

A BT-KPMG STUDY

INDIA'S BEST BANKS

INDIA'S BANKING LANDSCAPE IS SET TO CHANGE WITH THE IMPENDING ENTRY OF MANY LENDERS. *BUSINESS TODAY'S* 2014 LISTING OF THE COUNTRY'S BEST BANKS CELEBRATES THOSE WHO LOOK THE MOST READY TO FACE THE CHALLENGES.

It has been a multiple whammy of sorts for the Indian banking industry in recent years. Growth, profitability and asset quality have all been hit by slowing economic growth and high interest rates. Yet, some banks have continued to surge ahead despite the macroeconomic turbulence. The annual BT-KPMG Best Banks study discovers the best in class.

HDFC Bank has emerged as the winner for the second consecutive year. In a major surprise, YES Bank has entered the big boys' club and secured the fifth spot in the large banks category. State-run banks continue to be laggards – only UCO Bank and J&K Bank have emerged winners in two of the 13 award categories.

But the winners cannot rest on their laurels. Winds of change will sweep the banking sector in the next few years, altering the rules of the game. In 2015, most established lenders could face competition from payment

banks and small banks. Two new banks will also enter the arena soon – microfinance lender Bandhan Financial and infrastructure finance company IDFC have received licences from the Reserve Bank of India (RBI). "The new set of banking players will bring in new competencies," says Romesh Sobti, CEO of IndusInd Bank.

Most banks are also turning towards digital banking, which promises to structurally change the banking landscape. Leading from the front is HDFC Bank (see *Digital Banker* on page 58).

Meanwhile, RBI Governor Raghuram Rajan has a long list of reforms for the sector. These range from reviewing the archaic priority sector lending norms to the development of the debt market. These reforms will offer opportunities as well as challenges for banks.

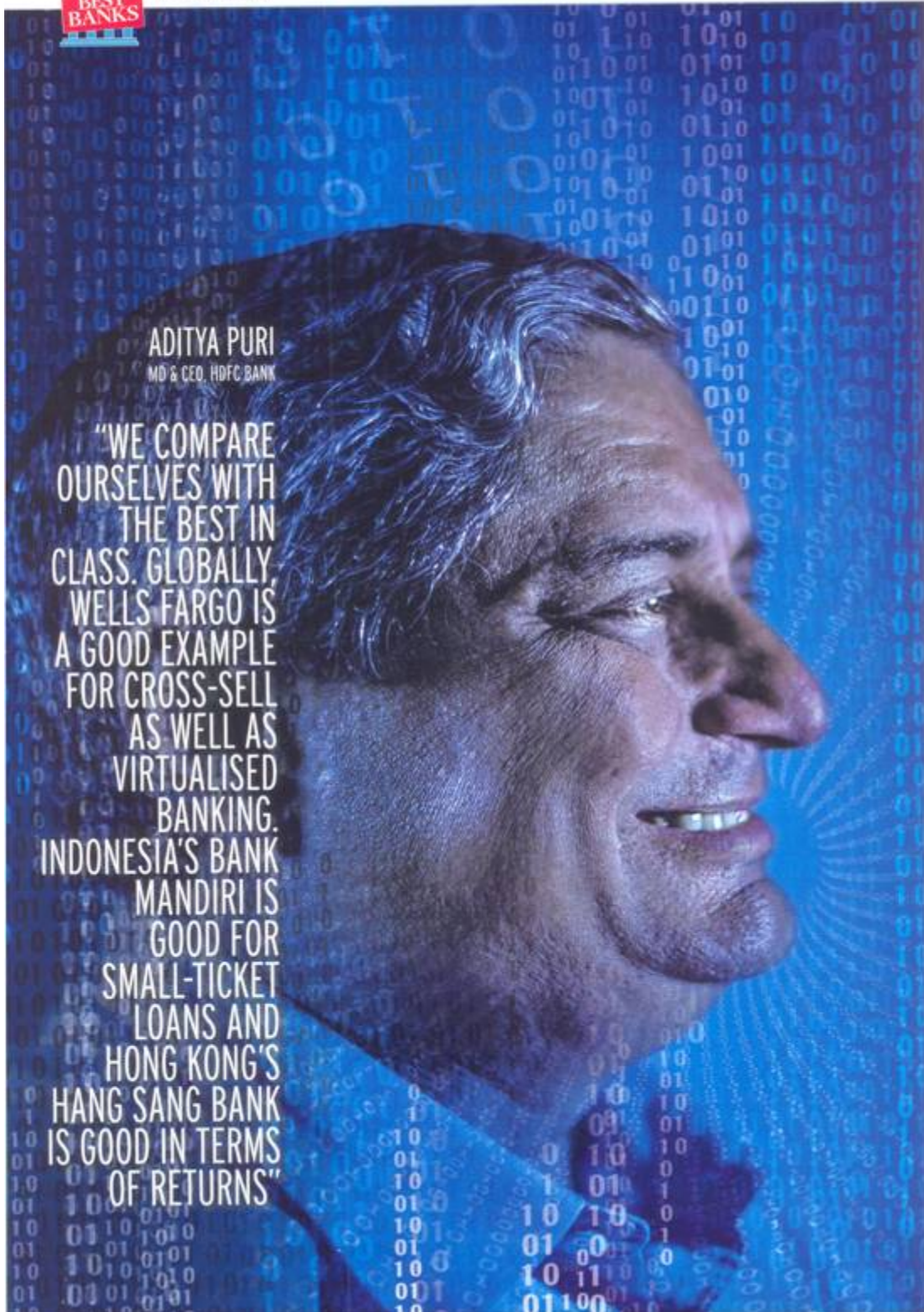
Clearly, Indian banks are being forced to learn new skills. Read on to discover how the winners have raised the bar to thrive in these changing times. ♦



