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Consistency, Quality, and Resilience

THE NEXT FRONTIER FOR PRODUCTIVITY EXCELLENCE

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Indian Banks' Association (IBA) is the premier service organization of the banking industry in India. Its members comprises of almost all the Public, Private, Urban Co–operative and Foreign banks having offices in India, developmental financial institutions, federations, merchant banks, housing finance corporations, asset reconstruction companies and other financial institutions.

Productivity in Indian Banking: 2013

CONSISTENCY, QUALITY, AND RESILIENCE

THE NEXT FRONTIER FOR PRODUCTIVITY EXCELLENCE

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August 2013 | The Boston Consulting Group

خدا تجھے کسی طوفاں سے آشنا کرے
کہ تیرے بحر کی موجوں میں اضطراب نہیں

Khuda tujhe kisi toofaan se aashna kar de
Ki tere beher ki moujoun mein izteraab nahin

God bring you acquainted with some storm!
No billow in your sea (soul) break in foam (passion)

— *Muhammad Iqbal*
Legendry Urdu Poet (1877–1938)

A lot of human progress can be attributed to challenges that trigger passion and align minds towards resolute action. May the current mild turmoil engender a quantum leap in productivity and capacity in Indian banking.

CONTENTS

6 PREFACE

7 EXECUTIVE SUMMARY

9 THE OPPORTUNITY IN TURBULENCE
Progress in Indian Banking: Enough to Celebrate; Lot More to Do
Three Years Hence: Many Challenges; Even More Opportunities

16 HIGH PERFORMANCE CORPORATE BANKING
Overall Strong Advocacy; But Not For All
Fix Operations and Technology: Industry Tell Banks
How to Be a Primary Bank?
Pathways To a Resilient and Profitable Corporate Franchise
How to Win in SMEs
Implications for Banks

27 MANAGING BALANCE SHEET STRESS
Green Shoots in Otherwise Red Landscape
Gold Can Be Golden: Possibilities in Agriculture Lending
Speed of Credit Process: A Covert Driver of Credit Quality
Advanced Approaches for Risk Management
Business Model for SME Credit: A Fine Balancing Act
Pulling it All Together: Creating the Right Credit Culture
Pricing: The White Knight of Commercial Banking
Tough Love: Smarter Way to Restructure

39 BRANCHES OF THE FUTURE
A Possible Trinity: Coverage, Clutter and Client Sourcing
Geoanalytics: Next Generation Footprint and Location Planning
The Five Star Branch Concept: Roadmap to Sales Excellence
Peek into the Future: Customer Experience in 2015

50 CUSTOMER–CENTRIC AND LEAN OPERATIONS
Tooth–To–Tail Ratio: Aim for Four–Fold Increase
No Back Office: Operations Paradigm Comes Full Circle?
New Paradigm In Process Optimization: End–To–End and Customer–Centric
Performance Indicators: Fostering Collaboration Across Silos
Low IT Spends in Indian Banking: Pride or Prejudice?
Smart Source: From Vendors to Partners

60 DIGITAL TRANSFORMATION
Cash: Continue to Hold The Fort, But Cracks Visible
Cheque: Retail Customers Letting Go, Businesses Holding on
ATM: Easy Pickings Are Over, Tighten The Belts
Digital Channels: Making Inroads, But Too Early to Declare Victory
How to Turbo Charge Digital Adoption: Four Pronged Approach
New "New" Channel: Realizing Potential of Business Correspondents (BC)

75 HIGH PRODUCTIVITY ORGANIZATIONAL DESIGN
Overheads: Bulge at the Top
Functional Excellence: Smarter Decision Support
Investing in Performance Management: Business of People
Performance Culture: The Holy Grail

81 APPENDIX

84 GLOSSARY

86 FOR FURTHER READING

87 NOTE TO THE READER

PREFACE

THIS REPORT IS THE third in the "Productivity Excellence" series of BCG reports which are published and released on the occasion of the annual FICCI–IBA Banking Conference (FIBAC). In 2011, a report titled "Being Five Star in Productivity" and in 2012, a report titled "From Five Star to Seven Star in Productivity" was published by BCG. These reports are based on very extensive primary research and analysis on the data collected from almost all the banks in India (38 banks in 2013), complemented with primary surveys on customers (over 500 corporate customers surveyed in 2013). The primary goal of the research is to identify and elucidate practices, ideas and approaches that banks in India can adopt to sustain their financial strength while pursuing the objective of financial inclusion, which requires extra–ordinary cost efficiency, productivity and innovation. This series defines productivity in a broad sense covering diverse areas like branch, back–office, digital channels, administrative offices and bad debt management.

This report "Consistency, Quality and Resilience: The Next Frontier for Productivity Excellence" is being published amidst widespread negative sentiment in the Indian economy and valid but over stretched concerns regarding the health of Indian banks. The Indian banking industry is in solid health, when looked at, through a balanced spectrum of metrics. It enjoys continuously reducing leverage, lowering reliance on wholesale debt, increasing digital adoption, robust and steady cost–income ratio and steady profitability as a sector. It is also ramping up branches at an unprecedented pace of 8 percent to reach semi–urban and rural India. Banks in India, because of their financial soundness, have been able to help the corporate sector survive the policy hurdles regarding investments. This report identifies an action agenda for banks to come out stronger and from this phase. BCG research has shown that adaptive organizations which prepare to deal with volatility better, outperform others when better climate returns.

EXECUTIVE SUMMARY

Corporate sector has dominated discussions on Indian banking for last several months—for sluggish credit growth or for extraordinary levels of restructured debt. This study, deep dived into corporates with interviews of more than 500 corporate customers. We found that the advocacy level for Indian banks by their corporate clients, at 21 percent, is among the best in the world. But it drops dramatically in industries which use more transaction banking and advisory products that need high operations quality and technology expertise. Providers of current accounts are predominantly considered primary banks and they get nearly 2–3X share of wallet compared to secondary banks. The paradigm has shifted. Providers of term lending do not get even half the share of wallet. Industry expressed its unequivocal demand for better quality operations and technology from banks to facilitate faster turnaround, innovation, and customization.

Indian banking industry needs a step change in operations. 55 percent of workforce in the industry does non–customer facing back end work. This needs to go down to 20 percent. It needs lean and customer centric operations driven by process quality and technology. Back offices are fragmented and sub scale. Processes are slow, error prone, and costly. Investment in technology is low with insufficient emphasis on operational excellence. Large number of new value–conscious consumers are entering the banking industry in small towns and villages. They need a new model to be served profitably.

A new thinking on branch design is required. From a 2–3 percent growth per annum a decade back, today, the number of bank branches is growing at about ten percent. We predict that this pace will continue for next decade. But branches are getting more cluttered by the day. Number of cash transactions done inside branches has gone up by 7.5 percent in last two years. This is unsustainable. Rural low cost branches have to be based on a completely fresh thinking. The rural model has to reform the ultra efficient urban branches of the future. Branches need a step jump in adoption of self service. Branches of the future would be small, modular, pa-

perless, with no back office, and with on the spot fulfilment. For this, they need geoanalytics driven placement, true single windows and disciplined operating rhythm. Such branches are described in detail as "5– Star" branches in this report.

Much more intensive adoption of digital channels is needed than previously imagined. Convenient mass banking is not viable without a step jump in digital adoption. This study has revealed that while there is good progress, the pace of digital adoption is not enough. We see slower adoption of digital in business banking (current accounts) as compared to personal banking (savings accounts). Private sector is hitting a plateau on digital adoption and needs fresh thinking. Public sector is catching up fast albeit from a lower base. Cash and cheque transaction per current account of private sector went up by 20–25 percent in last two years. Industry needs to invest to make online propositions more powerful for business. The share of ATMs in digital transaction has come down from 80 percent to 70 percent in two years. The ten percent gap was filled by NEFT/RTGS (six percent) and mobile (three percent). However, share of POS transactions did not go up. Poor adoption of digital payments at merchant POS terminal remains one of the biggest weaknesses of Indian banking. The Business Correspondent (BC) channel has not taken off with average of one BC per branch. We predict this number to go to about 10 over the next decade as new bank entrants bring more committed energy to make it work.

On the issue of bad debt management, the banking industry is indeed in a tight spot. The NPA levels could cross five percent in next two years if policy uncertainty persists. Deeper examination of NPA profile shows more opportunity than threats. Over the last two years, retail segment NPA have come down across the bank type and product type. Use of information bureau for retail loans has taken off extensively in this time frame. The same has not happened in MSME financing. This study found that banks have huge opportunity to use information analytics for credit assessment and early warning systems. Credit processes need to be re–engineered with technology to reduce response time. Banks with slow credit process have high NPA since best customers get fed up and leave. Credit is a judgment decision and cannot be abdicated to models. Capability and intuition of the credit cadre has to be enhanced through teaming and apprenticeship. Use of gold as collateral for agriculture lending could double the agriculture credit flow at very low NPA.

Restructuring of loans is a valid bank decision to assist a corporate in distress. However, banks need to do a more thorough due diligence of the prospects of survival and a rigorous assessment of tough management actions needed on strategy, operations, technology and HR to ensure that the turnaround indeed happens and banks' sacrifice is paid off.

Indian banks need to invest now to get a step change in productivity and capacity. Higher customer demands, tighter regulation, and fierce new competition will necessitate it. They could support industry survive in difficult times due to their sound health. They have to support industry thrive in better days. For that they need to be healthier.

THE OPPORTUNITY IN TURBULENCE

POWERFUL PRODUCTIVITY LEVERS IN INDIAN BANKING

"There is a tide in the affairs of men
Which, taken at the flood, leads on to fortune ..."
— William Shakespeare

THIS STUDY IS BEING published in the midst of widespread anxiety regarding rising bad debt on the books of Indian banks. Rising bad debt and economic head winds are not the only worry for banks. There are stiffer challenges on the horizon in the form of fierce competition arising due to handing out of new banking licenses, a much more demanding regulatory environment and changing customer profile and expectations. The next three years will be a defining period for the Indian banking industry. While the challenges are real, a deeper examination also reveals a relatively solid banking system with many things to cheer about. While bad debt has gone up at an overall level, it has handsomely decreased in some segments. Digital adoption is showing an impressive trajectory and branches are being opened at three times the rate at which they were being opened a decade ago. Parallely, banks are maintaining a cost–income ratio below 50 percent with Return on Assets (ROA) close to one percent. Further, the leverage of the Indian banking industry has continuously reduced, reaching a safe value of 12.5 and the reliance on wholesale deposits has also come down remarkably in the last two years. In times of turmoil also lies a great opportunity for players to make strategic moves and reshape the future. This is the opportunity that banks need to grab to build new capabilities and further improve productivity.

Progress in Indian Banking: Enough to Celebrate; Lot More to Do

In 2011, BCG had published a study on the productivity in Indian banking titled "Being 5–star in Productivity". This report outlined an action agenda for the industry around five dimensions—branch sales and service, lean operations and technology, high performance organization design, digital channel excellence and bad debt management. Two years on, our latest study of the sector finds banks having made good progress on many dimensions, showing marginal improvement on some and regressing on a few.

Exhibit 1.1 summarizes the overall score card on various dimensions. There is creditable performance on digital adoption.

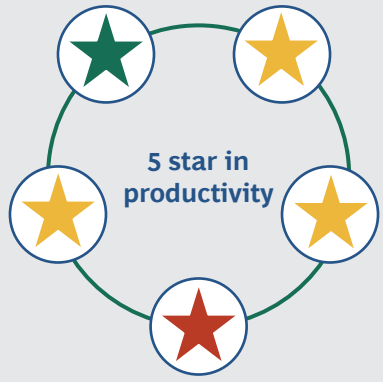
As depicted in Exhibit 1.2, across the board, there has been an increase in digital intensity in bank transactions. In FY 2010–11, digital transactions were 1.1 times the total cash and cheque transactions. Today they are 1.6 times—a 45 percent jump. Public sector banks have made the most visible progress (a 55 percent jump). Private sector banks have

EXHIBIT 1.1 | Overall Assessment on Five Star in Productivity

Movement from FY 2010–11 to FY 2012–13

New channel excellence
- Active savings bank accounts in metros using internet banking up by ~400 basis points over FY 2010-11
- Transaction digital intensity[1] up by ~50 basis points over FY 2010-11

Lean operations and operating model
- Marginal increase (~15% over FY 2010-11) in size of back–offices—still sub–scale
- Overall expenditure on IT still around 2.1% of revenues
- No significant reduction in turnaround time for account opening



Bad debt management
- Overall Gross NPA (%) up by ~100 basis points over FY 2010-11
- Commercial segment Gross NPA up by ~160 basis points over FY 2010-11
- Retail segment Gross NPA down by ~140 basis points over FY 2010-11
- Corporate debt restructuring at ~7% of advances over FY 2010-11

Branch sales and service excellence
- Share of non-urban in new branches at 74% up from 59% in FY 2010-11
- No. of new branches opened has increased by 7% over FY 2010-11
- Savings bank accounts opened per urban branch has remained stagnant
- Cash transactions per branch has increased by 7.5% over FY 2010-11

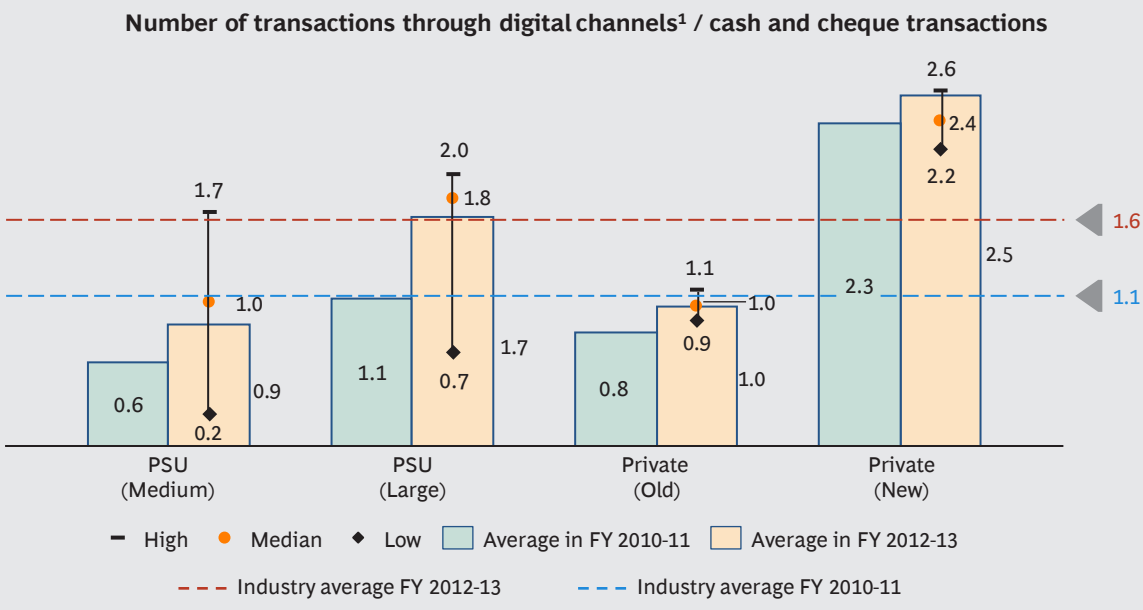
High–performance organization design
- Percentage of admin (HO+RO) staff at 12%, close to best in class at 10%
- Rise in admin staff by 1.6% over FY 2010-11
- Variable component of compensation increased from 1.6% in FY 2010-11 to 2.1% in FY 2012-13
- Not much change in finance, accounts, planning and HR staff over FY 2010-11

Changes seen over FY 2010-11 — Clear improvement — Marginal improvement — Clear deterioration

Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: NPA: Non–performing assets; HO: Head office or corporate center of the bank; RO: Regional offices / zonal offices / divisional offices of the bank.
[1]Transaction digital intensity refers to ratio of number of transactions through digital channels (ATM, POS, internet / online and mobile) to cash and cheque transactions in the bank.

EXHIBIT 1.2 | Momentum Seen Towards Digitization

Indian banks have done a reasonable job of increasing digital channel penetration



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 2 Private (Old), 3 PSU (Large) and 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
[1]Transactions through digital channels includes all financial transactions at ATMs by own customers, POS terminals, internet / online transactions and all mobile transactions.

also made progress (a 10 percent rise) from a relatively higher base and need a second wind. One of the subsequent chapters highlights how personal banking customers have adopted digital channels much faster than corporate banking clients. The size of the opportunity in digital is much bigger than what the banks have achieved so far. Progress on POS and mobile is not where it should be and the report highlights an action agenda for the same.

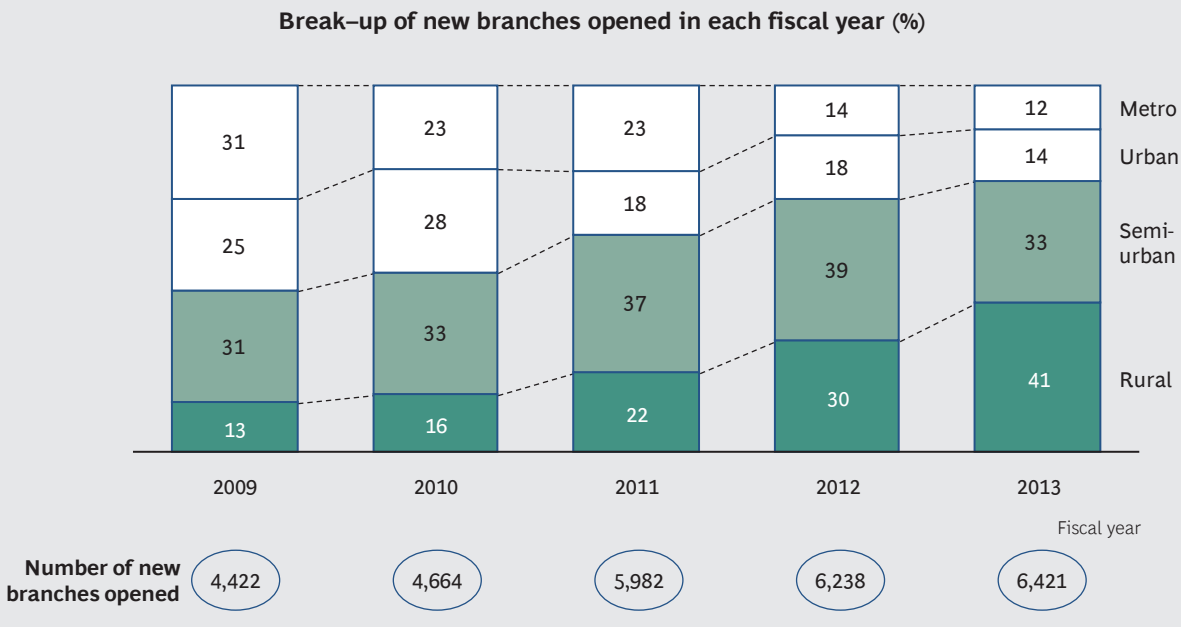
The industry has accelerated on branch additions. As depicted in Exhibit 1.3, for the last four years, every year more branches have been added as compared to the previous one. Moreover, the branch additions in semi–urban and rural areas have increased steadily, accounting for 75 percent of the total branches opened in FY 2012–13. This is an achievement for the banking industry and for the Reserve Bank of India (RBI).

Driven by multiple factors, including– increasing branch penetration, the Indian banking industry reduced its reliance on bulk deposits during the last two years. This is depicted in Exhibit 1.4. For the banking industry as a whole, retail term deposits as a proportion of the total term deposit base increased from 46 percent to 52 percent. New private sector, which was particularly low at 26 percent retail composition in term deposits in FY 2010–11 has come up to 33 percent in two years. The overall systemic robustness of the banking industry is steadily inching in the right direction. These achievements notwithstanding, branches have more cash transaction per day than before and the clutter is only increasing. The number of accounts opened per day by branches has remained flat during this period. Banks need to build on their laurels in the branches.

