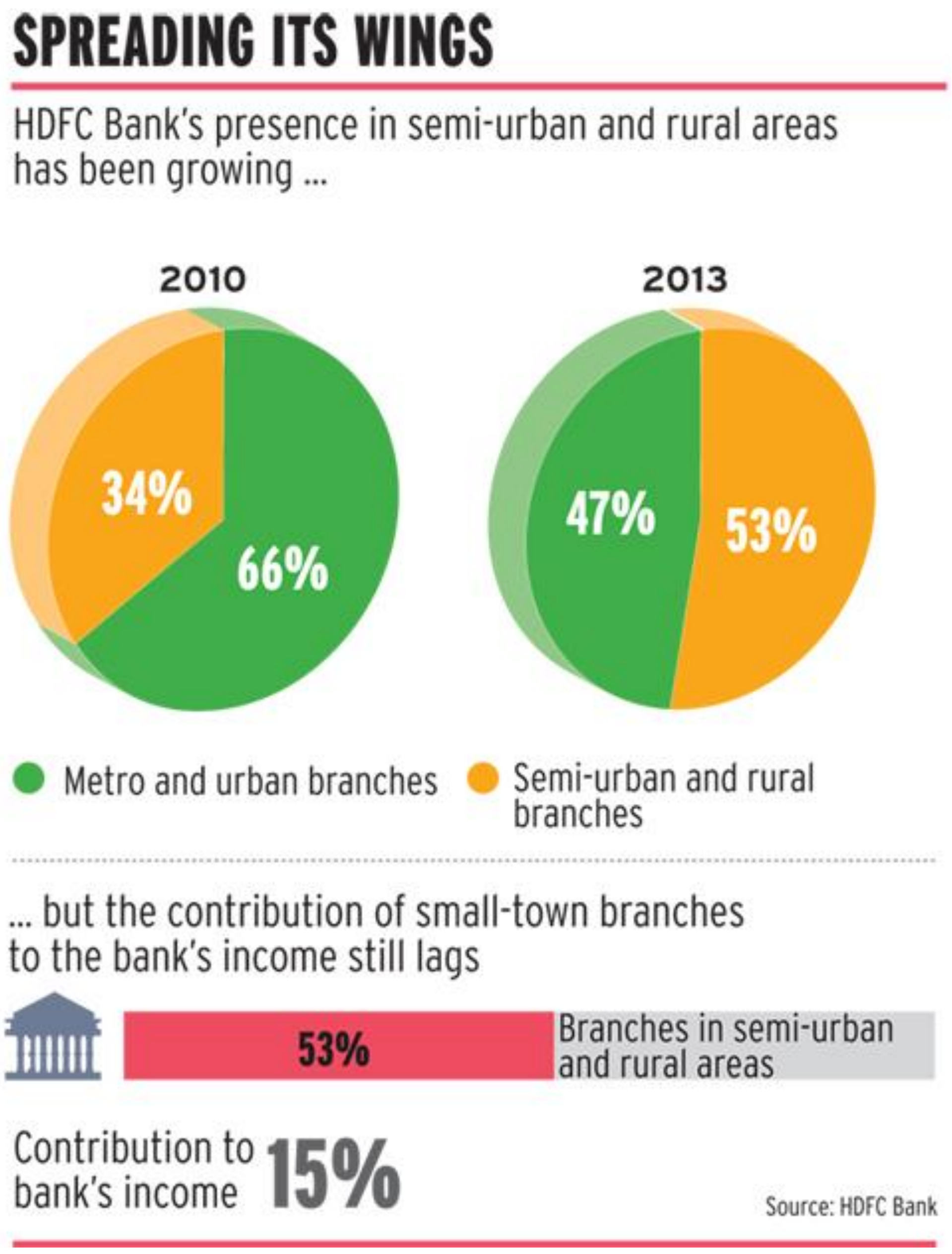
It is noon, and 48-year-old Shankarbhai Rethalia is a bit tired as he reaches the HDFC Bank branch in Bavla, a village in Gujarat some 35 km from Ahmedabad. He takes off his shoes and enters the air-conditioned branch, some 15 km from his home in Kotha Talawadi, where he owns 50 acres of farmland. He visits the Bavla branch once a week, not just to make transactions but also to seek the advice of the executive who handles his loan portfolio, on how he can earn more on his agriculture proceeds.

Rethalia is not the only privileged customer of the branch. This semi-urban branch counts many traders among its customers. The region has 110 rice processing mills, one of the largest such hubs in the country, well located near the Mundra and Kandla ports. In the Bavla area, there **are seven state-run banks,** including State Bank of India, and cooperative banks. Rethalia, who switched loyalties from a cooperative bank, is all praise for the private-sector HDFC Bank, which not only gave him a higher limit on loans, but also structured the loan according to his needs. Eight months ago, Rethalia got a loan of Rs 18 lakh for crop and working capital at an interest rate of around 11.5 to 12 per cent. His previous banker, Ahmedabad Co-operative Bank, gave him a Rs 3-lakh loan at a comparatively lower rate.