HDFC Bank

ADITYA PURI
MD & CEO, HDFC BANK

"WE COMPARE OURSELVES WITH THE BEST IN CLASS. GLOBALLY, WELLS FARGO IS A GOOD EXAMPLE FOR CROSS-SELL AS WELL AS VIRTUALISED BANKING. INDONESIA'S BANK MANDIRI IS GOOD FOR SMALL-TICKET LOANS AND HONG KONG'S HANG SANG BANK IS GOOD IN TERMS OF RETURNS"



OVERALL WINNER (LARGE BANK)

DIGITAL BANKER

HDFC BANK IS TRANSFORMING ITSELF FROM A BRICK-AND-MORTAR ENTITY INTO A FULL-SCALE DIGITAL BANK. **By ANAND ADHIKARI**

In November, Aditya Puri made a trip to Silicon Valley, home to the world's largest technology companies from Apple and eBay to Facebook and Google. The MD & CEO of India's second-largest private bank, HDFC Bank, was keen to study high-tech innovations and disruptive technologies that could find application in the Indian banking industry. "I met a lot of technology geeks," says Puri, 64, with a grin. In a two-day packed schedule, he visited

MasterCard Innovations, Khosla Ventures, Singtel Technologies and Silicon Valley Bank, among others. His itinerary also included a visit to technology giant Apple Inc. A month ago, the iPhone and iPad maker had launched its mobile payment solution 'Apple Pay' in the US and some other markets. This new product allows contactless payment through iPhone 6 in merchant establishments.

The Indian financial services market is yet to see the introduction of such cutting-edge technology, but Puri

PHOTOGRAPH BY VIVAN MEHRA



promises to change things. "We have the capability to do whatever Apple Pay or PayPal can do," he says, sitting in his boardroom on the sixth floor of HDFC House at central Mumbai. PayPal is owned by eBay and is one of the world's largest Internet payment companies. "I will put out my own (mobile) wallet now," says Puri. In the first phase, the bank will be launching a product that will combine debit card and credit card limits under one wallet for payments in a merchant establishment through an application-based system. In the next phase, the bank is working on a contactless payment service using the near field communication (NFC) technology. Indeed, it is similar to what Apple Pay does.

The mobile wallet through NFC technology actually has the potential to replace physical debit and credit cards as there are some 900 million mobile users in

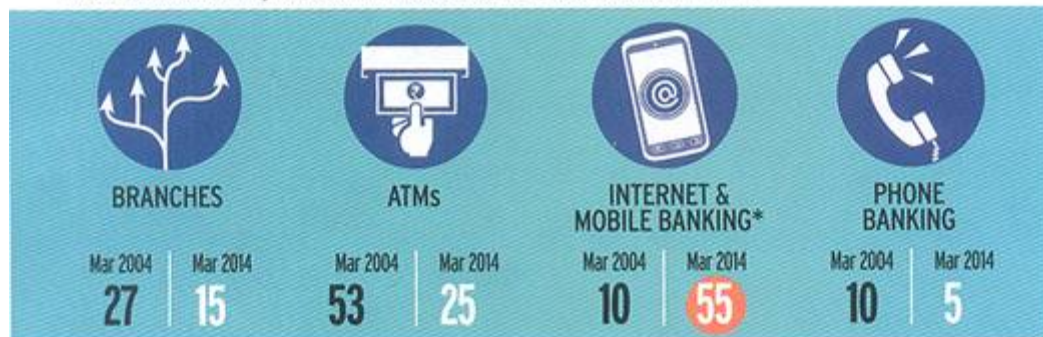
Clearly, Puri is as devoted to HDFC Bank today as he was 20 years ago, when he started building the bank from scratch as the CEO. Currently, Puri is the longest-serving CEO of any bank in India and still has over six years left at the helm. HDFC Bank at present has a balance sheet size of ₹4.91 lakh crore and is the second-largest private sector bank – seventh-largest overall – in the country in terms of total assets.