Gross NPA on bank books have reached 3.4 percent of the total advances with the restructured loans standing at 7.1 percent. There is a possibility that 15 to 20 percent of the restructured book may slip into NPA by FY 2013–14, should the economy not improve and gross NPA could reach close to 5 percent. Banks have lent a helping hand to industry which is stretched due to policy hurdles, approval delays, and economic slowdown. And

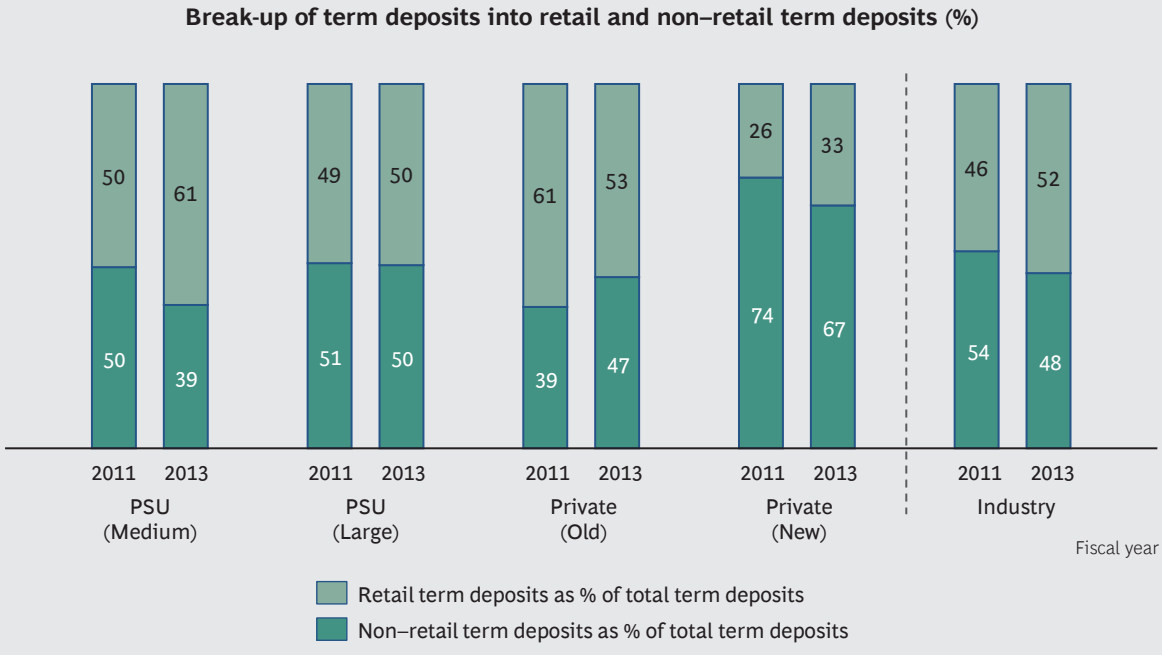
EXHIBIT 1.3 | Branch Expansion up 45 percent in Five Years

Semi–urban and rural share in new branches upto 74 percent in FY 2012–13 from 44 percent in FY 2008–09



Sources: IBA data; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

EXHIBIT 1.4 | Less Reliance on Bulk Deposits



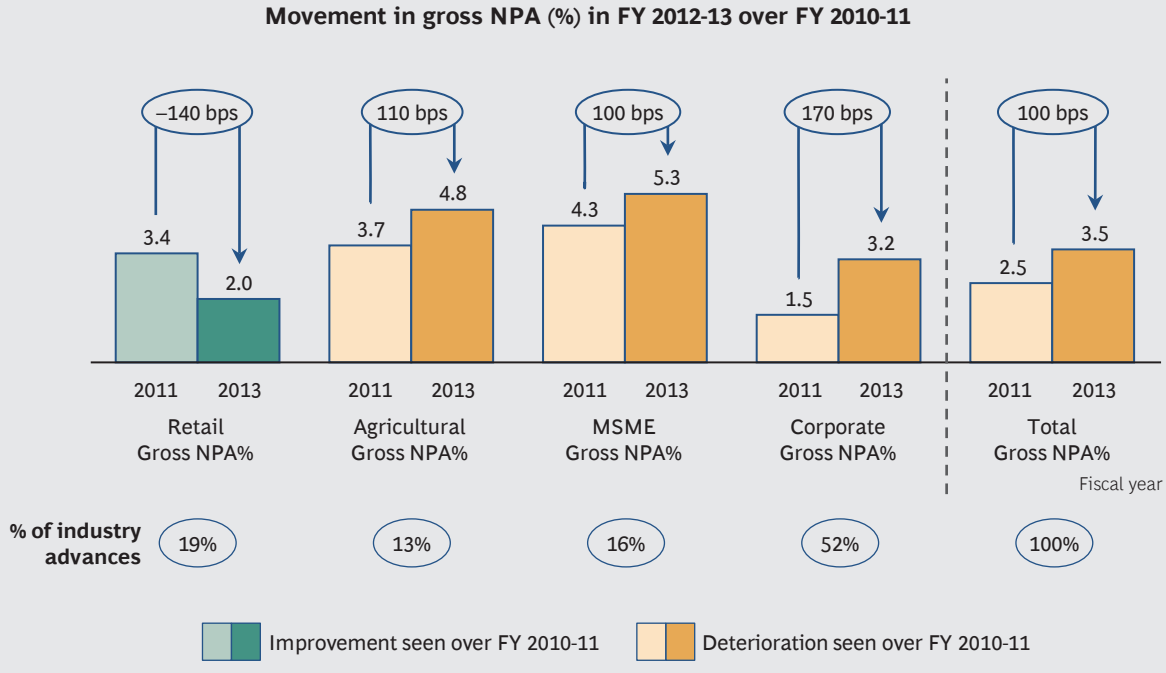
Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 3 Private (Old), 3 PSU (Large) and 9 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

the impact of this restructuring on the banks' books has been significant, implications of which loom large on the banking sector's projected financial performance. This research has highlighted a disaggregated position of NPA and found that retail NPA ratios declined handsomely during this timeframe from 3.4 percent to 2.0 percent. This is depicted in Exhibit 1.5. Despite the perceived slowdown in the economy, the retail engine kept humming fast and profitably. New practices adopted by the banking system, such as the usage of credit information bureaus for retail lending, are credited with driving a significant proportion of this improvement.

Customer feedback gathered for this report, from over 500 corporate clients of Indian banks, is stellar. While tepid demand for credit has hogged the limelight in discussions, the level of Indian corporates' advocacy for their banks was found to be in line with the best BCG has seen across the world. Giving Indian banks a net advocacy score of 21 percent, corporate have handsomely recognized the former's contribution in terms of flexibility and relationship. Along with the praise, corporates have highlighted the need for banks to improve operations, technology, turnaround time, and innovation. A study of corporates' banking relationship revealed how banks can improve profitability of their relationships by building primary relationships with clients, improving service levels with regards to transaction banking products, and ensuring a multi product relationship with their clients.

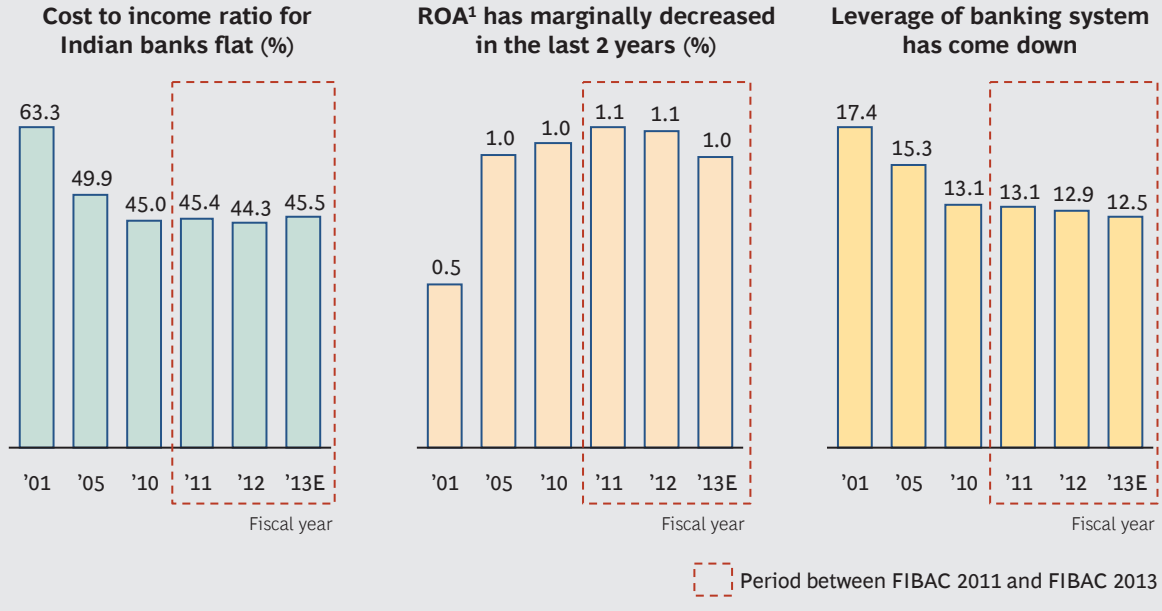
Despite the challenges, the health of the Indian banking industry continues to be solid. Exhibit 1.6 depicts the key ratios pertaining to the sector. The cost–income ratio has been range bound with a very marginal uptick. Profitability, measured by ROA, has also been steady, registering a marginal decline over the most recent fiscal year. Over the last ten years, the leverage (debt–to–equity ratio) of Indian banks came down from 17.4 to 12.5. The banking industry and the Reserve Bank of India have managed to make the financial system more robust so that it can absorb shocks.

EXHIBIT 1.5 | NPA Has Gone up But Not Everywhere



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; bps: Basis points; NPA: Non–performing assets; MSME: Micro, small and medium enterprises.

EXHIBIT 1.6 | Steady Financials



Sources: IBA data; Capitaline data; BCG analysis.
Note: FY'13E: Estimated value for FY 2012–13, data sourced from capitaline; Leverage refers to debt to equity ratio and is calculated as (ROE/ROA)–1; ROA: Return on assets.
[1]ROA is calculated for the Indian banking industry excluding foreign banks.

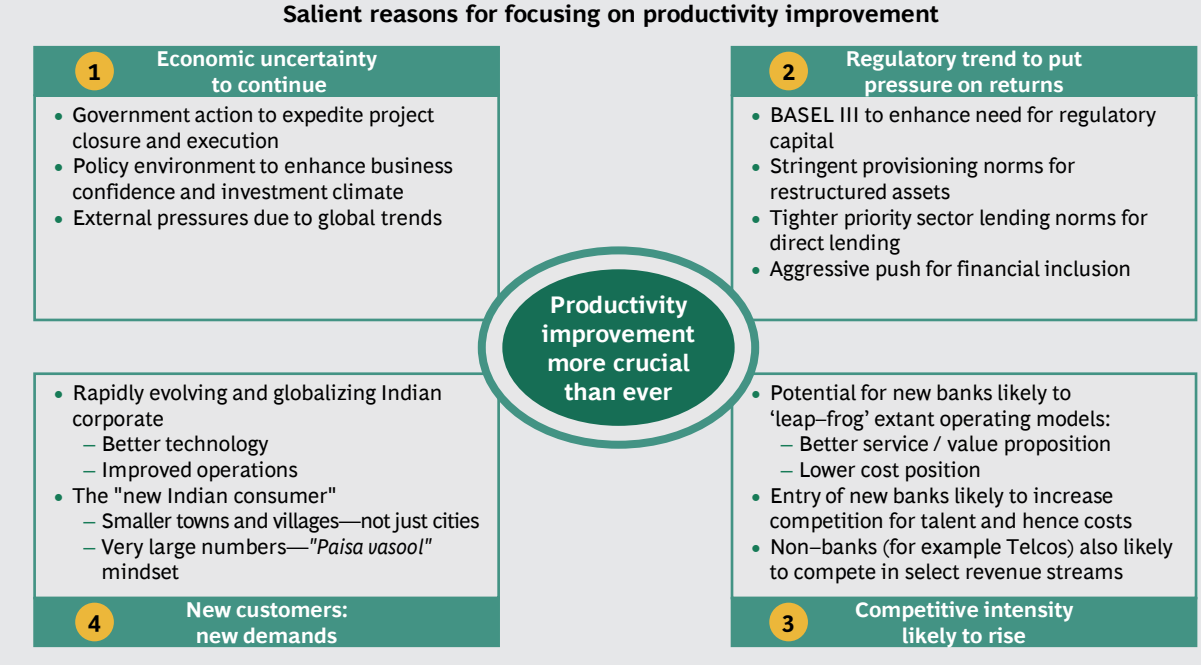
Three Years Hence: Many Challenges; Even More Opportunities

The challenge is not just the economic uncertainty and their natural fall out in terms of rising bad debt. The next three years are expected to witness trends that will compound the pressure on banks. As depicted in Exhibit 1.7, three other trends will put pressure on banks performance, apart from the economic uncertainty. The regulatory framework is expected to be much tougher. Restructuring norms will result in additional provisions every year. New Priority Sector Lending (PSL) norms mean even higher remote business gathering with deeper penetration in rural and semi–urban areas. The new Basel III regulatory framework would require banks to beef up their capital ratios, meaning that they will need to generate higher ROA to meet their profitability goals. An even bigger threat is likely to come from the new "new" private sector banks that should get banking licenses and begin operations within two to three years. These new "new" banks would come with customer value propositions that are a generation ahead of the ones offered by the incumbent industry players. They would come with next generation technology without any legacy issues to deal with. They would seek to lure away customers and employees from existing banks. All of this would lead to a spike in costs. Customer expectations are rapidly rising. The corporate survey highlighted that customers are unhappy with the service quality, technology, and operations. Meeting such expectations needs a continuous upgrade of infrastructure and capabilities.

On the retail end, we expect a massive surge in customers– hither to unbanked– to enter the space. These customers come with very high value for money ("*Paisa Vasool*") demands. They are large in number and they are based in smaller towns and villages. Serving them will put strong demand on operations and technology

Indian banks are not helpless in light of external circumstances. They are blessed with powerful opportunities that can more than offset the challenges, thus ensuring sustained healthy balance sheets and value creation. Unfortunately, it is not a choice but a compulsion to invest heavily in these opportunities in order to enhance productivity. These levers are critical to restore the banking in-

EXHIBIT 1.7 | Looking Ahead, Productivity Enhancement More Crucial Than Ever



Source: BCG analysis.

dustry to the pink of health, when the economy finally turns and the industry again looks at banks to support and fund their ambitions. This report has identified a range of ideas that banks should evaluate.

Chapter 2: Enhance profitability of corporate book with stronger transaction banking, deeper primary relationships, higher share of wallet through multi product relationships and better pricing

Chapter 3: Revamp credit processes and systems with technology, information analytics, and capacity building in Small and Medium Enterprises (SME) credit and smarter restructuring

Chapter 4: Further enhance branch productivity through a battle tested five star approach. Leap frog to next generation paperless branches

Chapter 5: Adopt lean processes and operating model with high "tooth–to–tail" ratio and realign technology investments

Chapter 6: Step jump in digital adoption with special emphasis on new customer on–boarding and channel design

Chapter 7: Higher organizational effectiveness through delayering the administrative offices and more effective incentive system

HIGH PERFORMANCE CORPORATE BANKING

INSIGHTS FROM INDUSTRY FEEDBACK

"Your most unhappy customers are your greatest source of learning"

— Bill Gates

While the retail segment has been reasonably vibrant for Indian banks in the last two years, the lack of credit demand from corporate has been a drag on growth. We surveyed over 500 companies ranging from very large to very small to understand how they bank and the level of satisfaction with Indian banks. We found overall advocacy of Indian banks is at par with international benchmarks. Nonetheless, when results are broken down by size of companies, type of banks, sectors and products, several differences emerge. As a major feedback from corporates, Indian banks need to improve their operational and technological capabilities to meet the service expectation. We found that across all segments, being a primary banker is disproportionately beneficial. Conventional wisdom that lending is crucial for primary banking relationship is challenged. Instead, we find that transaction banking products (such as current account) are primary drivers of such relationships. Product intensity varies across sectors and banks need to re–evaluate their current client portfolio to ensure they are not overweight on lending intensive sectors. Public sector's client profile is one of the reasons why its NPA levels is high. Finally, an attempt is made to deep dive into the attributes that are considered important by corporates for each product. Analysis shows stark differences in SMEs' and large corporates' needs as well as satisfaction levels across attributes. Overall, banks have a significant profitability improvement opportunity in their corporate books.

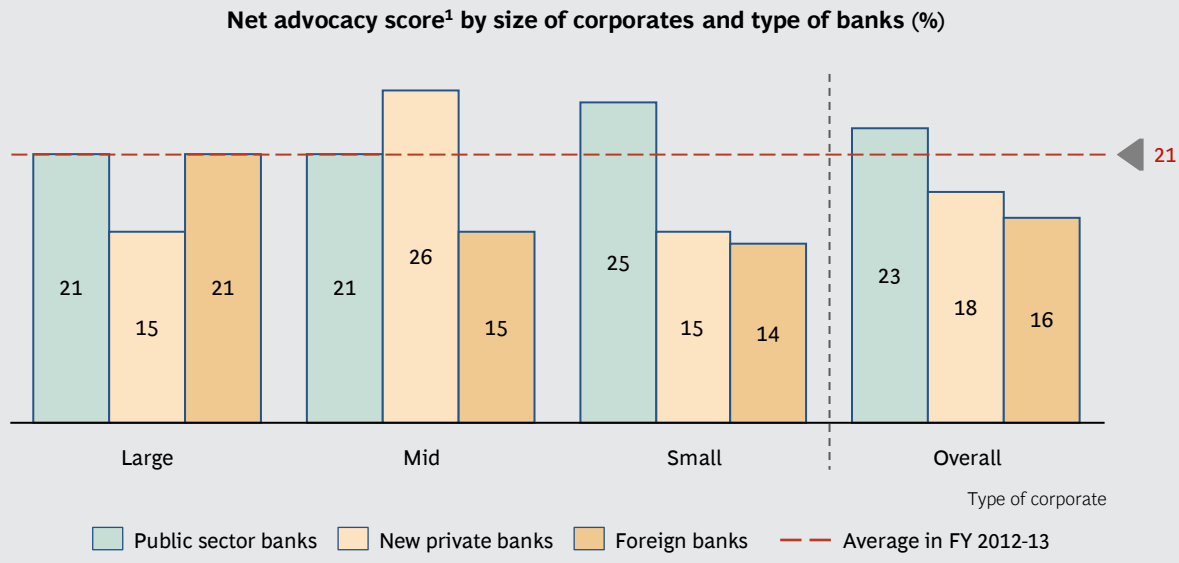
Overall Strong Advocacy; But Not For All

The overall advocacy level for Indian banks by corporate clients stands at 21 percent, a pretty good score given that scores above 20 percent are considered good for corporate banks internationally. However, there are significant variations. Exhibit 2.1 depicts the advocacy scores for different types of Indian banks by the size of corporate clients. Overall, the score for public sector banks is highest at 23 percent, followed by the new private sector banks at 18 percent and foreign banks at 16 percent.

The advocacy level for public sector banks goes up as we move from large to small corporates, standing out at 25 percent in the small corporate segment. The reverse is observed for foreign banks where the advocacy level falls as we move from large to small corporates. On the other hand, new private sector banks enjoy the highest advocacy in the mid–corporate segment. Clearly, different segments of the Indian corporate sector find

EXHIBIT 2.1 | Healthy Advocacy Score for Indian Banks

Overall advocacy for new private and foreign banks is lower than PSBs



Sources: FICCI–BCG Survey; BCG analysis.
Note: Classification of corporates–Large: Having revenue of more than Rs. 1,000 cr. in FY 2012–13; Mid: Having revenue between Rs. 250–1,000 cr. in FY 2012–13; Small: Having revenue of less than Rs. 250 cr. in FY 2012–13; Public sector banks include SBI & Associates and nationalized banks; Old private sector banks (4) and other banks (4) have been excluded from the analysis above because of very small "N".
[1]Measured by Net Advocacy Score=Very Likely–Unlikely–Very Unlikely measured as a percentage of "N".

the propositions from different type of banks most suitable.

The variations across industry and products are more pronounced. Exhibit 2.2 highlights the stark variations in advocacy scores by industry, by product and by bank (top ten). Within the top ten banks, the advocacy score goes down from 38 percent to 10 percent. Two public sector banks top the charts. The list of top ten banks includes five public sector banks, three new private sector banks and two foreign banks.

Advocacy scores by product show an interesting pattern. Traditional products such as term loans, working capital finance, current account and trade finance get good advocacy scores. However, technology–and operations–intensive products like cash management, supply chain finance, custody, and advisory products like capital markets and investment management get relatively lower scores.

Certain sectors stand out in their advocacy for their bankers. Banks enjoy advocacy scores significantly above the average in verticals including professional services, financial services, manufacturing, power, energy and infrastructure, and telecom and IT. On the other hand, logistics, pharma and healthcare, real estate, retail and FMCG, metals and mining, education, etc. have significantly lower advocacy scores. It is observed that industries with higher product intensity (number of banking products used per customer) of transaction banking and advisory products, in general, have lower advocacy. Barring a few exceptions (for example, real estate, which has its unique context), most other industries show this pattern (as depicted in Exhibit 2.3).