Even big traders are switching to HDFC Bank. Gyanshayam Thakkar, a trader who opened Bavla's first supermarket, explains: "Before HDFC Bank, we were dealing with co-operative and state-run banks. The biggest problem with state-run banks was that whenever the manager got transferred, our business would be affected, as the new manager's **style of operation** was different. We had to start all over again and build a relationship with them." Last year, Thakkar's turnover was Rs 40 crore. Low interest rates alone are no guarantee of customer loyalty - banks must also offer customised products, higher loan limits, faster processing and good customer service. And private-sector banks have the edge.

HDFC Bank's five-year-old Bavla branch is reaping the rewards. It's lending more than mobilising deposits. It has deposits of Rs 23.5 crore and assets of Rs 45.5 crore. In semi-urban and rural areas, banks typically lend more and get fewer deposits, as compared to urban branches -  a big challenge. But it's also where the growth is: today, every private-sector bank is expanding its footprint in semi-urban and rural areas because the metro and urban markets are saturated. Some 53 per cent of HDFC Bank's 3,251 branches are in semi-urban and rural areas, up from 34 per cent three years ago. The bank aims to raise this number to 60 per cent in the next three years. Ninety per cent of the branches it opened in the last year were in these areas.




Paresh Sukthankar, Executive Director, HDFC Bank, says the branch expansion reflects a**shift from wholesale to retail business.** "What we did in 12 to 13 years in urban areas, we are now replicating in semi-urban and rural areas," he adds. The move to smaller towns started five years ago, when the bank acquired the mid-sized Centurion Bank of Punjab. Centurion itself had acquired Lord Krishna Bank, which had a good network in southern India, especially Kerala, and the Bank of Punjab, which had a strong presence in North India.

"The acquisition gave us dominant franchises in lot of states, and also a product range that was more suited to rural and interior areas," says **Managing Director Aditya Puri.** "We were getting a much smaller balance sheet, but we were getting a large branch network, which at that point was close to 40-50 per cent of our branch network," he says.

But the Centurion acquisition weakened the bank's asset quality, and productivity and efficiency ratio. This is reflected in the fact that after topping Business Today's best banks list for four years running until 2008, it slipped in the rankings. It has taken five years for it to get back to the top.

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"If the country grows, we grow," says Puri. "Our hypothesis was that if the economy is growing, it will have a trickle-down effect to rural areas." Given the limited access to organised finance in rural areas, where a large chunk of the population lives, the opportunity is substantial. But there are challenges. "Unlike urban market, the mindset, operations, products, distribution, sales and even back-office have to be different from the urban region," says Puri.

Sukthankar adds that the bank has started offering products such as loans and credit cards to existing and new customers although they are risky. "It's a good way to indulge customers," he says. He emphasises that the bank is not compromising on quality. Today 15 per cent of its income is from rural and semi-urban branches, and the bank believes it can grow to 50 per cent in five years.

Despite concerns about delinquencies in semi-urban and rural areas, experts aren't worried. An analyst from a foreign brokerage said on condition of anonymity: "They are a conservative bank. They don't take rash decisions. They understand a product and market, test it, and then expand."

Prateek Agrawal, Chief Investment Officer at ASK Investments, says: "It has the lowest cost of funds, and maintains high levels of spread without taking much risk, which is why they have low non-performing assets. Its asset-liability mismatch is the lowest in the industry." He adds that the bank has a high return on assets. Greater income generation from fee-based products augur well for the bank, he says, and the bank has a higher return on equity.

Experts say newer products such as gold loans and tractor financing will help improve margins but they don't see income from rural business rising from 15 to 50 per cent in five years. Puri, however, appears confident of achieving his target. "These are virgin markets," he says. "Penetration is still low. It's not easy terrain - every market has to be tackled differently. We have learnt the hard way, and have worked hard to achieve some success."

## CHALLENGES IN SEMI-URBAN AND RURAL INDIA

Some hurdles in raising the semi-urban and rural contribution to the bank's income

- Strong presence of public-sector and cooperative banks
- Self-employed people and traders, but no corporate business
- Cash economy, transactions outside banking channels
- People are conservative, joint family system still strong
- Strong presence of niche NBFCs
- Developing relationships will take years
- Difficult to plot credit history as many customers use non-banking channels to borrow money
- Not a market for high-margin credit cards or large-ticket home and car loans
- Need to offer customised products and flexibility at times of a bad monsoon etc
- Training and development of local employees, especially on the bank's ethics code

Semi-urban and rural operations are about more than money: there are financial inclusion and other issues. For example, the bank formed a self-help group in Bavla and gave Kanchanben Kolipatel and Bhavanaben Thakor - both local women in their thirties - Rs 17,500 each to start their own business. Thakor, who makes nearly Rs 400 a day selling cutlery, has helped her husband buy a Mahindra truck, and their children go to school. Kolipatel earns Rs 200 a day selling saris, and helped her husband buy an autorickshaw.

Small-town banking offers both potential and challenges, and perhaps the biggest challenge is giving the human touch to service in these markets. So far, HDFC Bank has got it right.