In the BT-KPMG Best Banks study, HDFC Bank has emerged as the best bank for the second year in a row. ICICI Bank is perched at the second spot but is closing the gap on key financial parameters, including cost to income ratio and capital adequacy ratio. (See *Bridging the Gap*.)

Puri himself is not wasting time in comparisons with other Indian banks. He has identified digital bank-

MORPHING INTO A DIGITAL BANK

Internet and mobile banking now account for more than half of HDFC Bank's transaction volumes



Figures in per cent, Source: HDFC Bank *Internet banking through desktops, tablets and mobile phones

India. So far, the point of sales (POS) network has remained limited because of the costs involved. In a country of over a billion people, the POS system is installed at just over a million merchant establishments. HDFC Bank's own network adds up to 2.15 lakh. However, the new contactless POS machine is expected to be much cheaper and the bank plans a major expansion of its network soon.

HDFC Bank is already a market leader in e-commerce. "Almost 45 per cent of the transactions are on our (debit or credit) cards," says Puri whose bank is a market leader in credit cards. The bank also runs the payment gateway to process electronic transactions. "We are building a digital bank that should be faster in finding out our customer needs through analytics and also provide products, including those not manufactured by us (like mutual funds, insurance, etc.)," says Puri.

ing as the next big opportunity and is focused on creating a world-class Indian bank, something the management had articulated 20 years ago in its vision statement. So where does he look for inspiration? "Globally, Wells Fargo is a good example for cross-sell as well as virtualised banking. Bank Mandiri in Indonesia is very good for small- ticket loans. There are banks in Hong Kong, such as Hang Sang Bank, which are very good in terms of returns," says Puri. "So depending upon each segment, we compare ourselves with whoever is the best in class globally."

Rewarding Shareholders

HDFC Bank has a better return on assets (ROA), at 1.72 per cent, than Hong Kong-based Hang Sang Bank, the bank Puri has set as a benchmark. Today, the bank's return on capital employed (ROCE), at 21.28 per cent,



THE BIG RURAL EXPANSION

HDFC Bank needs to boost revenues from rural branches

is the best in the Indian banking industry. SBI, the country's largest bank, is way behind with 10.03 per cent, while ICICI Bank has ROCE of 14.28 per cent. The stellar performance by the bank is reflected in its market capitalisation (market cap). HDFC Bank has a market cap of ₹2.23 lakh crore against a balance sheet size of ₹4.91 lakh crore. ICICI Bank, with a much larger balance sheet size (₹5.94 lakh crore) has a market cap of ₹1.99 lakh crore. SBI, whose balance sheet is three and a half times more than that of HDFC, has a market cap of just ₹2.33 lakh crore.

But there are challenges, too. "We feel that the bank will see consolidation phase going forward. This will be also due to the fact that other private banks are ramping up rapidly and offering better returns to customers on their deposits along with better customer service," says Rakesh Shinde, research analyst (banking) at Bonanza Portfolio Ltd. Indeed, mid-sized banks have already started eating into HDFC Bank's current and savings account (CASA) share as a percentage of total deposits. The bank's CASA has fallen from 47.4 per cent to 44.8 per cent in the last one year.

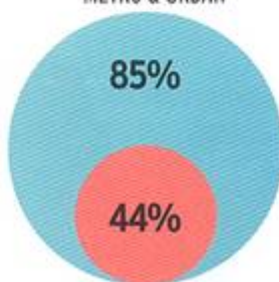
HDFC Bank also needs to boost revenues from rural India. Already, some 55 per cent of HDFC Bank's branches are in the rural and semi-urban areas. The bank is also opening 90 per cent of its new branches outside metros and semi-urban areas. "The share of revenues of semi-urban and rural branches will grow from 15 per cent to 35 per cent in the next five years," says Puri. (See *The Big Rural Expansion*.)