Fix Operations And Technology: Industry Tell Banks

Exhibit 2.4 illustrates corporates' perspective on the key strengths and weaknesses of the Indian banking industry. On the whole, three strengths stand out by a large margin. Corporates believe that the Indian banks offer high–quality relationship management and good domestic branch network that serve their needs well. They also said that the Indian banks display a high degree of flexibility in supporting corporate clients. On the other hand, the perceived weaknesses show a pat-

EXHIBIT 2.2 | Advocacy Varies by Sector, Product and by Bank



Sources: FICCI–BCG survey, BCG analysis.
Note: Sectors having less than 15 responses and banks having less than 15 data points have been excluded; Public sector banks include SBI and Associates and nationalized banks.
[1]Measured by Net Advocacy Score=Very Likely–Unlikely–Very Unlikely measured as a percentage of "N".

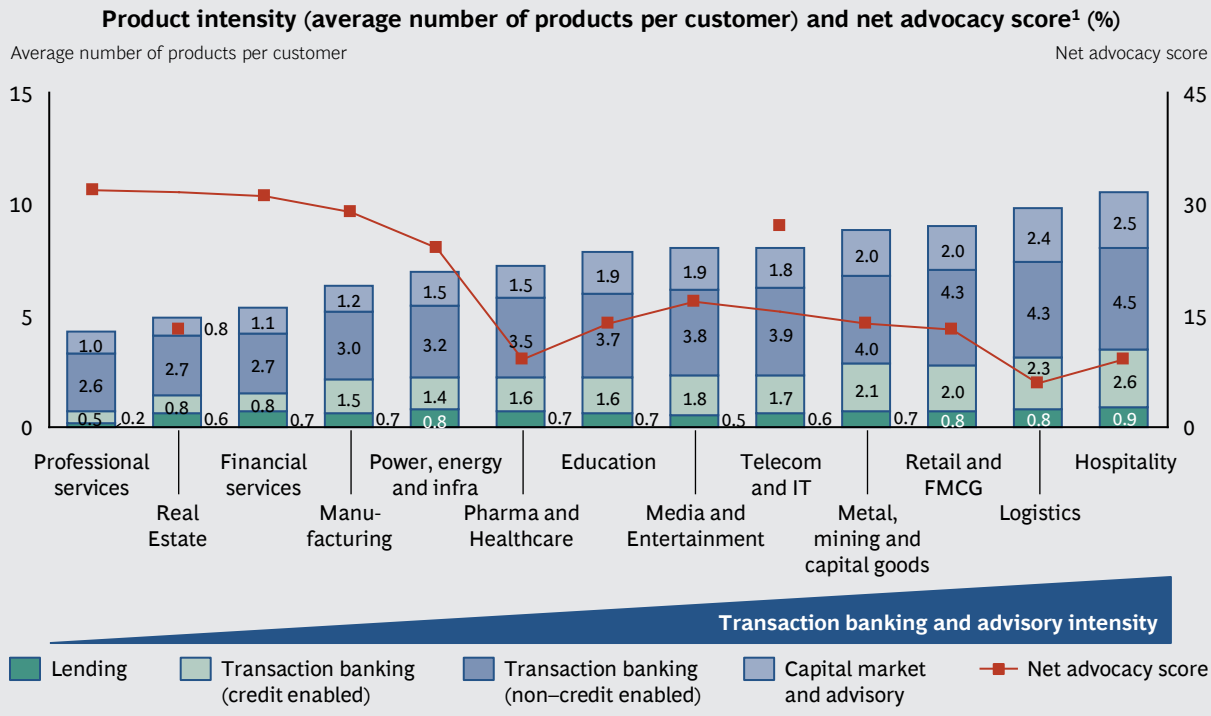
tern. Innovation stands out as the weakest spot. Speed of response / Turnaround Time (TAT), one of the top needs of corporate clients, is also cited as one of the prominent weaknesses. In general, areas that need operations– and technology–related expertise (for example, innovation, customization, fast processing and exception handling) are perceived as weaknesses.

How to Be a Primary Bank?

Most corporate customers perceive one bank to be their overall primary bank. As we mentioned earlier, this is the bank which has the first recall as their port–of–call for financial services. For some products the primary banks are different from the overall primary bank. Nonetheless, it is clear that the bank considered as overall primary bank gets larg-

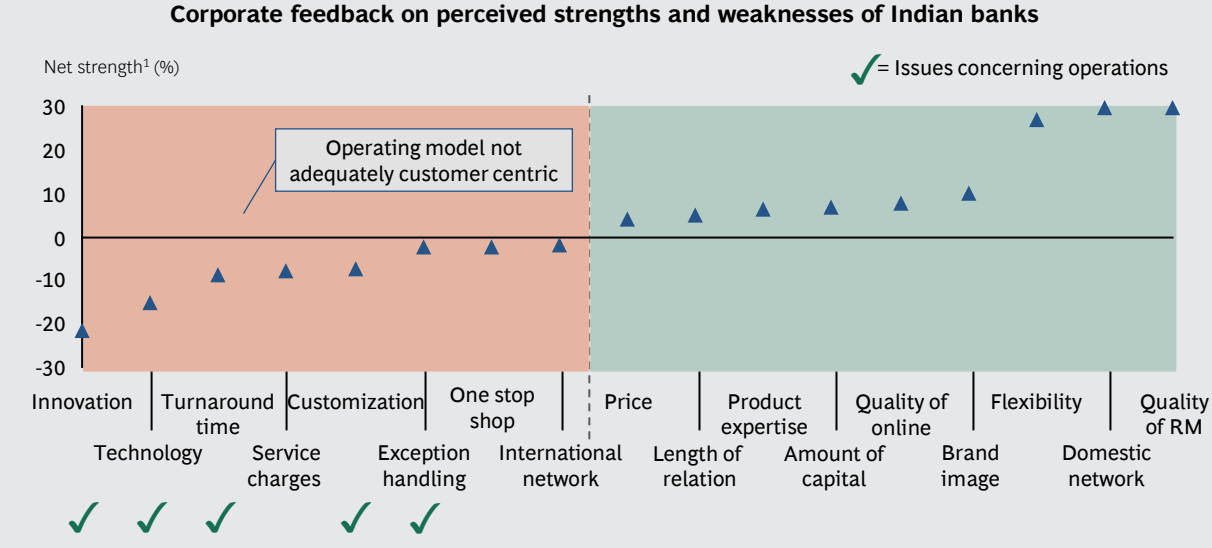
EXHIBIT 2.3 | Advocacy is Inversely Correlated with Product Intensity

Transaction banking and advisory products are primary drivers of product intensity



Sources: FICCI–BCG Survey; BCG analysis.
Note: Lending includes term loans; Transaction banking (credit enabled) includes working capital finance, trade finance, supply chain finance; Transaction banking (non–credit enabled) includes cash management, current account, payroll account, forex and custody; Capital market and advisory include capital market products, investment management and insurance; Sectors with less than 15 responses excluded from analysis.
[1]Measured by Net Advocacy Score = Very Likely–Unlikely–Very Unlikely measured as a percentage of "N".

EXHIBIT 2.4 | How Industry Views the Indian Banking Sector?



Source: FICCI–BCG Survey; BCG analysis.
[1]Net strength for an attribute is defined as number of corporates who voted it as strength minus the number of corporates who voted it as weakness. Positive values are overall strengths, negatives are weakness while zero values are neither strengths nor weaknesses.

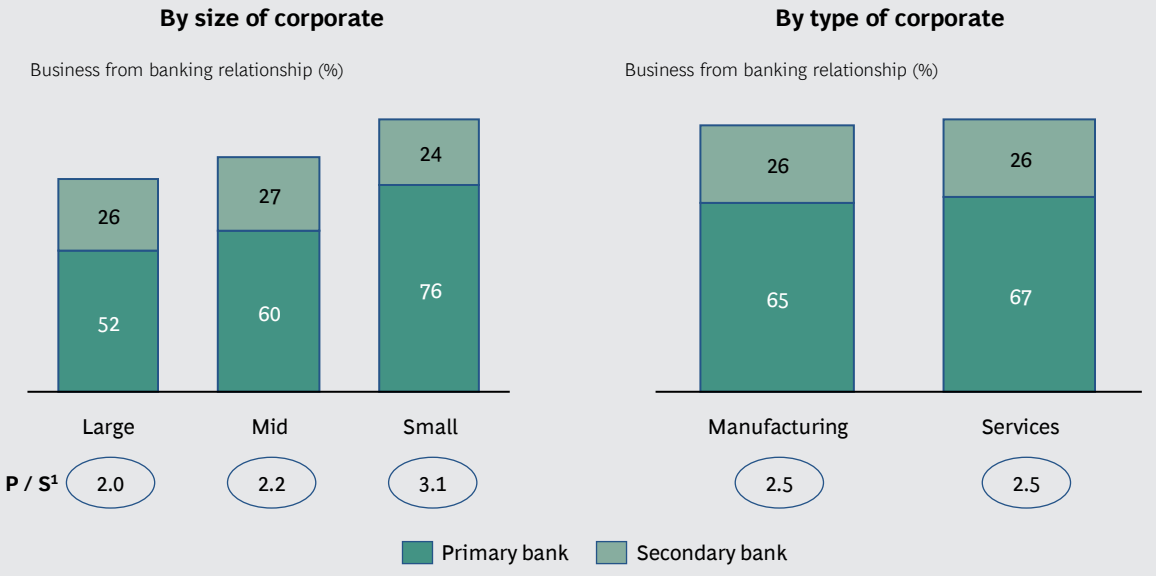
er share of business. As shown in Exhibit 2.5, primary bank's share of business from large corporate clients is typically 2X the share garnered by the secondary bank for same set of clients. The ratio increases to 3X for smaller clients. The same pattern is observed at the industry level (manufacturing and services). Hence, it is advantageous to be the primary bank of the corporates as such banks get proportionately higher share of clients' banking business.

Exhibit 2.6 depicts the pattern of banking relationships from the overall primary bank and other banks. The graph shows the proportion of total customers who use a particular product and within that, it shows the proportion of clients for whom the overall primary bank is the primary provider of that product as well. For instance, 93 percent of the sample uses current accounts and 82 percent have their overall primary bank as the primary bank for their current accounts also. Similarly, 42 percent of the 62 percent corporates in the sample who take working capital finance have their overall primary bank as the primary provider of working capital finance also.

It is clear from the analysis that the product that defines primary banking relationship is current account. Almost 90 percent of clients (using current account) keep current accounts with a bank that they consider their overall primary bank. Working capital finance comes a distant second. The corporate customers who do not use current account (seven percent of the sample) treat working capital facility (cash credit) for transaction purposes. For such customers, working capital finance determines the primary banking relationship.

It is very clear from Exhibit 2.7 that lending does not define primary banking relationship. Just because a bank is lending its balance sheet to a corporate client, it does not become the latter's primary bank. On the other hand, banks with substantial balance sheet exposure to a corporate client should use their bargaining power to be considered pri-

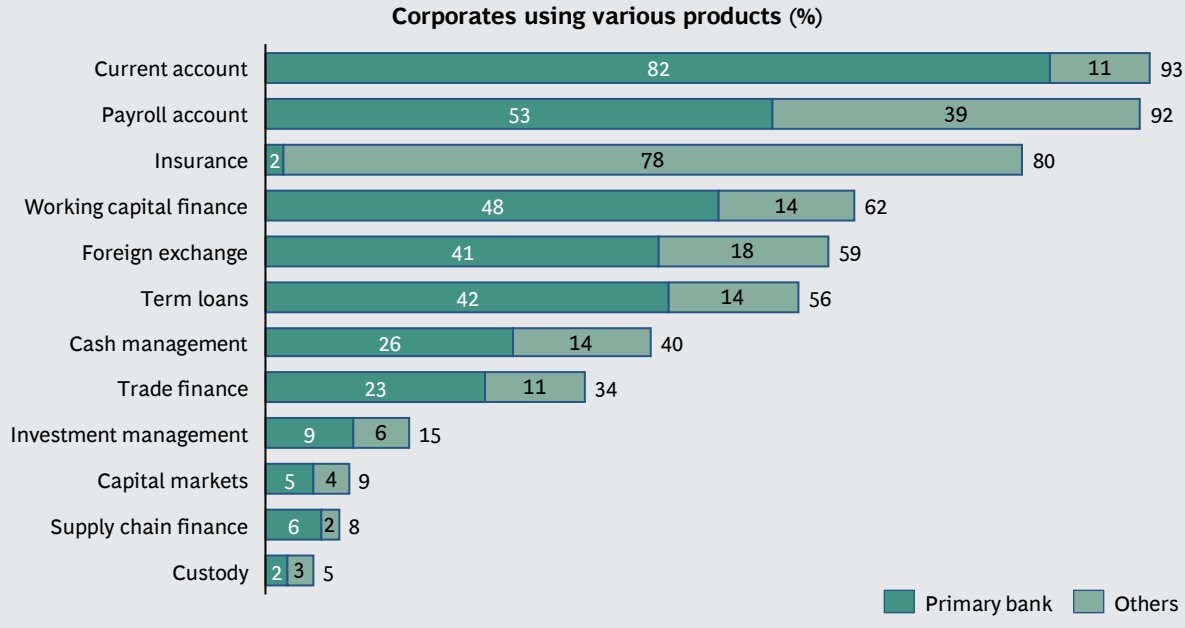
EXHIBIT 2.5 | Primary Banks Get ~2–3x Business Share Than Secondary Banks
Primary banks get higher share from smaller companies



Sources: FICCI–BCG Survey; BCG analysis.
Note: Primary bank is defined as the bank having maximum share of a corporate's banking business; Secondary bank is defined as the bank having second highest share of business; Classification of corporates—Large: Having revenue of more than Rs. 1,000 cr. in FY 2012–13; Mid: Having revenue between Rs. 250–1,000 cr. in FY 2012–13; Small: Having revenue of less than Rs. 250 cr. in FY 2012–13; Sectors have been classified as manufacturing and services based on National Industrial Classification Report from Central Statistical Organization; Manufacturing includes power & energy, pharma, textiles, metal, mining and capital goods, real estate, retail & FMCG, gems & jewellery, oil & gas; Services include education, professional services, advertising, media & entertainment, hospitality, logistics, civil aviation, financial sector, healthcare, trading, travel & tourism, telecom & IT and other miscellaneous services.
[1]P / S = Share of primary bank business / share of secondary bank business

EXHIBIT 2.6 | Current Account Determines Primary Banking Relationship

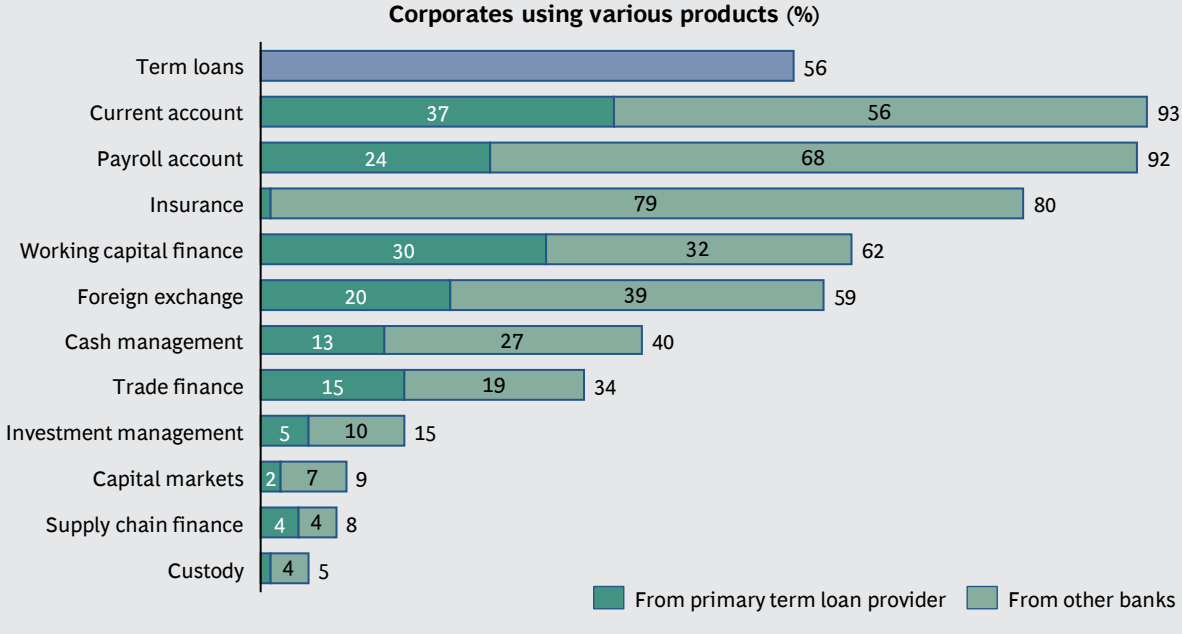
How many of your corporate clients keep their primary current account with you?



Sources: FICCI–BCG Survey; BCG analysis.
Note: Primary bank is defined as the bank which is regarded as the overall primary bank by the corporate.

EXHIBIT 2.7 | Lending is Not Enough to be Considered a Primary Bank

Lenders need to negotiate better share in other products / increase overall share of wallet



Sources: FICCI–BCG Survey; BCG analysis.
Note: Primary bank is defined as the bank which is regarded as the overall primary bank by the corporate.

mary banks for other profitable products. Even as the off–take of term loans by corporate clients for capacity expansion is low due to the ongoing economic slowdown (only 56 percent of corporates in the sample use term loans), banks could use this opportunity to build business in other products by leveraging the existing lending relationship.

Pathways To a Resilient and Profitable Corporate Franchise

Exhibit 2.6 shows that primary banks often do not get a healthy share of all profitable products from their corporate clients. Payroll account is a case in point. Only 53 percent of customers use their overall primary bank as the primary bank for payroll accounts while 92 percent of the corporates in sample avail payroll account facility. Hence, banks are missing on a significant profitability opportunity given the huge float from salary accounts of corporates' employees. Similarly, only 60–65 percent of corporate customers use their overall primary bank as the primary bank for cash management, forex products, trade finance and working capital finance. Banks who enjoy primary bank status with their corporate clients can use the relationship to deepen their engagement with such customers by offering more profitable products.

There are several industry segments that are not capital intensive and do not use term loans. Only 56 percent of the sample uses a term loan facility. Banks need to approach the remaining 44 percent with propositions that are not lending–driven, but are more oriented towards facilitating transactions. While there is tepid demand for credit in the corporate segment currently, banks can focus on the non–credit driven parts of the product portfolio.

Exhibit 2.3 shows the intensity of product usage by different sectors. It is evident that requirement of banking products and services is very high in case of certain sectors. Capitalizing on such relationships can be extremely profitable for banks, given their huge cross–selling potential.

As depicted in Exhibit 2.3, lending products (pure term lending and credit–enabled transaction products) are a small portion of the product portfolio needed by many sectors. Non–credit enabled transaction banking products (for example, current account, payroll account, forex etc.), and capital markets and advisory products constitute a major component of corporate demand. Banks need to evaluate whether their client mix has a fair share of customers from sectors that have high product intensity so as to achieve higher profitability per client.

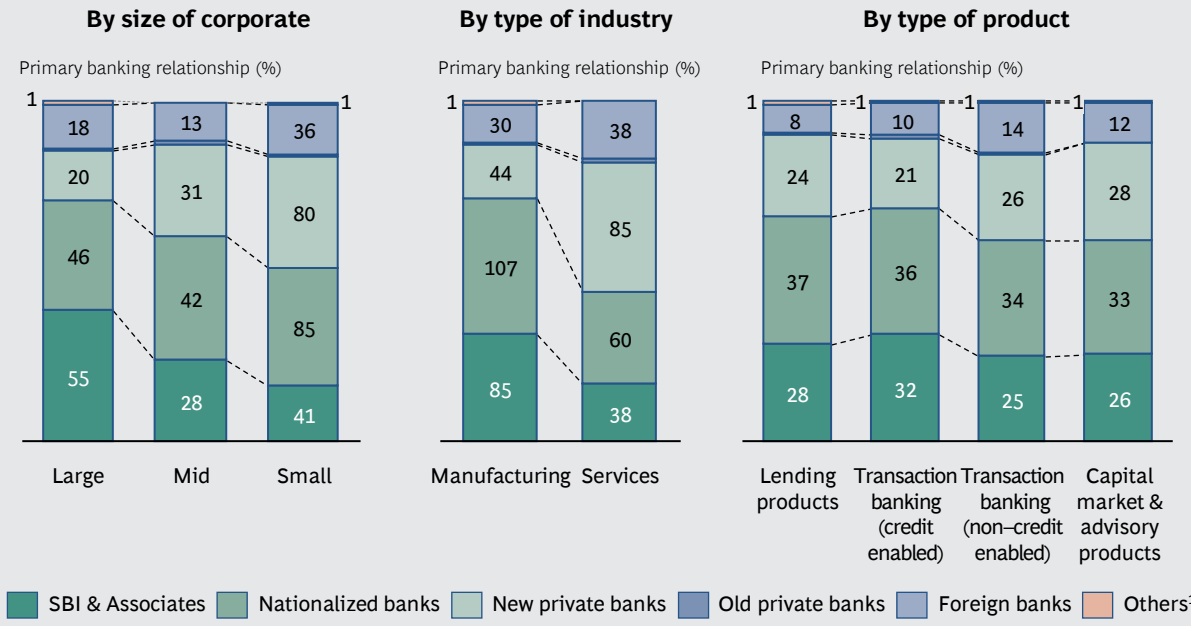
Exhibit 2.8 shows the current pattern of primary banking relationships in the Indian corporate banking market. It is evident that public sector banks dominate manufacturing and other more traditional industry segments such as power, energy and infrastructure. New private sector banks dominate the services segment. The manufacturing sector is more lending oriented in its product demand and this leads to a more lending–oriented product portfolio of public sector banks. Share of public sector banks in lending and credit–enabled transaction banking products is higher. This can be changed with a concerted attempt to broaden and balance the customer portfolio.

Public sector lenders are the predominant primary banks for large corporate clients. As the size of corporates reduce, the share of primary banking relationship shifts to new private sector banks. Smaller corporates are less price sensitive and give much higher share of their business to their primary bank. If managed well, the profitability of serving this segment is very high. The next section discusses the areas where small enterprises are not happy, and what would it take for banks to build primary relationships with such customers.

On the other hand, data clearly highlights that public sector banks in general, and State Bank of India in particular, have a unique opportunity to leverage the extensive primary banking relationships to enhance depth and profitability of their corporate franchise.

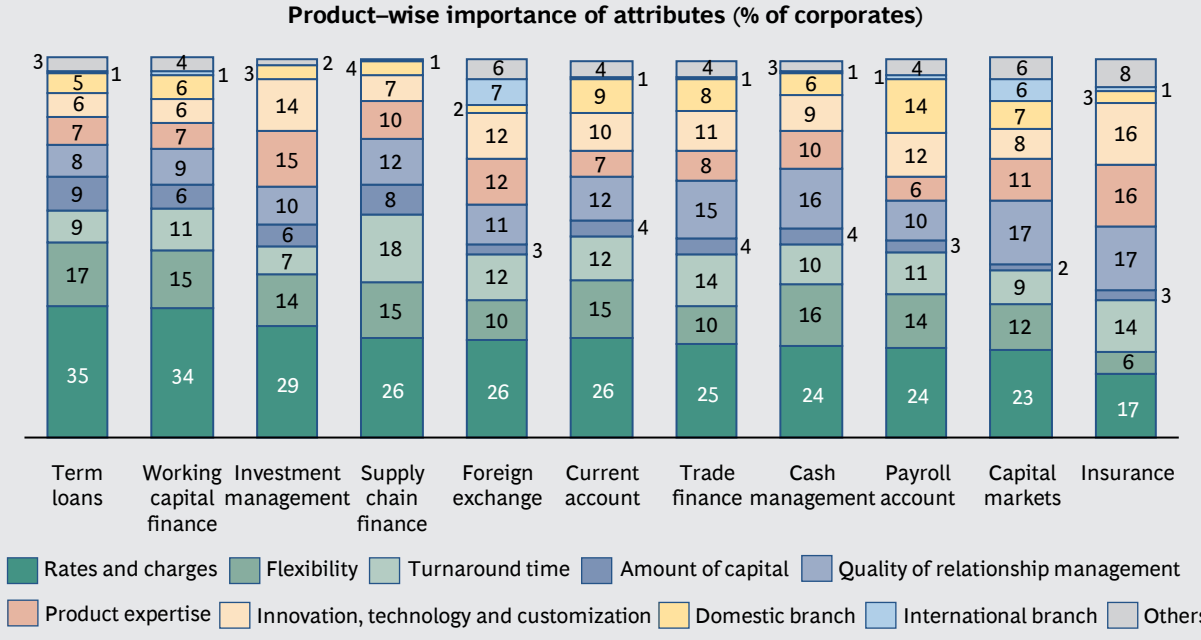
Primary banks can gain a share of corporate clients' wallets by being competitive on the product portfolio. Exhibit 2.9 shows the relative importance of various attributes in a

EXHIBIT 2.8 | Pattern in Primary Banking Relationships



Sources: FICCI–BCG Survey; BCG analysis.
Note: Classification of corporates—Large: Having revenue of more than Rs. 1,000 cr. in FY 2012–13; Mid: Having revenue between Rs. 250–1,000 cr. in FY 2012–13; Small: Having revenue of less than Rs. 250 cr. in FY 2012–13; Lending products include term loans; Transaction banking (credit enabled) include working capital finance, trade finance and supply chain finance; Transaction banking (non–credit enabled) includes cash management, current account, payroll account, forex products and custodial services; Capital market and advisory products include capital market products, insurance and investment management.
[1]SIDBI and Cooperative bank.

EXHIBIT 2.9 | Product Wise Attributes Critical to Customers



Sources: FICCI–BCG Survey; BCG analysis.
Note: Rates and charges include cost of capital and service charges; Technology includes quality of online and mobile banking; Others include exception handling, length of relationship and brand image of the bank.

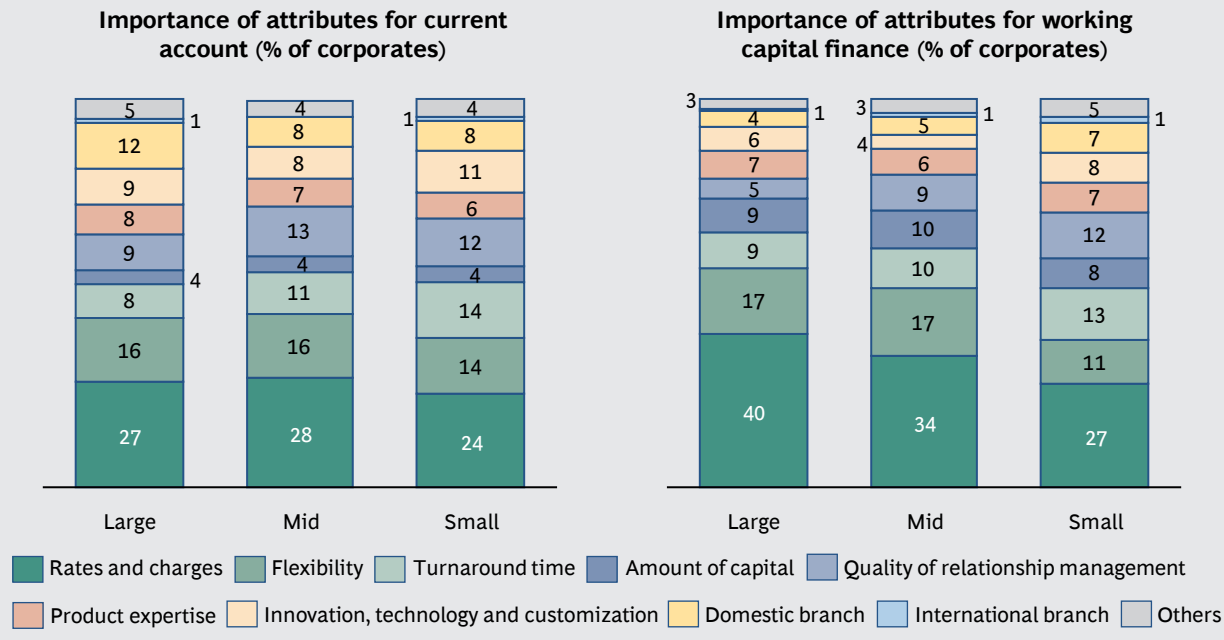
product from a customer's perspective. Pricing and service charges stand out as the predominant factor across the board. The importance of price is higher in traditional lending–oriented products and is less important in transaction banking products. Banks whose product portfolio is skewed toward traditional products face relatively higher margin pressure during times of economic slowdown. Beyond pricing, the top attributes important to customers are flexibility and shorter turnaround time. The other three critical elements are quality of relationship management, product expertise, and innovation, technology and customization. The weight of attributes varies by product and can be used by banks to fine–tune their product proposition.

How to Win in SMEs

Needs of the SMEs are very different from those of larger corporates. Exhibit 2.10 encapsulates the feedback from companies of different sizes for current account (non–credit enabled transaction product) and working capital finance (credit–enabled transaction product). SMEs are less price sensitive than large corporates. The difference in sensitivity to price between the two is particularly stark in case of working capital finance. It is a bit subdued, but perceptible, even in case of current account. Therefore, SME franchise is more profitable with right pricing. SMEs place higher emphasis on turnaround time and quality of relationship management. By emphasizing on these two attributes, a bank can build a more compelling SME business model, and gain share as a primary bank in the segment.

Exhibits 2.11 depict the contrast in levels of satisfaction between large and small corporate clients. The exhibits show the satisfaction levels for each attribute across six most used corporate banking products. It is evident that the satisfaction level of small corporates is invariably below that of large corporates across all products. The small corporate segment does not get enough quality service. The gap between satisfaction levels of large and small corporates is much larger in cash management, working capital finance and trade finance while being smaller in current account, payroll account and term loan.

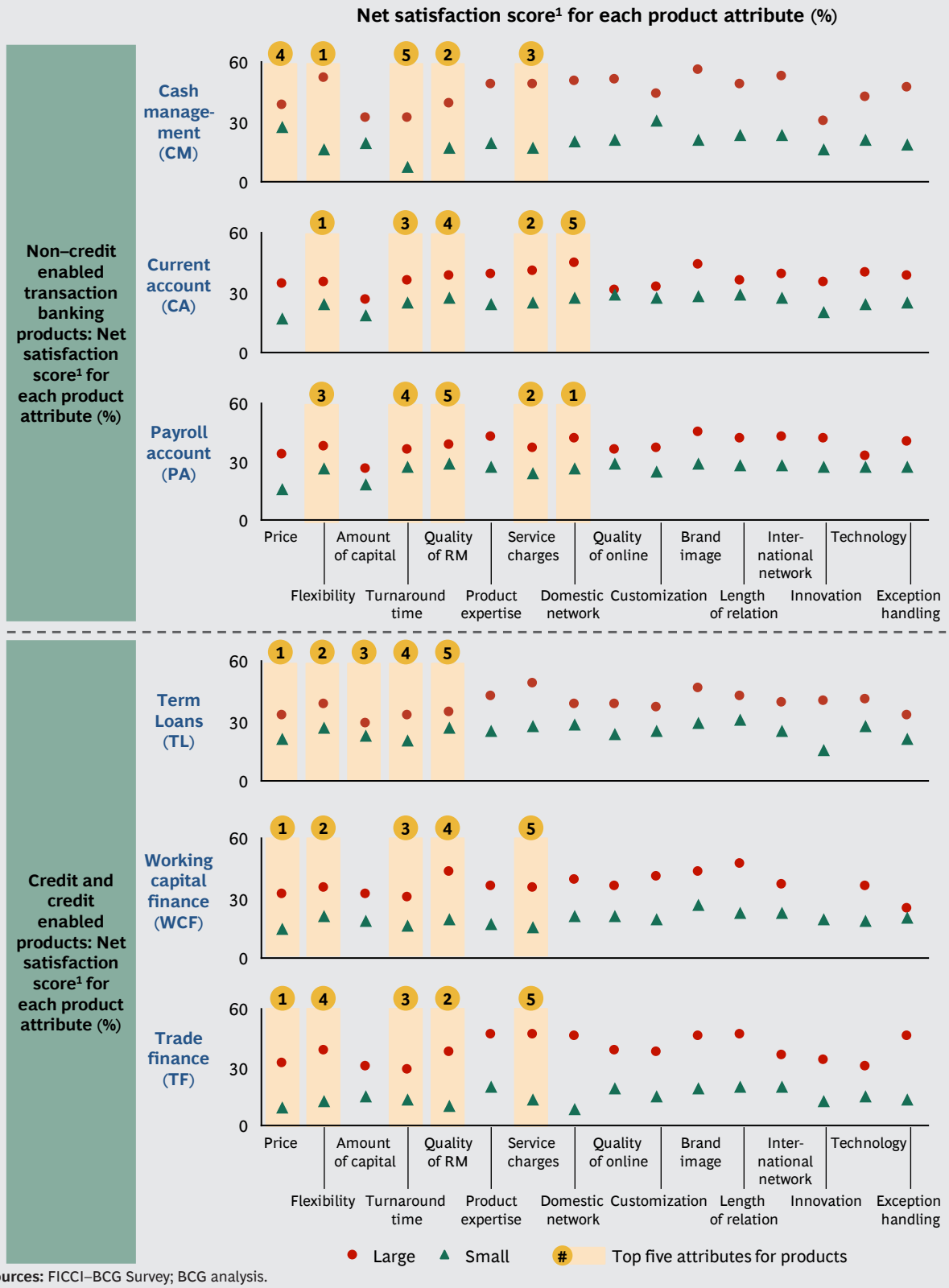
Exhibit 2.10 | Business Markets for SME Needs to Acknowledge Their Unique Demands
SME place lesser emphasis on price; higher on turnaround time and relationship management



Sources: FICCI–BCG Survey; BCG analysis.
Note: Rates and charges include cost of capital and service charges; Technology includes quality of online and mobile banking; Others include exception handling, length of relationship and brand image of the bank; Large corporates: Having revenue of more than Rs. 1,000 cr. in FY 2012–13; Mid corporates: Having revenue between Rs. 250–1,000 cr. in FY 2012–13; Small: Having revenue of less than Rs. 250 cr. in FY 2012–13.

EXHIBIT 2.11 | Variation in Satisfaction Between Large and Small Corporates

Higher dissatisfaction in credit–enabled transaction banking (WCF, TF) and technology–centric products (CM)



Sources: FICCI–BCG Survey; BCG analysis.

Note: Large corporates: Having revenue of more than Rs. 1,000 cr. in FY 2012–13; Small corporates: Having revenue of less than Rs. 250 cr. in FY 2012–13

[1]Net satisfaction score = Corporates who voted one minus the sum of corporates who voted as three or four on their satisfaction for each product attribute as a percent of total respondents for that particular product.

Clearly, small corporates do not get the desired service quality in products with a higher operations component.

SME business can be very profitable. For the banks who get it right, it is the most profitable segment in the corporate bank. It requires a different business model. Pricing is better. Clients are more willing to pay for service than large corporate clients. Moreover, SMEs have the personal business of owners that can be cross sold by the banks (consumer loans, savings, wealth management). In India, bad debt is a major drag in SME business profitability. So, deeper discussion on SME business model has been placed in the following chapters.

Implications for Banks

The feedback from corporates carries clear implications for banks. Even with the current slowdown in credit demand, there is a tremendous scope to improve profitability in the corporate banking franchise. Banks need to answer the following questions regarding their client and product portfolios, as well as their service levels based on technological and operational capabilities:

1. For how many of your clients are you the primary bank? Do you get your appropriate share in client business volumes? For how many products that your client purchases, are you a primary banker?
2. Is the client portfolio balanced? Is it too biased toward industry segments that are credit heavy and transaction light?
3. Is the product portfolio balanced? Does the bank have strengths in credit driven products and weaknesses in transaction products that are more driven by IT and operations?
4. Does the bank have a transaction banking unit that focuses on excellence in transaction banking products like cash management, current account, trade finance etc.?
5. Does the bank have a distinct SME banking model that ensures right level of relationship management, quick response time and right attention to operation quality in technology centric products?
6. Does the bank plan to use operation and technology to differentiate its proposition to corporate clients?

MANAGING BALANCE SHEET STRESS

NEXT–GENERATION CREDIT AND COLLECTIONS PRACTICES

"Our fears always outnumber our dangers"
— Latin Proverb

Between FY 2010–11 and FY 2012–13, bad debt on the books of Indian banks has increased inordinately. There is a justifiable alarm. Naysayers believe there is a lot of bad debt that is hidden, and it would surface in days to come. Fatalists argue that it is driven by economic headwinds, and that we have to wait till the economic troubles abate. A closer examination of facts, however, throws up a nuanced view that belies both naysayers and fatalists. This research highlights that:

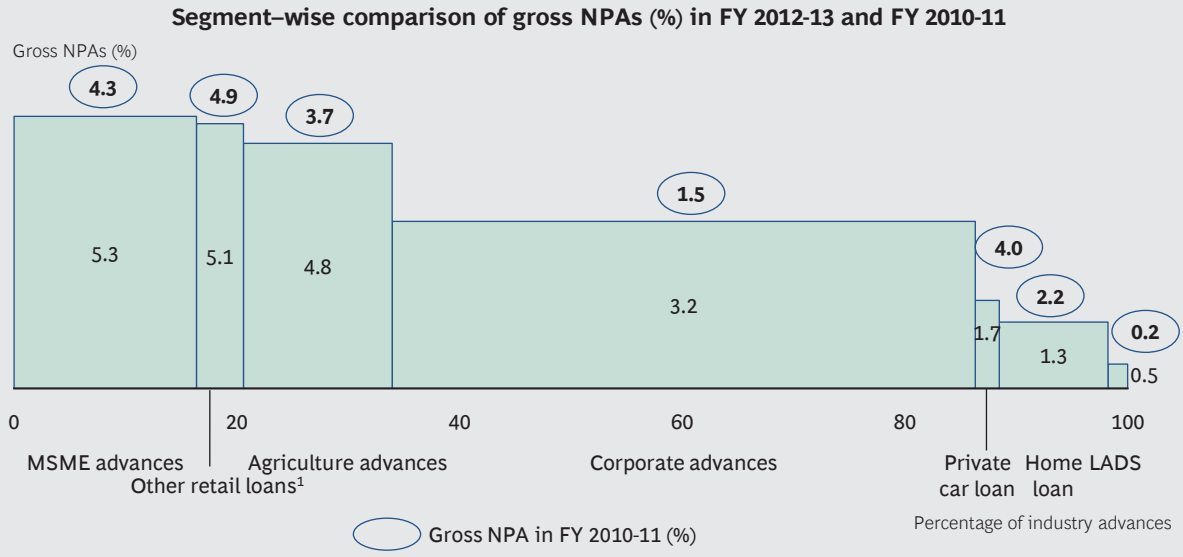
- Growth in bad debt is primarily driven by corporate and SME credit, which accounted for almost 90 percent of the growth in NPA. Every other category of lending saw at least one type of bank actually improving their gross NPA ratio by more than 100 basis points
- Cutting across bank type, retail credit saw a dramatic decline in bad debt. Advanced approaches like use of credit information bureaus have played a role. Such advanced approaches like deploying information and data analytics are missing in corporate credit
- Banks need to invest in enhancing quality of credit process, reducing cycle times, enhancing technical capacity, and improving pricing
- Banks need to develop capabilities in better strategic due diligence and monitoring and oversight of management and operational turnaround of restructured assets

Green Shoots in Otherwise Red Landscape

Exhibit 3.1 depicts the disaggregated profile of NPA in the industry in FY 2012–13, and in FY 2010–11. MSME and agriculture advances stand out as Achilles' heel. Both segments saw a one percent increase in gross NPA ratio over FY 2010–11. The corporate advances had the highest growth in gross NPA, from 1.5 percent in FY 2010–11 to 3.2 percent in FY 2012–13. Major segments of retail saw a reduction in NPA levels.