Puri gets his inspiration from Bank Mandiri, the largest bank in Indonesia, which has a sizeable rural presence. In fact, Puri has worked in the last three to

SEMI-URBAN AND RURAL



METRO & URBAN



● Share of branches
● Share in revenues

four years to perfect the rural and semi-urban business model. "It is not by chance you find a virgin rural and semi-urban territory. It must be difficult to go there," says Puri, who asserts that the essence of banking is in taking a calculated risk. The bank has never launched a venture or a product without doing extensive pilot testing. "It took three to four years for us to go rural because we kept testing the products. We have also made our mistakes. But the mistakes are small and so nobody notices it," says Puri.

Virtual Bank

Meanwhile, Puri is busy building a virtual bank. His admiration for the US-based Wells Fargo & Co is well known. Wells Fargo is the world's largest bank in terms of market capitalisation, ahead of JP Morgan Chase and China's ICBC. HDFC Bank actually mirrors Wells Fargo in many respects. It is unaffected by the global slowdown, a consistent performer and is also a darling of investors. Puri is now transforming HDFC Bank into a digital bank, something Wells Fargo CEO and Chairman John G Stumpf did with his bank. A year ago, Puri assigned the bank's digital initiative to Nitin Chugh, a senior industry professional.

The bank is already a sizable digital bank, stresses Chugh. "There is a very systematic focus within the bank in making customers use and adopt digital channel," says Chugh.

That reflects in the numbers. Today, 85 per cent of the transactions by customers takes place through non-branch channels. The mobile and Internet banking channel contributes almost 55 per cent. (See *Morphing into a Digital Bank*.)

RAKESH SHINDE/RESEARCH ANALYST (BANKING)/ BONANZA PORTFOLIO

"HDFC BANK WILL SEE CONSOLIDATION PHASE GOING FORWARD. THIS WILL BE ALSO DUE TO THE FACT THAT OTHER PRIVATE BANKS ARE OFFERING BETTER RETURNS TO CUSTOMERS ON THEIR DEPOSITS ALONG WITH BETTER CUSTOMER SERVICE"



NITIN CHUGH/ HEAD (DIGITAL)/ HDFC BANK

"WE ARE TRYING TO BUILD DIGITAL CAPABILITIES OF OFFERING THE SAME BANKING EXPERIENCE, EASE, LEVEL OF ENGAGEMENT AND PRODUCT COMPREHENSIVENESS THAT WE OFFER FACE-TO-FACE ACROSS OUR ONLINE CHANNELS"

But clearly, digital banking is not about doing routine transactions. A digital bank should be able to offer products online such as opening a bank account or offering loans. "We are trying to build the digital capabilities of offering the same banking experience, ease, level of engagement and product comprehensiveness that we offer face-to-face across online channels," says Chugh. In fact, the bank is almost ready. HDFC Bank has already finished 75 per cent of the work involved. "The basic infrastructure is ready and we have to fine-tune the system," says Puri. HDFC Bank has already invested in data warehousing, analytics, outbound call centres and models for customer relationship management (CRM). "Now we are in a position to launch our most comprehensive offering, which will be in line with global standards whereby everything you can do physically, you can do virtually," says Puri.

Puri wants the customer to be at the centre stage.



HVHR BSHDEV

"The whole war is going to be over who owns the customers," he says. The bank has been displaying customised product offering through Internet banking, mobile banking and at ATMs. "We have got all the analysis of customers at the back end. We have the offers ready. So when you come to the ATM, they communicate with the customers," says Puri.

Today, HDFC Bank staff in its branches are busy handholding customers that many of the transactions that they do in a branch can be done over the ATM, phone banking and Internet- and mobile-banking. So what does that mean for the future of branches? "The area (serving the population) that the branches cover will become larger and larger," says Puri. The branches will be more involved in acquisition of customers and explaining the fine print in products and servicing, if a customer encounters a problem.

Puri believes that the people-intensity in the banking system will certainly reduce in future. "Once you can issue a valid digital signature, the people can send documents online," he says. That will change the face of Indian banking as and when it happens. ♦

BRIDGING THE GAP

ICICI Bank is closing in on HDFC Bank, the best bank in BT-KPMG Study



| PARAMETERS | ICICI BANK | HDFC BANK |
|----------------------------|------------|-----------|
| Balance sheet size* | 5,94,641 | 4,91,599 |
| Capital adequacy | 17.70% | 16.07% |
| Cost to income ratio | 0.38 | 0.46 |
| Growth in fee income | 13.76% | 12.71% |
| Growth in operating profit | 25.72% | 25.66% |

*In ₹ crore, Source: BT-KPMG Study

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