Exhibit 3.2 gives a more granular picture of the change in gross NPA observed in different segments between FY 2010–11 and FY 2012–13. In retail segments, almost all bank types witnessed a significant improvement in gross NPA. Corporate segment is the only one where we notice deterioration across all bank types–the trend being more pronounced in the public sector, a bit less so in the private sector. We find that the private sector has improved its NPA performance in

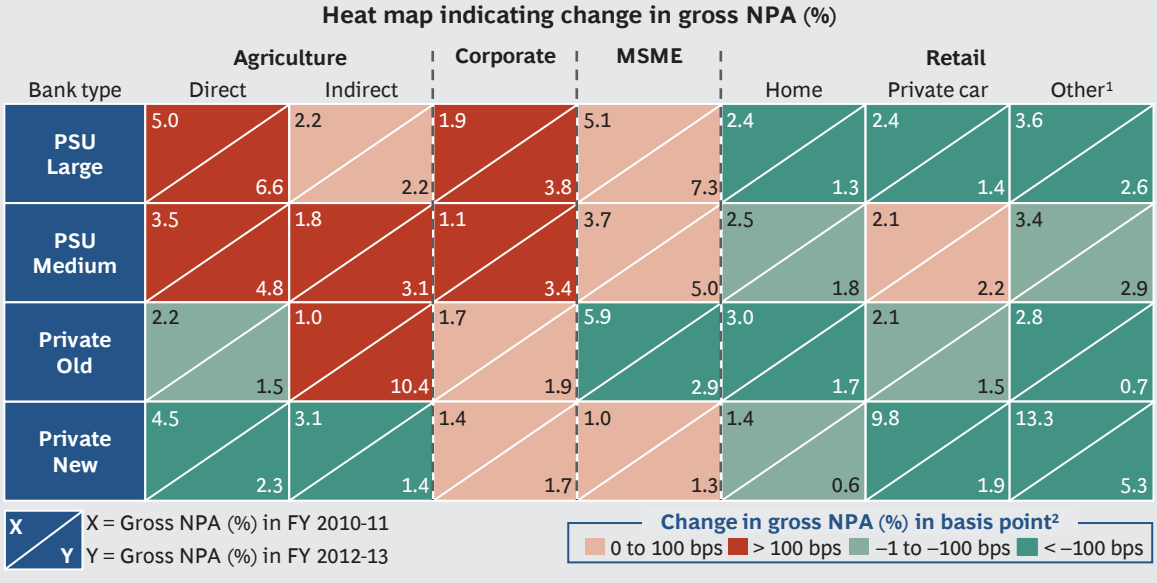
EXHIBIT 3.1 | NPA Profile in Indian Banking



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; NPA: Non–performing assets; LADS: Loan against deposits and shares; MSME: Micro, small and medium enterprises.
[1]Other retail loans includes personal, clean, unsecured loans and credit card loans.

EXHIBIT 3.2 | Green Shoots in an Otherwise Red Landscape

Green in retail and private new banks; attention required on direct agricultural, corporate and MSME



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; NPA: Non–performing assets; MSME: Micro, small and medium enterprises.
[1]Other retail loans include personal / clean / unsecured loans, student / education loans, credit cards, loan against deposits and security and non–agri jewel loans.
[2]Change in Gross NPA (%) in bps measured for FY 2012–13 over FY 2010–11.

agriculture segments, with the old private banks having the best performance at 1.5 percent of gross NPA.

The banking industry's success in retail lending is explained in large measure by the sector's adoption of credit information bureaus for credit appraisal. Such measures have not yet been taken in agriculture and MSME credit. Over the next three to five years, banks have to capitalize on rollout of Aadhaar to ensure adoption of information bureau for direct agriculture. MSME and corporate segments lend themselves to much more extensive use of data driven analysis techniques. They have to be adopted with urgency.

Our research has highlighted a set of specific ideas for each segment that can be effectively deployed by banks in the meanwhile.

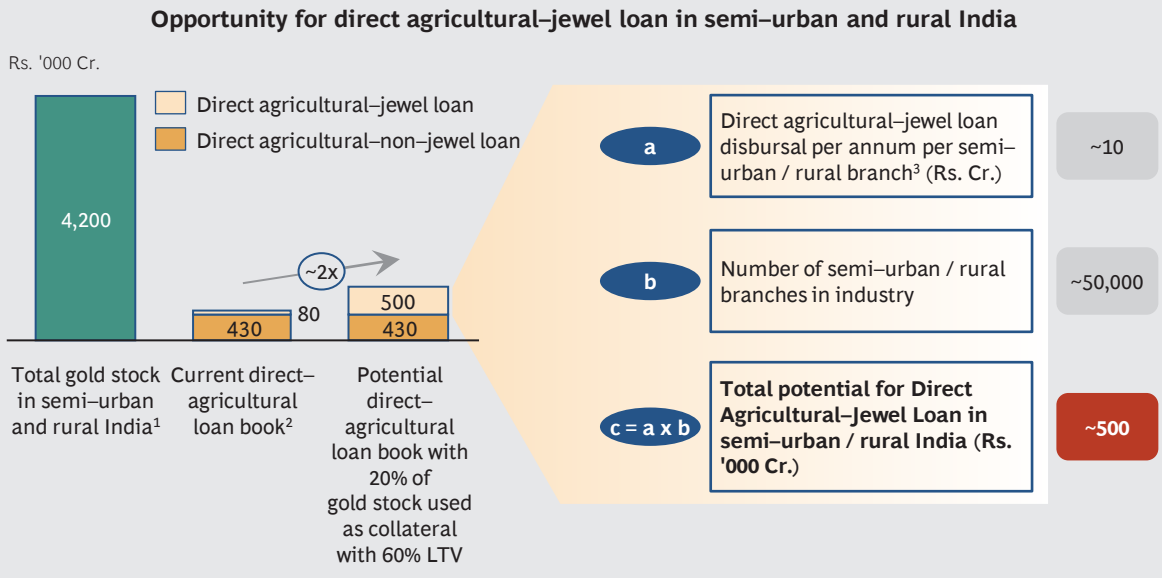
Gold Can be Golden: Possibilities in Agriculture Lending

Agriculture lending suffers from lack of any credible collateral. Threat of repossession of agricultural land is not a strong–enough deterrent to default. The experience of some banks and NBFCs in gold–backed agriculture loans offers an interesting opportunity in the medium term. Currently, about 16 percent of total direct agricultural lending of banks is based on gold being used as collateral.

It is estimated that the total gold stock held by households in semi–urban and rural India is close to Rs. 42 trillion. This stock is most likely to be in the form of jewellery. If 20 percent of this stock were to be used as collateral at 60 percent loan to value, to take loans for agricultural purposes, we could support Rs. 4.2 trillion of additional lending for agriculture purposes. This is nearly equal to the total current annual flow of credit for direct agriculture. This is a realistic possibility when triangulated with reference to banks' distribution network. Rs. 5 trillion of direct agriculture credit amounts to Rs. 100 million of gold–backed agriculture lending from each semi–urban or rural branch. Some banks actively pursuing such lending have indeed found this much off–take of credit per–branch feasible. This scenario is depicted in Exhibit 3.3. The massive amount of unproductive gold in India

EXHIBIT 3.3 | Gold Can be Golden

Opportunity to nearly double direct–agricultural loan book using gold as a collateral



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; World Gold Council; RBI; BCG case experience; BCG analysis.
Note: Data of 3 Private (New), 3 Private (Old), 1 PSU (Large) and 6 PSU (Medium) banks excluded from the analysis (regarding proportion of jewel loan in direct agri loans) because of data consistency issues or data unavailability; LTV: Loan to value ratio.
[1]Price of 10 gms of 24 karat gold taken as Rs. 30,000.
[2]Data for FY 2012–13 for 37 listed Indian banks.
[3]Based on BCG's experience in Indian markets.

can thus be leveraged to facilitate flow of credit to the crucial sector in a profitable and sustainable manner.

Speed of Credit Process: A Covert Driver of Credit Quality

BCG research and case experience have shown that the speed of decision making in the credit process has a direct bearing on the quality of the portfolio. Banks with very robust and thorough–but slow–credit process often end up with poor loan book. High turnaround time triggers a vicious cycle that is self–feeding, and creates an ecosystem that fosters poor credit (as shown in Exhibit 3.4). Good customers, typically, do not wait for the delayed decision, and try out other sources. This leads to adverse selection, and only poor–quality customers end up with the bank. The bad debt experience of the bank leads to low confidence among its credit staff, and encourages heightened risk averseness. Banks react by adding more checks and balances, which further elongates the decision time. Reduction of turnaround time is the first step in the journey toward excellence in credit. It is a tough nut to crack.

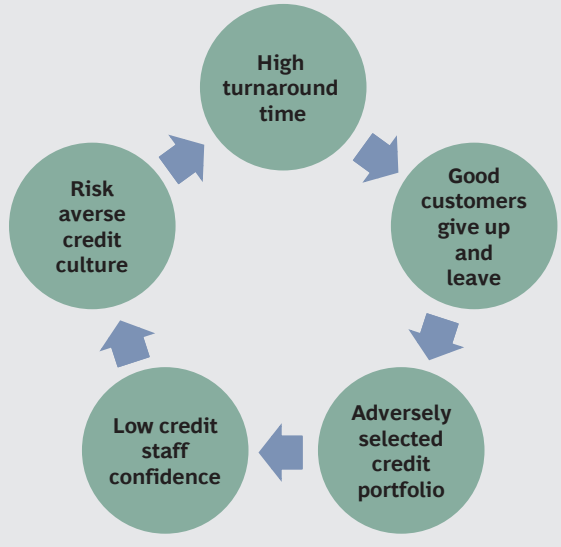
BCG project experience has shown that the following levers need to be pulled.

1. *Segmentation of credit process:* Certain credit proposals have to be automatic, some need to have light touch, and the remaining require full due diligence. Based on the amount of loan and the credit score of the customer, the process can be segmented so that certain proposals will be processed straight through while others get varying levels of manual processing. This is particularly true for annual renewals of the existing limits.

2. *Workflow automation:* The entire process has to be on an electronic platform, with minimum paper movement in the organization. Any paper involved is scanned at the very first instance, and then truncated.

3. *Rationalization of product portfolio:* Simplicity of product portfolio helps in ensuring that relationship managers and credit staff stay focused, and can explain to customers with confidence and authority. A plethora of products gives a false sense of comfort to the bank that it is customer centric. BCG case experience has shown that the majority of products are not known to the field staff, do not contribute much business, and simply add to complexity.

Exhibit 3.4 | Delay in Credit Decisions Triggers a Vicious Cycle



Source: BCG analysis.

4. *Templatized short credit memoranda:* Long credit memoranda typically do not contain more information. They hide lack of real information in a lot of words. We have found that templatized memoranda with restriction in size ensures quality and brevity of note and hence the decision.

5. *Modular documentation:* Documentation is often very lengthy, with a large number of signatures required for legal documents. In BCG experience, this documentation process can be streamlined by making it modular. Different modules may be required for different products.

6. *Remove wasteful iterations:* Redesign of processes steps should be undertaken to remove process inefficiency. Redundant checks, rework, queries and loops, and instances of "First Time Not Right (FTNR)" need to be identified and eliminated. The credit memoranda, prepared in the first instance, have to be final in terms of quality so that no rework is needed later.

7. *Process transparency:* The credit process has to be made transparent to the customer. If credit process workflow is automated, it is possible to give the customer access to the current status of his / her application. This has a strong bearing on customer satisfaction with the process, as well as on retention of quality customers.

8. *Use of advanced data analytics approaches:* Use of advanced approaches, based on analysis of data, to predict risk worthiness, or to provide early warning signals, is a powerful lever in commercial credit. It is of particular relevance in SME credit as it reduces cost of monitoring relatively small–ticket SME loans. Banks are at a particular advantage. Bank have core banking solutions established for the last five to seven years. They sit on huge data on customer transactions. This data can be analyzed to assess creditworthiness, or to trigger early warnings. In India, surrogate data gathered from external sources has to supplement financial and transaction data. This is critical due to non–reliability of financial data of certain type of customers. Surrogate data can be non–financial data like utility bills, etc. Predictive techniques throw up signals to inform and complement human judgment, and not to replace it. It is critical that the final decision is not abdicated to the machine even as the machine aides in the decision process and makes it faster.

Advanced Approaches for Risk Management

Advanced risk management approaches relate to the use of analytics on data gathered from a diverse range of sources. As shown in Exhibit 3.5, the following six types of analytics have been found to be useful in commercial credit:

1. *Statistically valid credit scoring:* Ratings or scoring schemes used by banks are often not statistically valid. Information systems are now pervasive, and banks possess historical data for reasonably long periods. It is imperative that scoring schemes are statistically validated. BCG's experience has been that such schemes that are purchased off the shelf typically do not give desired results. Credit scoring should be developed and validated in house by the bank's own team. It is a core skill that should not be "outsourced".

2. *Predictive early warning systems:* Conduct of the current account (or cash credit / over draft) is a massive source of insight. Good old convention requires bankers to review the conduct of account personally to assess its health. With advanced analytics, it is now possible to generate predictive signals that can trigger deeper scrutiny. This allows for right amount of human intervention early enough in an account, where otherwise it is unviable to do so given the high cost of human oversight.

3. *Information bureau services:* Impact of information bureau on quality of credit is apparent in retail. The same is not yet leveraged for commercial credit. Credit

Exhibit 3.5 | Advanced Approaches for Risk Management

1		**Statistically validated credit scoring**	**Credit scoring based on surrogate data / non–financial metrics** • Highly local factors • Factors specific to owners (vs. financials of business) • Ranking of financial metrics (vs. absolute values)
2		**Predictive early warning systems**	**Predictive Early Warning Systems (EWS)** • Statistically valid model based on conduct of operating account • Identify 15–20% accounts that deserve manual personal attention
3		**Information bureau**	**SME information bureau** • Credit history • Surrogate information (for example, utility bills) **Portfolio check / evaluation**
4		**Psychometric evaluation of credit worthiness**	**Predict borrower propensity to repay** • Statistical model • Qualitative questionnaire • Online administration
5		**Standardized judgment**	**Standardise the subjective judgment to assess risk** • Management behavior • Operating environment • Market feedback • Supply chain feedback
6		**POS data based credit line**	**Track and analyse data of transactions at POS terminal to establish** • Credit worthiness • Extent of credit limit

Source: BCG analysis.
Note: SME: Small and medium enterprises; POS: Point of sale.

history is a powerful enabler of SME credit, in the absence of collateral or reliable financials. Information bureau services need to be utilized not just at the point of origination, but also during the entire loan life cycle, to identify stress in portfolio that is not apparent superficially. The fact that a borrower has defaulted to other lenders is an early indicator of upcoming stress on your books also. Information bureaus have to be able to use not just information submitted by the banks, but also utility bill payments and similar records, to create valid scores.

4. *Psychometric evaluation of creditworthiness:* The latest innovation in SME credit is the use of psychometric assessments to predict a prospect's creditworthiness. Psychometric

tests rely on statistical analysis of answers given by the prospect to a number of structured questions that relate to his or her willingness to repay, appreciation of the obligation, understanding of business economics and business acumen.

5. *Standardized judgment:* The element of judgment cannot be taken out in SME lending since data is never perfect and reliable. On the other hand, given the small ticket size of SME lending, it is not cost effective to allocate enough personnel time to each loan account for assessment and ongoing monitoring. Automatic, data–based early warning systems throw up 15 percent accounts that merit attention. Such accounts need to be subjected to judgment–based evaluation. It has been found that even in subjective assessment a few key questions have most predictive power, and leaving it to the discretion of credit officer risks losing sight of critical questions. In a standardized judgment approach, the critical questions are standardized and coded in a multiple choice format. This lends to easy data capture, analytics, and future validation.

6. *POS data–based credit lines:* Transactions at Point Of Sale (POS) terminals provide a very rich source of data regarding patterns of revenue flow for a merchant establishment. This data can be tracked, analyzed, and used to establish creditworthiness and the extent of loan limit for the establishment.

Business Model for SME Credit: A Fine Balancing Act

Business model for SME banking requires a serious balancing act. SMEs are high risk, and the business model needs to provide for sufficient risk oversight. But their borrowing is smaller in ticket size. Operating costs for SME credit can be prohibitive with SMEs credit requiring the same dedicated attention and monitoring as large corporate credit. Further, it is found that personal banking business of SME clients (owners / proprietors) is substantial, and critical to create a profitable SME business portfolio. The business model design has to manage this complex interplay between operating costs, cost of bad debt, and cross–selling efficiency. Banks which do not get this interplay right risk having one of the vectors misaligned, leading to an unviable franchise.

1. *Fully decentralized model:* Traditionally, the model for SME has been fully decentralized. Branches are expected to be mini banks in themselves, and do all types of business. The branch manager is expected to lend up to his / her delegated limit, and seek approvals for higher amounts. The credit evaluation and subsequent monitoring are supposed to take place at the branch level where the customer relationship resides. This approach has obvious advantages in the form of credit sanctioning and monitoring happening close to the customer. In an ideal context, this should lead to high–quality risk management and cross–selling. In practice, though, many banks have found it difficult. Branches do not have sufficient credit expertise. They tend to make mistakes or overlook important signals under client–relationship pressures, or anxiety to meet targets. They also do not make good–quality credit memoranda due to poor skills, believing that the same will be reviewed by senior authorities in any case.

Fully centralized model: The other extreme model tries to address the lack of credit skills in branches by fully centralizing the credit assessment and monitoring of SME credit at back–office credit centers. Branches are expected to source leads and send applications for sanction to the back–office center. The loan is parked in a branch, and the branch is expected to maintain relationship and cross–sell to the customer. Such a model has obvious advantages in terms of concentration of credit skills, with an expectation that it would lead to better credit decisions and monitoring. However, the model faces practical issues on the ground. Branches feel a lack of control over the process due to hand–off to the back office. More importantly, they feel a certain lack of confidence in facing the customer due to poor technical knowledge. This hampers

the quality of their conversations and cross–selling. The customer would rather talk directly to the central credit team to clarify / discuss as credit matters are rarely straightforward. If the central team is difficult to reach, good customers are unlikely to stick around.

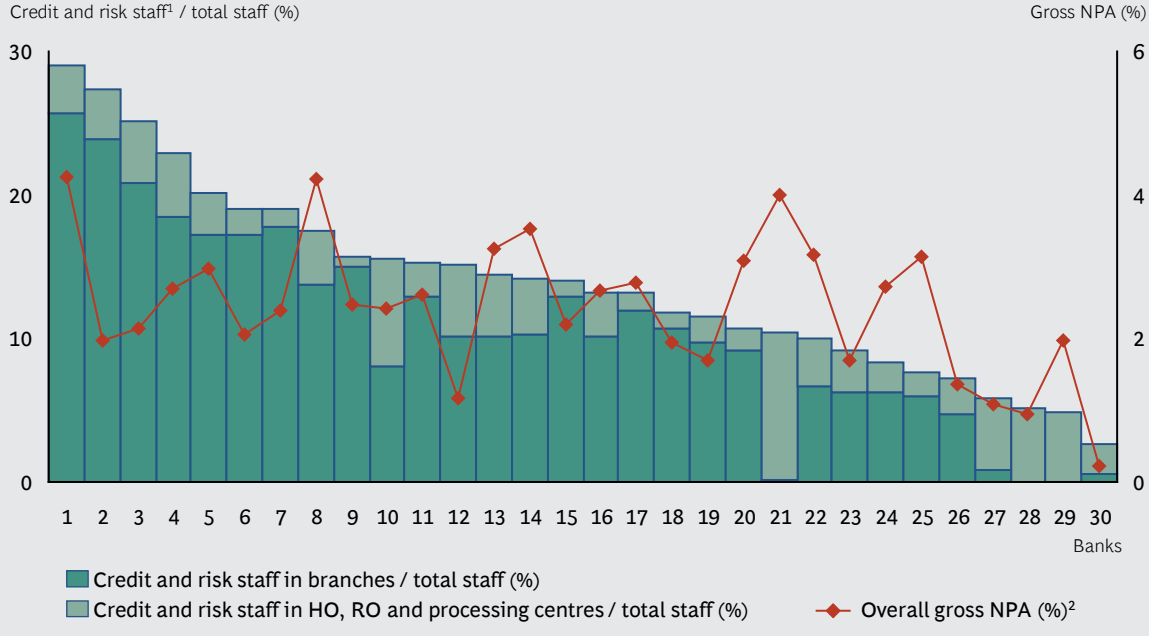
2. *A destination model that is some way away:* A model to which advanced economies have gradually migrated is one where branches retain the power to sanction credit based on a powerful statistically valid scoring system. Branches can take quick decisions based on scoring system, and therefore all the branches can be fully leveraged to generate business. A central credit team maintains and updates the scoring system. The central team also monitors the credit closely while the branches manage relationships and cross–sell other products. Statistically valid scoring systems are a prerequisite for this approach.

3. *An intermediate hybrid model:* A viable model in the interim is to have branches serving as primary vehicles of relationship and cross–selling, with acquisition of new customers and credit monitoring to be done by a credit trained, outbound sales force that is centrally managed and mentored by a competent credit authority in the SME business unit. The sales force is physically stationed in high SME potential branches.

4. *Asset–based finance model:* Financing productive assets (construction equipment, commercial vehicle, etc.), with the option of repossessing them in the event of default, is a successful model espoused by non–bank finance companies across the world, and also in India. In India, some banks are also successfully deploying this model to create a very profitable SME business. Given the prevailing challenges in availability of financials of SMEs and difficulties in enforcing collat-

Exhibit 3.6 | Building Foundations of Bank's Credit Expertise

Number and location of credit and risk staff vs. gross NPA experience



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (New), 1 Private (Old) and 5 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; The total staff includes the staff of captive subsidiary company as well as the outsourced staff.
[1]Credit and risk staff includes credit and risk staff at Head–office, regional offices, processing centers (retail and SME) and at branches.
[2]Gross NPA (%) calculated for the period FY 2010–11 to FY 2012–13.

eral, this model breaks the compromise. However, experience has not been uniform. The model requires specialized expertise in the form of repossession of equipment, disposal of repossessed equipment, and direct feet–on–street–based customer acquisition and collections (which are often in cash). In a bank, this business has to be run as an independent vertical within the SME unit to ensure the key tenants of this business model are kept intact and not diluted.

Pulling it all Together: Creating the Right Credit Culture

Lending is often considered synonymous with banking. Credit management is a core skill for banks. The recent banking crisis in the West has highlighted the perils of overdependence on statistical models, external rating agencies, external guarantee providers, as well as the danger of overspecialization of risk function wherein line staff start to feel less responsible for bad debt. Even as Indian banks adopt advanced approaches, it is critical for them to embrace a balanced model that nurtures the right credit culture of the bank and creates right foundations for ownership and responsibility. The element of judgment and intuition in credit has to be retained and nurtured, and not jettisoned for black–box models. Such skills come with careful training and personal mentorship of credit specialists.

Exhibit 3.6 depicts the proportion of total staff time that is spent on credit in various banks. It ranges from close to three percent of total effective FTE to almost 30 percent. This is a massive range. Banks that have a high proportion of staff involved in credit believe in the generalist paradigm, i.e. credit powers should lie with all bankers in important positions. This is helpful in ensuring ownership. Banks that have multilayered credit processes, where the file moves through multiple hands, end up involving even more people in the credit process. As the chart shows, bad debt management is not any better in cases where a lot of people are involved in credit. It is actually marginally worse. Perhaps because quality time spent per person is actually less, the depth of expertise is low, and multiple hand–offs reduce the level of responsibility that any one person feels.

The other important question is the location of credit staff. Exhibit 3.6 shows the percentage of credit staff working in branches (dark green portion in the bars) versus those in centralized locations like administrative offices and back–office processing centers (light green portion). A significant variation is evident from the exhibit. While some banks have almost entire credit staff centralized in a few places, others have them decentralized in branches. Centralization leads to better mentorship due to co–location of experts with apprentices. Decentralization allows credit managers to know customers better—a critical factor in SME lending.

Depending upon the line of business, the model should be carefully designed. Retail, SME and corporate lending require different models. Banks need to answer the following set of questions:

- How many employees are involved in credit? Is there responsible ownership at each level or is it just one more procedural step in the chain?
- How are the skills being developed? How much through structured instruction? How much through mentorship and on–the–job apprenticeship?
- Do employees take full ownership of statistical models, or is there a reliance on external agencies for creation and updating of models?
- Does the bank rely too much on external advice, and comfort itself in the form of ratings and guarantees?
- Does the credit process ensure rich appreciation and knowledge of the customer, or does it take the decision away from customer?
- Does the credit process scuttle intuition and personal judgment, or does it allow the same in meaningful ways to inform the judgment?

Pricing: The White Knight of Commercial Banking

BCG experience has shown that disciplined pricing can lead to a 15 percent to 20 percent jump in the revenues for a bank's commercial credit portfolio. This is a powerful lever in ensuring a profitable commercial lending franchise and is often grossly under–leveraged. The common reasons for under–pricing that need to be challenged are explained below:

1. *Risk–based pricing:* In India, many credit segments operate at one price for all. There is no explicit linkage of price to risk assessment. BCG experience has shown a ten percent to 15 percent uptick in revenue on the portfolio by following a more disciplined approach to pricing.

2. *Marginal cost pricing:* Since costs are typically fixed, banks focus on incremental revenue to defray them. If incremental revenues cover only marginal cost, banks, over time, accumulate a number of clients who do not meet margin thresholds. In a bank, BCG found 17 percent of clients unprofitable on a variable basis, and an additional 15 percent unprofitable on a full–cost basis.

3. *Absence of deliberate de–averaging:* Wholesale contracts allow individual clients to be priced according to the competitive intensity and the bargaining power both parties have in the situation. Yet, we found that a majority of the firms still do not robustly segment customers (for example, based on size, stickiness and bargaining power). We found several instances where the smaller clients paid lower prices than larger ones. Similarly, we observed practices such as lower prices for "price insensitive" segments, and flat fees for growth segments.

4. *Bundling gone awry:* Bundled pricing tends to help cross–sell more products. But when it is structured poorly, the provider can lose out substantially. The scenario can go like this: the client starts negotiating on prices; the provider agrees to lower prices if the customer buys another product; the customer agrees, so the bank lowers prices. So far so good. But what if the customer suddenly stops buying the additional product? The profitable product exits but the subsidized one stays.

5. *One way street on volume discounts:* Similarly, volumes may decline over time while the pricing structure remains the same. Either the original pricing was not "tiered" to volume ranges, or the bank does not effectively track volume changes. In the sample of banks that we observed, we consistently found almost zero (actual R square[1] of 0.01) correlation between price and volume.

6. *Omitted charges:* In industries with recurring revenue streams, it is common to see service creep. As much as 50 percent of revenue can be lost due to "leakage" (not billing for services rendered) and "slippage" (not charging for certain services appearing in the fee schedule).

7. *Dated service charges:* BCG has often found in its client work that almost 20 percent of client contracts were over ten years old. Just on an inflation–adjusted basis, the service charges should have gone up significantly over time. It is not built into the contract.

8. *Adverse sales incentives:* In pursuit of market share, sales incentives often reward revenue growth or retention. In the absence of pricing criteria, this can create an adverse incentive to actually lower prices (and therefore margin) to get more revenue. Right pricing discipline will ensure customers are charged according to their risk profile and in line with service levels. Any attrition of customers subsequent to introduction of such disciplined pricing is more than offset by the uptick in revenues from the remaining portfolio. Typically, the most attractive customers get right price and stick around with the bank.

Tough Love: Smarter Way to Restructure

Over last two years, banks have supported corporates with massive restructuring of debt. At almost seven percent of advances, this is an unprecedented helping hand. Banks should go out and support the indus-

try through temporary crises. This is a role expected of banks and it has an overall positive impact on the economy as it keeps the factories humming and wages flowing. The underlying assumption here is that the restructuring has been done with sufficient due diligence so that the units are indeed viable and going through only a temporary downturn, and that their promoters will do what they are promising. This is where we have a gap in our system. Banks need to adopt the "tough love" approach.

Banks need to develop systems and capabilities in two specific areas. First is **strategic due diligence** of restructuring applicants' business plan, and second is a mechanism to maintain oversight of the restructured business. Corporte Debt Restructuring (CDR) and bilateral mechanisms restructure the debt under certain conditions and assumptions regarding business growth, profitability, market share, product quality, cost efficiency, etc. Banks need to have more robust technical expertise to do a more thorough pressure testing of business assumptions, and should benchmark it to other players in the industry. Whether a unit would be resurrected is critically dependent upon promoter actions and they need to be enforced through appropriate restructuring package oversight mechanism, covenants, and corporate governance.

An example is the U.S. government's restructuring aid to the U.S. auto giant General Motors (GM). The substantial infusion of funds was based on a thorough due diligence of viability of the business and identification of action points. This due diligence focused on benchmarking GM business with healthier competitors, and identifying an action agenda with regard to product portfolio, cost reduction, distribution set–up and productivity. The emphasis of due diligence was to ascertain a whole range of hard decisions and tough management initiatives that were really critical to turn around the company. This systematic approach ensured that GM followed through in earnest on the tough management actions to receive the support. Exhibit 3.7 depicts two critical capability gaps in current Indian banks' approach to restruc-

EXHIBIT 3.7 | Tough Love—Smarter Way to Restructure
Critical capabilities needed to ensure turnaround of restructured assests

Strategic due diligence to ascertain viability and establish action agenda / tough management decisions

1. **Product portfolio gaps vs. the projected market demand**
2. **Distribution network productivity vs. competition**
3. **Product quality benchmarking and identification of action points**
4. **Pressure testing of projections on market share and margins**
5. **Operations benchmarking vs. competition**
   - Wages
   - Economies of scale
   - Manufacturing flexibility in the plant
6. **Management capability audit / reshuffle needed**
7. **Corporate governance / board restructuring needed**

Oversight of restructuring package implementation / ensuring follow through on management end operational turnaround

Monitoring of management action plan
- Milestones agreed in roadmap
- Especial emphasis on tough decisions
  - Cost reduction
  - Product / brand rationalization etc.

Oversight mechanism
- Board positions, reporting

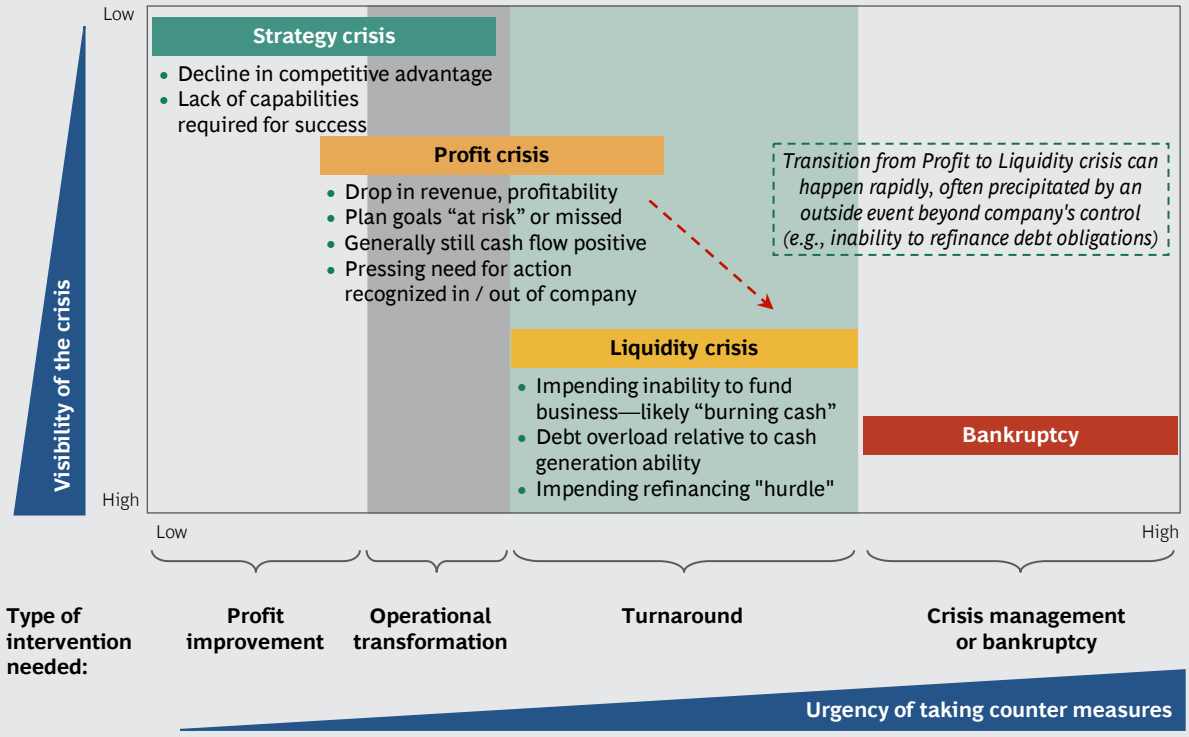
Specialist 3rd party support
- Over see and report compliance

Align promoter interests
- Promoter contribution / sacrifice
- Explore asset sell opportunities
- Unlock capital / release cash in a structure manner
- Sale of subsidiaries, unrelated investments, brands

Source: BCG analysis.

EXHIBIT 3.8 | Due to Economic Downturn, More Distressed Corporations Sliding Into 'Liquidity crisis', Increasing Need for Turnaround Work

Banks should trigger restructuring before clients ask for it



Source: BCG analysis.

turing of assets. Alongwith the 'love' in form of banks' sacrifice to support and follow through on restructuring, there should be a 'tough' stance to force and follow through on tough decisions.

Restructuring of bank credit is needed when the corporate entity has gone to an advanced stage of stress. As depicted in Exhibit 3.8, a corporate entity goes through a strategy crisis followed by a profit crisis before entering liquidity crisis when financial restructuring is required. Vigilent banks should insist on a profit improvement exercise and operational turnaround program to be taken up by the management team at that stage. This restructuring would be without sacrifice for banks. Banks need to develop internal expertise and partnerships to be able to follow through on these early stage actions. Their monitoring systems should trigger demands on their corporate clients for profit improvement or operational improvement programmes.

NOTE:
1. R square refers to the co–efficient of determination

BRANCHES OF THE FUTURE

"Be sure you have put your feet in the right place…then stand firm"

— Abraham Lincoln

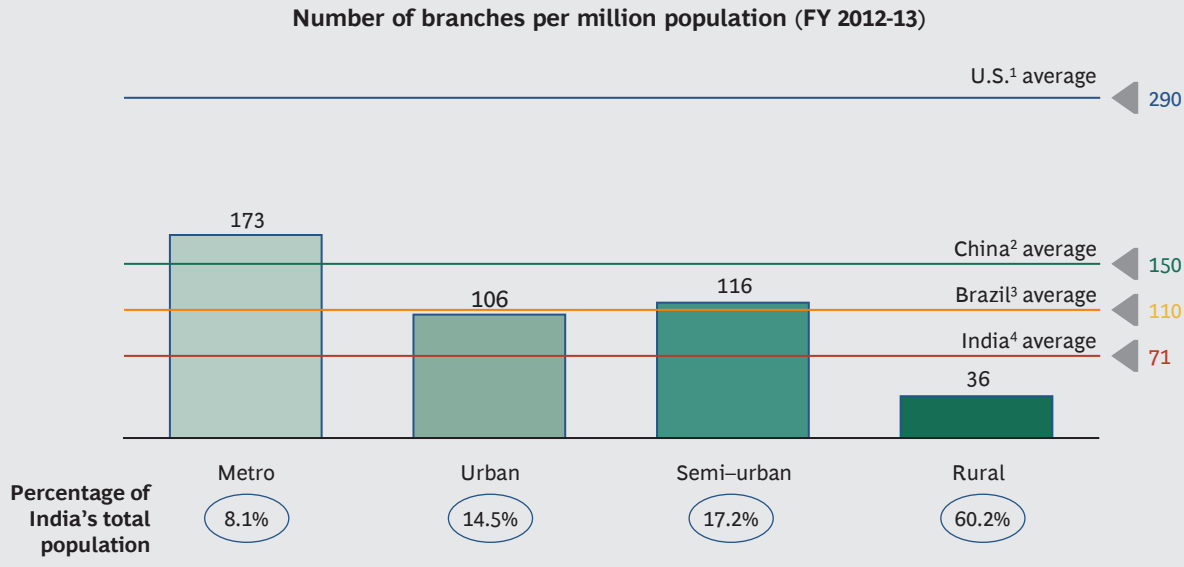
BRANCHES ARE A STRATEGIC asset for banks. While digital channels indeed complement branches, so far all prophecies predicting complete cannibalization of branches by digital channels have not come true. In fact, the FIBAC 2012 study found that branches continue to be crucial for banks. At a basic level, a physical presence gives the customer the psychological comfort of security of his / her savings. At a more nuanced level, BCG research for FIBAC 2012 found that banks which had customers visiting their branches, were more likely to have customer advocacy. Nonetheless, the branches in India have not kept pace with the change in customer needs and rapidly evolving technology capabilities. By and large, they continue to provide a cluttered interface to the customer. The common tendency is to take a standard format and try to customize it for new requirements – be it rural branches or GenY branches. This is rather suboptimal. A paradigm shift is needed to ensure that branches stay profitable as massive number of very different customers get banked over the next few years in different locations with different needs. Hence, banks need to design the future branches keeping the target audience in mind.

A Possible Trinity: Coverage, Clutter and Client Sourcing

Over the last decade, the Indian banking sector has witnessed a step change in the growth rate of branches, and emerged from the era of its own so called Hindu rate of growth. While the banking industry[1] added around 590 branches (growth of approximately 1.1 percent) in FY 2002–03, it added another 6,800 branches (growth of approximately 8.9 percent) in FY 2011–12. This is testament to the fact that banks rightfully see branches as a core channel for extending banking services in a customer–centric manner. Further, given the low penetration level of branches in India (refer Exhibit 4.1)—India has approximately only 71 branches per million people[2], compared to 110 for Brazil[3] and 150 for China[4]—the acceleration in branch footprint expansion is a welcome improvement.

As seen from Exhibit 4.1, rural India accounts for approximately 60 percent of India's population, but is facing an acute shortage of branches—only around 36 branches per million people, as against a national average of around 70.5. This statistic is bound to improve since Indian banks, under the guidance of the RBI, have been doing a commendable job of accelerating branch growth in rural areas (as shown in Exhibit 1.3). Approximately 30 percent of the new branches opened in FY 2011–12 and 41 percent of the new branches

EXHIBIT 4.1 | India Under–Penetrated in Terms of Number of Branches Per Million Population



Sources: RBI; Census 2001; Census 2011; World Bank; IBA; FIBAC Productivity Survey 2013; BCG analysis.
[1]For US, data for FY 2010–11. Only commercial banks have been included.
[2]For China, data for FY 2008–09. Post–offices and rural financial institutions have been included because post–offices and rural financial institutions are allowed to do banking in China.
[3]For Brazil, data for FY 2010–11. Post–offices have not been included.
[4]For India, data for FY 2012–13. Only scheduled commercial banks have been included for India. Co–operative banks and regional rural banks have not been considered. Population CAGR assumed to be similar to 2001 to 2011 growth in metro, urban, semi–urban and rural.

opened in FY 2012–13 were in rural centers[5]. All banking segments—private and public—opened a significant percentage of their branches in rural centers. The FIBAC 2013 survey found that new private banks and PSU large—and PSU medium–size banks opened over 40 percent of their new branches in rural centers (refer Exhibit 4.2). If the Indian banking sector adds another 70,000 branches in the next seven years and 25 percent of these new branches are located in rural unbanked centers (as currently mandated by RBI) and assuming that some branches in under–banked districts are also in rural centers, in FY 2019–20, it is conceivable that the national average density of branches in FY 2019–20 will be close to Brazil's current density. Density of branches in metro centers may start touching 200 per million people, rural density could be as high as today's national average of 70 and urban and semi–urban centers may have branch density of 120–150 per million people.

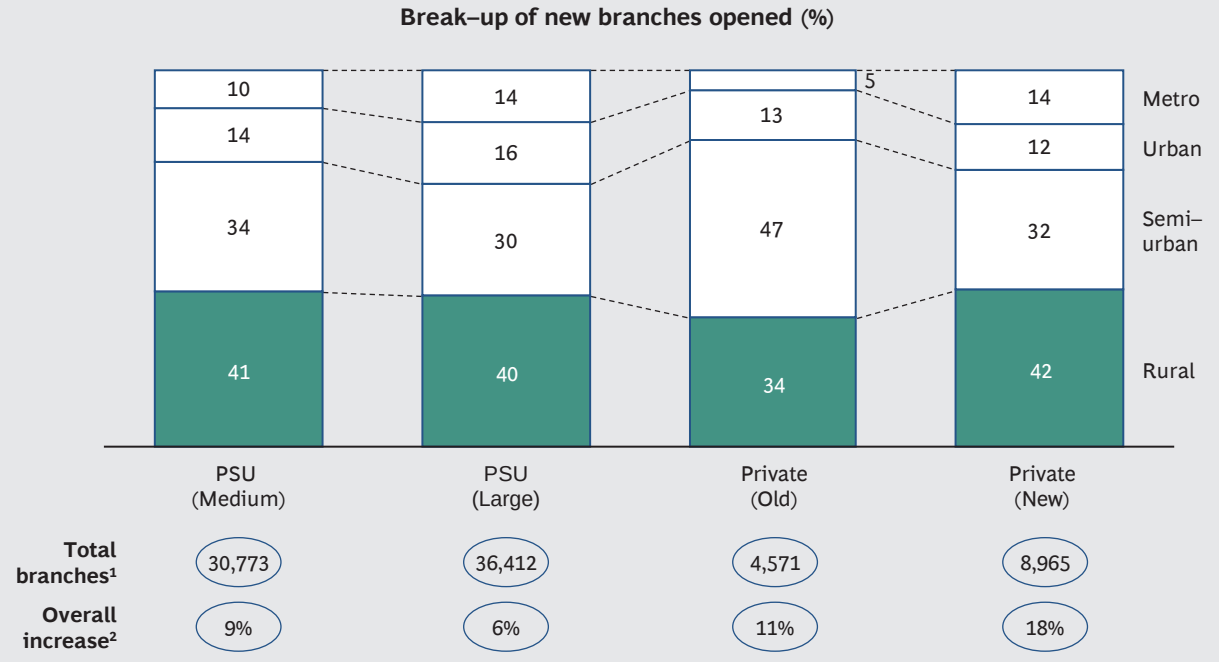
If we shift our focus from growth to productivity, a major challenge facing the Indian banking sector becomes evident. Data from the FIBAC 2013 and 2011 surveys show that branch productivity—measured in terms of number of savings accounts opened per metro and urban branch—has remained stagnant (refer Exhibit 4.3) for the industry as a whole.

While the new private sector banks have been able to improve their branch productivity by seven percent per annum over the last two fiscal years, for the industry as a whole the total number of savings accounts opened per (MU)[6] branch per annum has barely moved—from 1,076 in FY 2010–11 to 1,089 in FY 2012–13.

Further, despite growth in branches and increasing adoption of alternate channels, the number of cash transactions per branch per day has increased in FY 2012–13 over FY 2010–11 (refer Exhibit 4.4). This is another alarming sign that branches continue to be used as transaction hubs instead of sales and service centers.

Overall, low productivity and intense transaction focus are serious causes of concern for the sector.

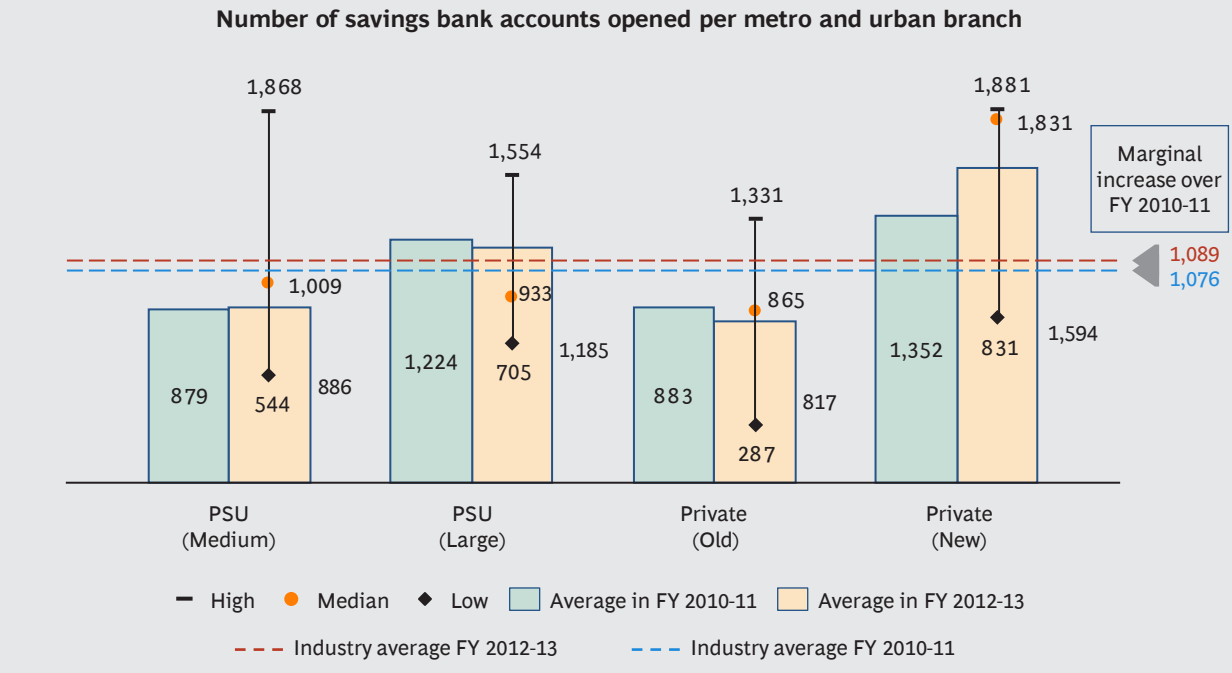
EXHIBIT 4.2| Indian Banking Appropriately Focussed on Under Penetrated Areas



Sources: IBA; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
¹Data for FY 2012–13.
²Increase in FY 2012–13 over FY 2011–12.

EXHIBIT 4.3 | Branch Productivity as a Sales Engine Helps Stayed Stagnant

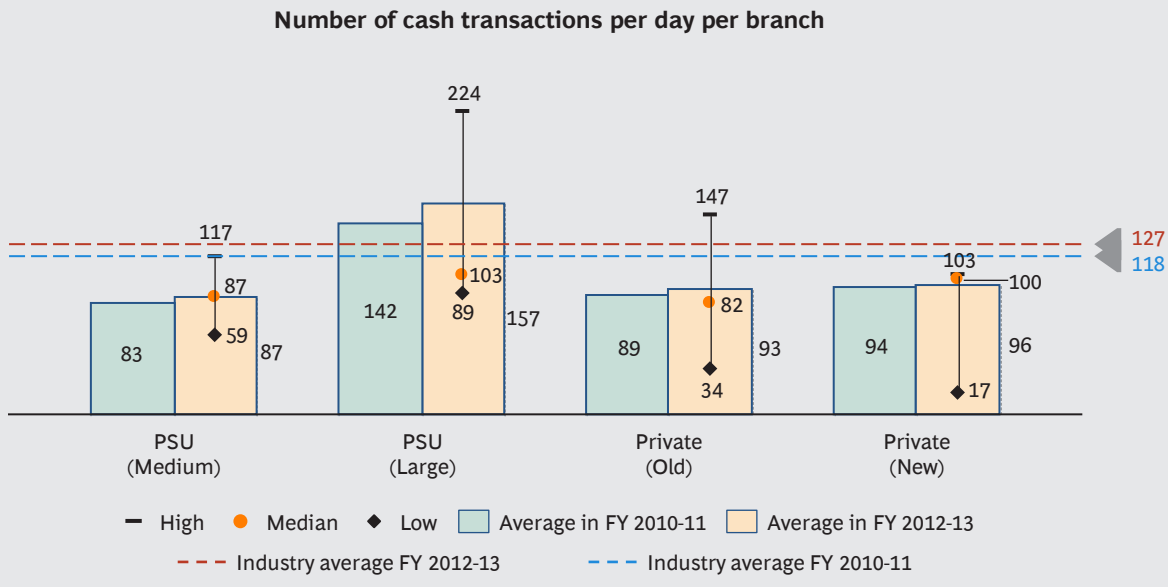
Massive range between the best and worst in each of the four categories of banks



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 3 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

EXHIBIT 4.4 | The Clutter in the Branches is Rising

Number of cash transactions per day per branch has gone up for all four categories of banks



Source: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 2 Private (Old), 1 PSU (Large) and 13 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; A year is assumed to have 300 working days; y–o–y: Year on year.

Geoanalytics: Next Generation Footprint and Location Planning

Going forward with rising branch density in metro and urban centers, location of branch will disproportionately impact its productivity. Technology has to supplement judgment in determining location and footprint in a major way. Geoanalytics has come of age and the technology is ready to be deployed in India.

If the Indian banking sector adds 7,000 to 10,000 branches annually over the next seven years, and assuming 75 percent of these are in semi–urban and rural centers, we expect the sector as a whole to spend over Rs. 10,000 crore (almost $2 billion) for branch build–out. Since a significant capital is at stake, it is imperative for banks to get the highest efficiency out of branches to ensure healthy return on capital.

Several aspirants for the new banking licenses have existing physical footprint. If a significant proportion of the existing footprint gets converted into branches, the intensity of competition for existing as well as new branches of current banks will dramatically rise.

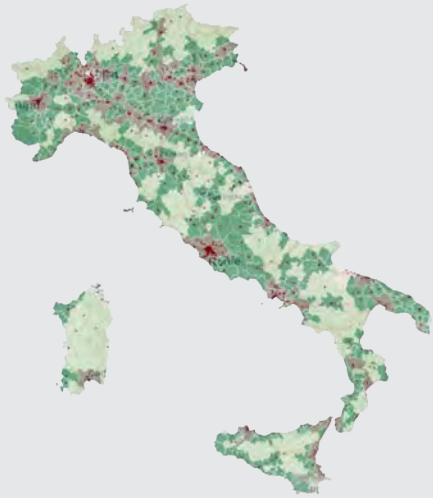
On 3 April 1984, when the then prime minister of India, Mrs. Indira Gandhi, asked astronaut Rakesh Sharma how India looked from space, his response was *"Saare Jahan Se Achcha Hindustan Hamara"*. With today's Geoanalytics capabilities, one can say a lot more about Indian topography without leaving the room. For example, it is possible for banks to pinpoint which exact location is best suited for opening a branch or an ATM by analyzing the population density, economic potential, competitors' branches / ATMs and geographical proximity to economic hot spots (upcoming areas like residential hubs, business centers etc). As shown in Exhibit 4.5, proprietary tools can be used to visually map precise locations for new branches, as well as to optimize existing footprint by relocating branches. The main power of Geoanalytics is that the tools can allow overlaying detailed geographical information like road distance, commute time with demographics data to identify optimal branch network.

The Five Star Branch Concept: Roadmap to Sales Excellence

The FIBAC 2013 survey reveals that branch resources are still spending inordinate

EXHIBIT 4.5 | Geoanalytics will Revolutionize Branch and ATM Opening

Different branch formats and marketing approaches based on micro market profile



For each municipality, Geoanalytics tool can provide the degree of urbanization within 1 sq.km. grid cells allowing branch format and marketing strategy to be highly localized

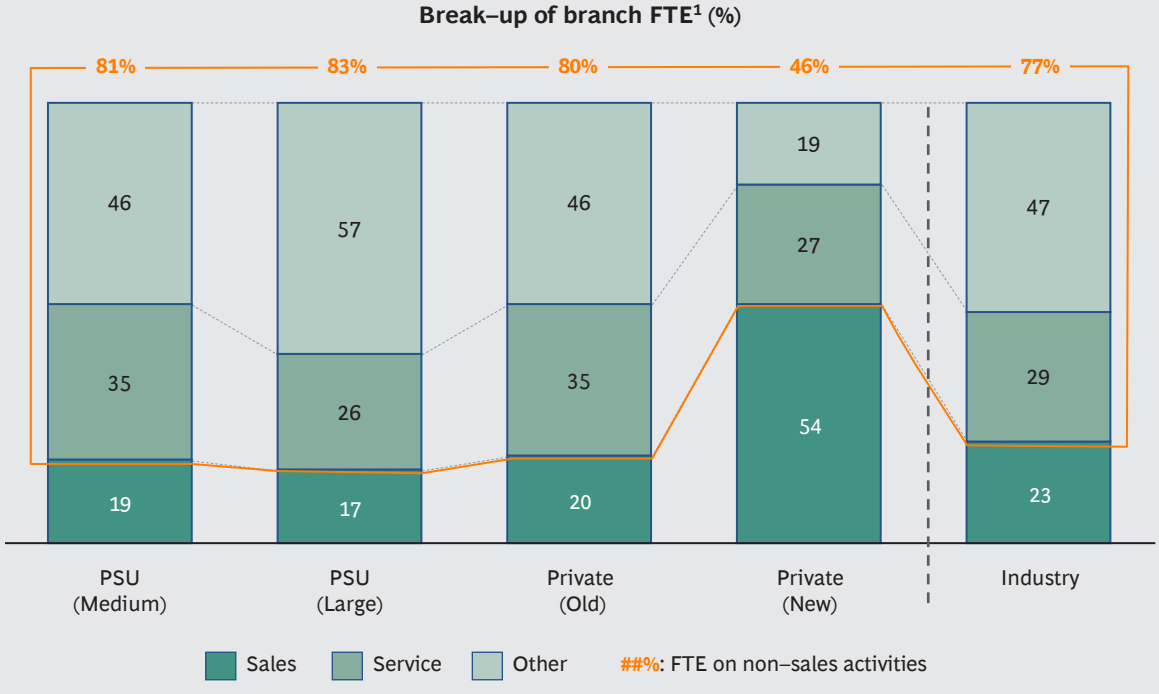
Maximize population coverage with constrained number of branches



Geoanalytics maps retail locations at a very micro level. Optimal locations can then be established using a spatial optimization model which locates the 5 sites which are closest to the largest population of the desired customers

Source: BCG analysis.

EXHIBIT 4.6 | Branches Still Spending Significant Time on Non–sales Activities



Sources: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (Old) and 3 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
[1]Branch FTE (Full time employee) is in–house employees, employees from captive subsidiary and outsourced employees, where applicable.

amounts of time (around 77 percent at industry level) in service and back–office activities (refer Exhibit 4.6). To a large extent, this is because bank branches in India have not leveraged the dramatic improvements enabled by changes in technology. The last wave of fundamental change in branches' operations was during the Core Banking rollout in the early part of the last decade, where several manual processes were automated and workload at the branches was dramatically reduced. Considering the subsequent advances in technology around self–service, workflow automation, image processing, and potentially eKYC, it is time for Indian banks to dramatically transform their branches.

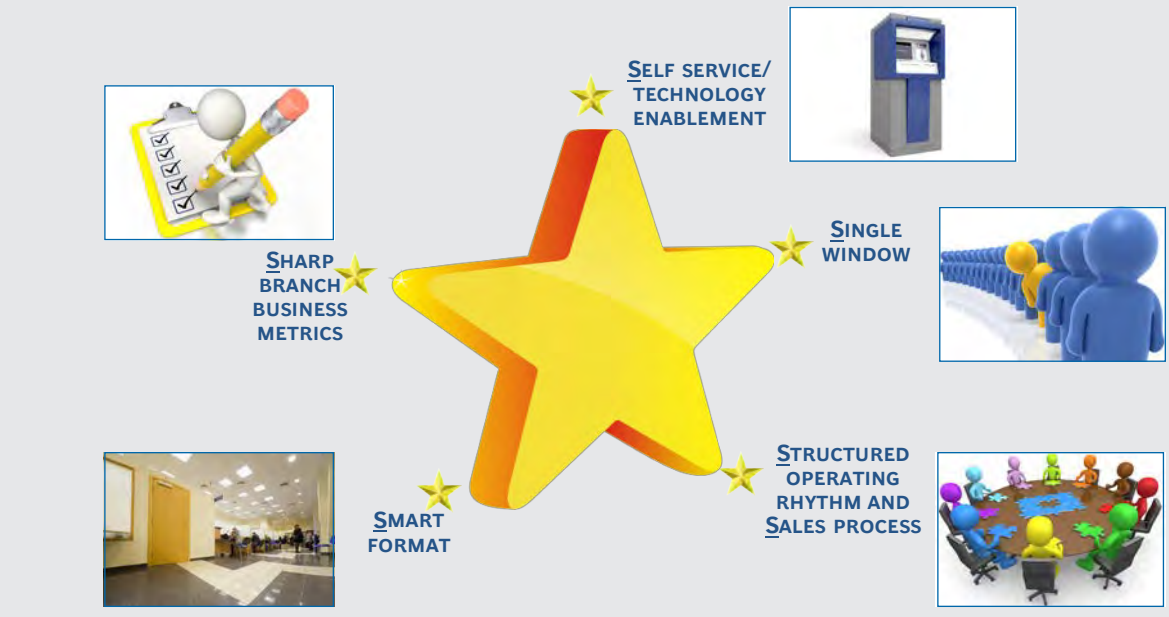
Some banks have undertaken branch transformation initiatives over the last two years. These initiatives have not yet resulted in marked improvement in business productivity (refer Exhibits 4.3 and 4.4). One needs to be extremely wary of superficial changes that put form above function and do not fundamentally change the operations of the branches.

We have found that real transformation of branches is hampered by five typical issues:

- Low levels of self–service—self–service is not optional, it's mandatory
- Inefficient branch workflow / single window—not just new counters but a dramatic reduction in touch points and TAT
- No systematic operating rhythm and role clarity—not just about reducing mundane work at branches, but fundamentally recasting the branch roles and rhythm to orient toward sales
- Inefficient branch layout / format—not just good looking but functional layout
- Poorly defined branch business metrics—simple, sharp and incessant focus on business

For banks to be able to fundamentally transform their branches into sales engines, a systematic five star approach is required. This is depicted in Exhibit 4.7. Each star stands for one of self service / technology enablement, single window, structured operating and sales rhythm, smart format and sharp branch business metrics. Branch that excels on all five is called a five star branch. In

EXHIBIT 4.7 | Five Star Branch Model for Taking Branch Productivity to the Next Frontier



Source: BCG analysis.

BCG case experience, five star branches have shown a much higher and sustainable uplift in sales productivity.

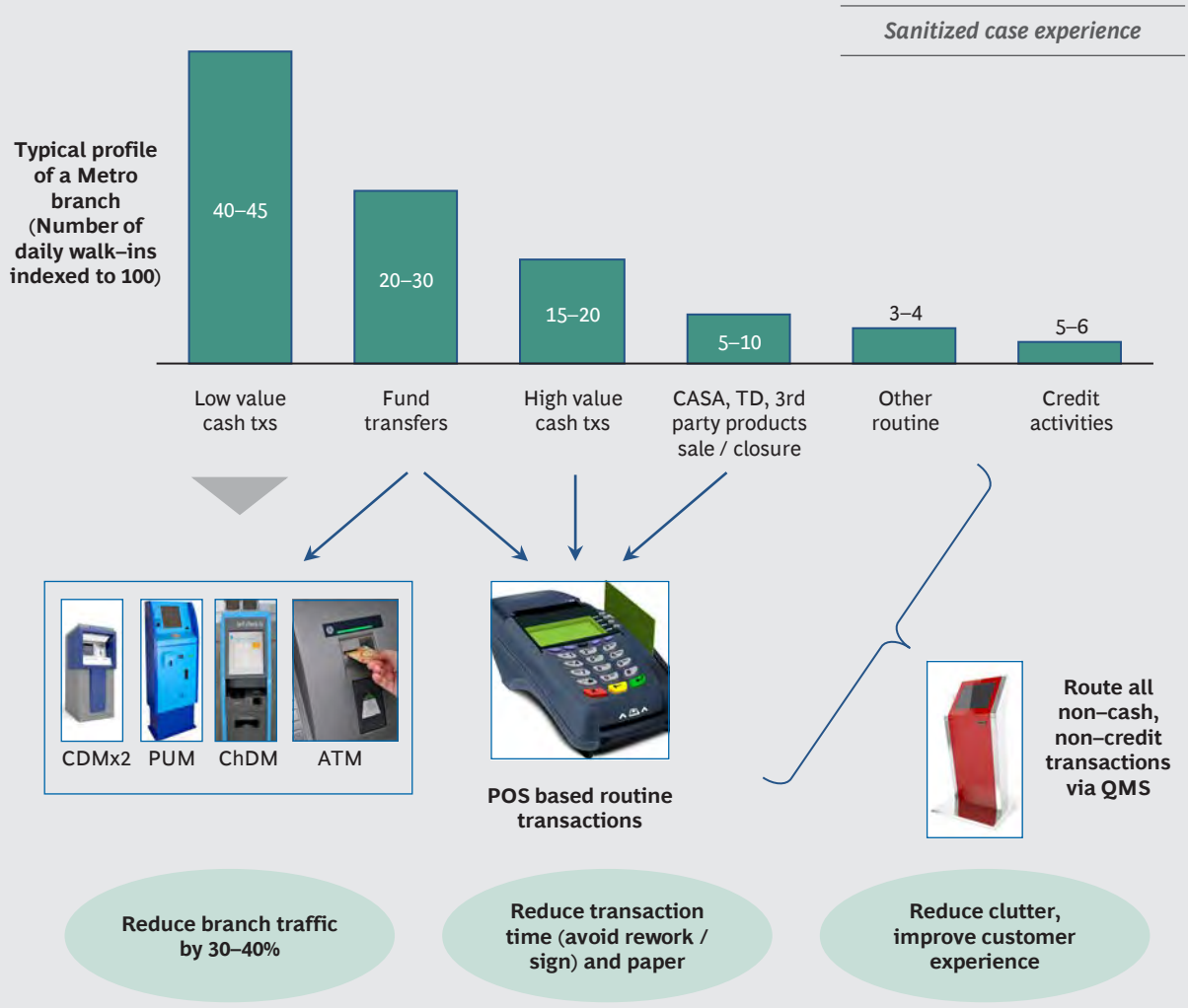
1. SELF–SERVICE AND WORKFLOW TECHNOLOGY ENABLEMENT: PUTTING BRANCHES IN THE 'E' MODE.

As a first step toward de–cluttering branches, it is important to allow customers to undertake basic transactions in a self–service model. Basic transactions such as cash deposit, passbook updation and cheque deposit account for a very large proportion of branch transactions. By using self–service machines like Bulk Note Acceptors (BNAs), pass book updation kiosk and cheque deposit machines / truncation, a significant proportion of the branch transaction load can be eliminated. BCG experience suggests a 30–40 percent reduction in footfall is possible in a typical metro branch through self–service enablement. This is depicted in Exhibit 4.8.

Moreover, as depicted in Exhibit 4.9, the FIBAC 2013 survey found that the banks which have higher levels of self service enablement in their branches have significantly lower proportion of non–sales staff in the branches.

However, blind enablement is not the solution. The IT architecture facilitating the interface

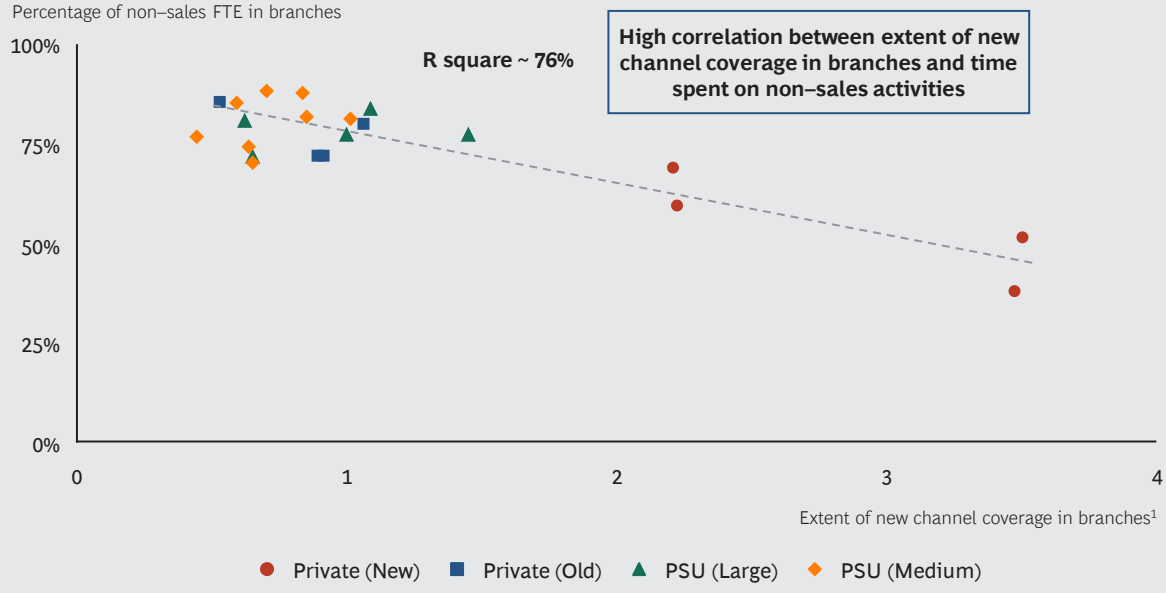
EXHIBIT 4.8 | Self Service Technology Can Reduce Branch Transaction Footfalls by 30–40%
Higher customer service, faster turnaround time, less paper, fewer errors



Source: BCG case experience.
Note: Txs: Transactions; CASA: Current account and savings bank account; TD: Term deposits; CDM: Cash deposit machine; ChDM: Cheque deposit machine; POS: Point of sales; PUM: Passbook updation machine; QMS: Queue management system.

EXHIBIT 4.9 | Greater Coverage of Self Service Channels Per Branch Translates Into Less Time Spent on Non–sales Activities

Non–sales FTE in branches as a percentage of total staff vs. extent of new channel coverage in branches



Source: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (New), 3 Private (Old), 1 PSU (Large) and 12 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; FTE: Full time employee.
[1]Extent of new channel coverage=(Number of ATMs + Number of cash deposit machines + Number of cheque deposit machine + Number of passbook printers) / Branch.

with the core banking system, as well as the ease of use of the machines, is crucial to ascertain. The added benefit of self–service is that the customers can access the machines 24x7.

Routine transactions, such as CASA account opening and third–party sales, can be made electronic by the use of smart work–flow technologies enabled by smart POS terminals. Adopting these technologies requires fundamental reworking of the work–flows. These technologies, if implemented correctly, can dramatically improve customer experience, employee satisfaction and branch productivity, making it a win–win proposition (Refer call out on "Peek into the future" at end of the chapter for more details).

2. CORRECTING THE MYTHS: GETTING TRUE PRODUCTIVITY GAIN OUT OF SINGLE WINDOW

Single window is one of the most misunderstood concepts in Indian banking. The FIBAC 2013 survey found that genuine single–window enablement is still a distant dream—while many banks claim some level of single–window enablement, the benefits are not visible. The common understanding is that single window means getting counters to do more than one type of transaction. It is easier said than done.

Real single–window enablement requires banks to strike the right balance between generalizing the majority of counters to smoothen out workload versus retaining a few specialized counters to cater to unique branch needs (such as huge intersol fund transfers). Further, for banks with maker / checker transactions, it is imperative that the maker / checker are thoughtfully located to ensure genuine single touch point for customers. Finally, the right MIS using the Queue Management System (QMS) is crucial for regular monitoring to ensure bottlenecks are identified early and eliminated.

We have found that a dramatic reduction in turnaround time, increase in customer / employee satisfaction and branch productivity

are possible if banks implement single window with the right rigor and thought.

3. STRUCTURED OPERATING RHYTHM AND ROLE CLARITY

As a first step towards improving branch productivity, the reporting structure and roles in branches need to be fundamentally recast to ensure that resources in the right numbers—and with the right skills—are deployed in the right activities. And also, for the five star branch banking to become the norm, setting in place a structured operating rhythm is crucial.

A structured operating rhythm refers to a format and frequency of conducting branch reviews to ensure the branch leadership is able to identify challenges and opportunities early on to make timely interventions. We have found that branches with better operating rhythm have happier employees with enhanced knowledge about banking and sharper customer focus. The FIBAC 2013 survey found that there is a massive gap between the frequency of structured branch meetings between private new banks and other banks. As depicted in Exhibit 4.10, new private banks have, on an average, 13 structured branch meetings per month, as compared to the industry average of five.

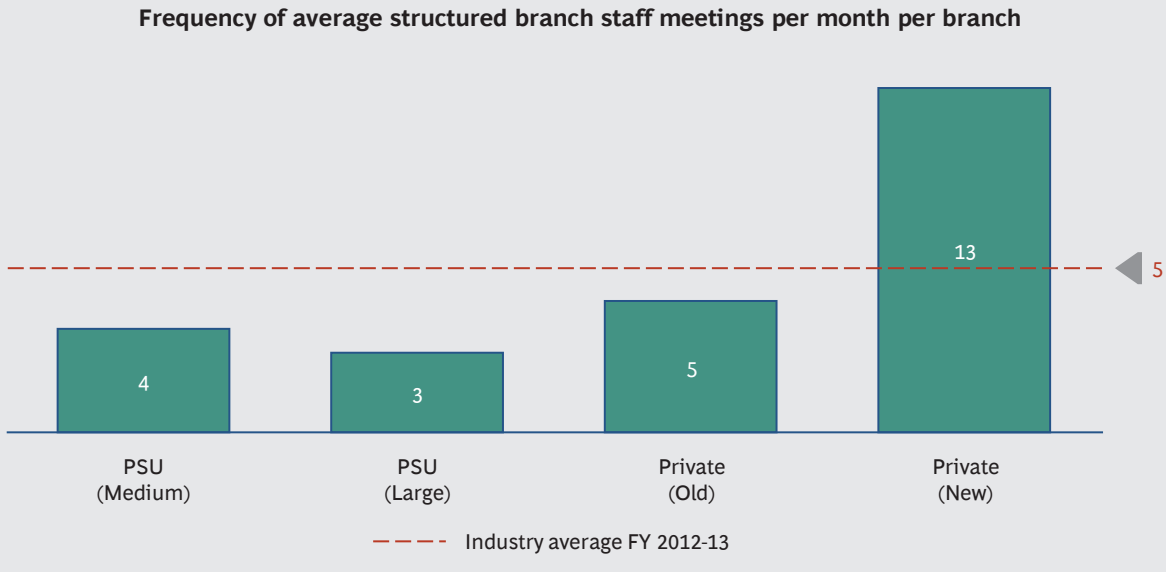
4. SMART FORMAT: BRANCH IN A BOX

Smart format involves two principles: (a) the overall layout of the branch has to ensure optimal customer pathways for navigating and interacting with the branch, and (b) having the right format based on the business potential of the catchment area.

In terms of optimal customer pathways, it is crucial to create a layout where the customer is able to easily navigate to the right destination, has appropriate visibility of important information– marketing material or statutory information—and has to traverse minimum distance / minimum touch points to fulfill his / her requirement. Achieving this requires scientifically locating various elements of the branch infrastructure, such as counters, printers, QMS machines, self service kiosks, marketing signage, etc.

As far as the right format pertaining to catchment potential is concerned, it is important to define different branch formats based on

EXHIBIT 4.10 | Creating Sales Culture in Branches

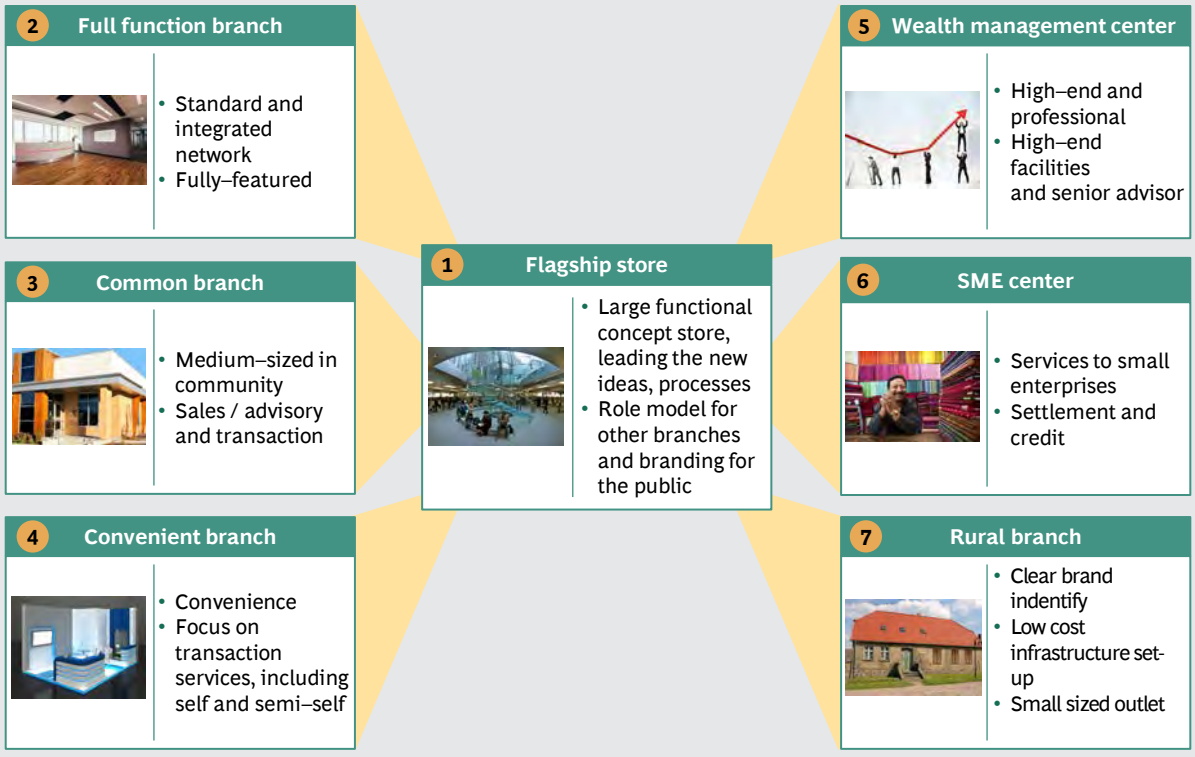


Sources: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (Old) and 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; mid–point of the range of values submitted by the banks has been considered for analysis 1–5 meetings/branch/month has been converted to 3 meetings/branch/month; 6–10 meetings/branch/month has been converted to 8 meetings/branch/month; 11–15 meetings/branch/month has been converted to 13 meetings/branch/month; >15 meetings/branch/month has been converted to 18 meetings/branch/month.

EXHIBIT 4.11| Smart Format: Graduate to Need Based Formats

Need to scientifically define branch formats based on customer segments and needs

BCG case experience



Source: BCG case experience.

catchment business potential. Specifically for rural areas, Indian banks cannot try to import the urban / metro branch layout by trying to downsize it to reduce cost. A fundamentally different branch format needs to be envisioned keeping in mind the rural customers' requirements and economics of serving the rural populace. An illustrative list of choices for branch formats is depicted in Exhibit 4.11.

Banks need to break up a branch into several modules and define heuristics for usage of appropriate modules in the right location. Modular design makes it possible to standardize branches, accelerate branch build out, centrally manufacture units and eventually reduce branch break–even point and payback period while improving customer experience. It is not too difficult to imagine a branch getting assembled from modularized components in almost a Lego block like fashion—some progressive banks are already moving to this concept.

5. SIMPLE, SHARP AND SHARED BRANCH BUSINESS METRICS

Having the right set of branch metrics is the cornerstone of a productive branch. However, it is imperative to not confuse the branch with too many or too complex metrics. We have often seen that banks either do not give branches a well–defined set of metrics or err on the side of giving too many (as high as 60 to 90) metrics which the branches cannot operate with.

It is important to ensure that a simple, sharp and shared vocabulary around branch performance is created and adhered to through the structured operating rhythm to drive productivity.

Going back to the Abraham Lincoln quote, the time is now for Indian banks to define their branch network footprint carefully, and then optimize productivity to create "branches of the future".

PEEK INTO THE FUTURE: CUSTOMER EXPERIENCE IN 2015

A paperless branch is no more a pipe dream. Technologies exist that can help create workflows in branches that require no paper—other than for regulatory compulsions. At each stage of the transaction value chain technologies can help transact completely in the e–Mode.

APPROACH FOR PAPERLESS BANKING

Enquiry / marketing	Account opening	On boarding	Service	Cross sell / up sell
• Mobile or internet based lead generation and capturing • Initiate purchase in any channel; close purchase in any channel	• Digital displays for sharing product information (interactive screens / tablets)	• Biometrics for eKYC and capturing customer data • Data capture at time of account opening directly on tablet. No scanning. No data entry • Fulfilment at the point of sale—internet, mobile banking—all active as you walk out of branch • Branch is able to do live demonstrations of all channels and features to the customer	• Smart cards (e.g. using RFID or smart chip) to identify customers in branches • Smart cards allow branch to be aware of last customer visit, purpose of visit and status of request in real-time • Data once updated on channel, updates all channels	• One view of customer ensures data for existing customer is automatically available with no need to fill redundant information during cross / up sell situation • Smart cards can help capture profile of customer quickly and thus provide quality sales cues to branch staff







Source: BCG analysis.

NOTE:
1. Only scheduled commercial banks have been included for India. Co–operative banks and regional rural banks have not been considered. Population CAGR assumed to be similar to 2001 to 2011 growth in metro, urban, semi–urban and rural.
2. For India, data for FY 2012–13.
3. For Brazil, data for FY 2010–11. Post–offices have not been included.
4. For China, data for FY 2008–09. Post–offices and rural financial institutions have been included because post–offices and rural financial institutions are allowed to do banking in China.
5. Data of 3 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
6. M: Metro, U: Urban.

CUSTOMER–CENTRIC AND LEAN OPERATION

NEW PARADIGM IN OPERATIONS

"I seem to have been like a child playing on the sea shore, finding now and then a prettier shell than ordinary, whilst the great ocean of truth lay undiscovered before me."

— Abraham Lincoln

More employees in Indian banks are engaged in non customer–facing activities than those performing customer–facing activities. Optimization of in non customer–facing activities is, therefore, the single largest lever for banks to improve the overall productivity. However, misguided Business Process Re–engineering (BPR) efforts, focused only on cost improvement and "freeing up" of the people, invariably lead to reduced customer service and increased risk. Process optimizations need a new paradigm—one involving an **end–to–end redesign**. Start with the first customer touch point and end with immaculate delivery of service to the customer, in a tightly controlled manner. This will require banks to collaborate across organizational silos, and to adopt new–age technology. In BCG experience, such end–to–end optimization leads to better service, lower costs and lower risks.

Tooth–to–Tail Ratio: Aim for Four–Fold Increase

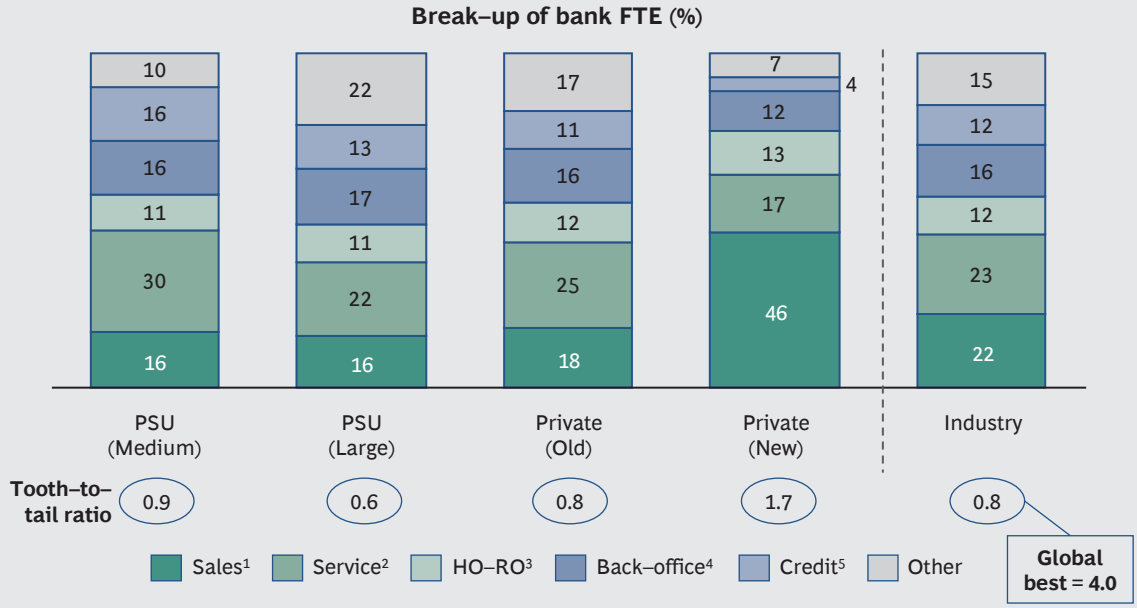
Exhibit 5.1 shows that the tooth–to–tail ratio for Indian banks is 0.8. The global best for this ratio is 4. Tooth being the sales and service employees facing the customer, and tail being the non–customer–facing employees. 55 percent of banking employees are involved in non–customer activities, aka, operations or back–office activities. This is likely an underestimate since many employees classified as sales and service are routinely involved in operational tasks such as filling forms for customers, doing data entry, collecting documents, delivering documents.

The best–in–class tooth–to–tail ratio requires 80 percent of employees in frontline, 10 percent in administrative roles (for example, HO, RO, ZO) and 10 percent in operational and credit roles. For the Indian banking sector, employees in administrative roles, at 12 percent, are close to the global best–in–class.

Meanwhile, 43 percent of the employees are in other non customer–facing roles, way above the global best–in–class figure of 10 percent—the primary driver being manual and paper–based operations. A plethora of vouchers and paper–based applications result in an army of people processing information:

- Redundant checks as paper crosses organizational boundaries in the name of control and risk—efficacy of which is still to be proven
- Suboptimal process designs and lack of job aids that could help improve efficiency

EXHIBIT 5.1 | Tooth–to–tail Ratio: India Industry Average at 0.8
Well below global best–in–class benchmark of 4



Source: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (Old) and 3 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; FTE: Full time employee.
[1]Sales FTE includes branch FTE on sales and out–bound sales force.
[2]Service includes branch FTE on service, call centre staff and internet banking staff.
[3]HO–RO includes all personnel in Head–office and Regional–offices, Zonal–offices and Divisional–offices.
[4]Back–office staff includes branch based back–office FTE, staff in operational back–offices and data–centre staff.
[5]Credit includes branch FTE on credit and staff involved in credit processes (Retail and SME) in processing centres.

- High fragmentation and low standardization in middle and back offices

As depicted in Exhibit 5.2, globally, 71 percent of the processes like credit document preparation and review, transaction processing, payments, fraud management, etc. are shared across business segments. Indian banks only share about 50 percent of processes across business segments, resulting in fragmentation, lack of standardization and duplication of efforts. As shown in Exhibit 5.3, the average size of processing center in Indian banks is 22. While most banks have a few large processing centers, the manual and paper–based nature of operations results in a proliferation of large number of small processing centers at the city level.

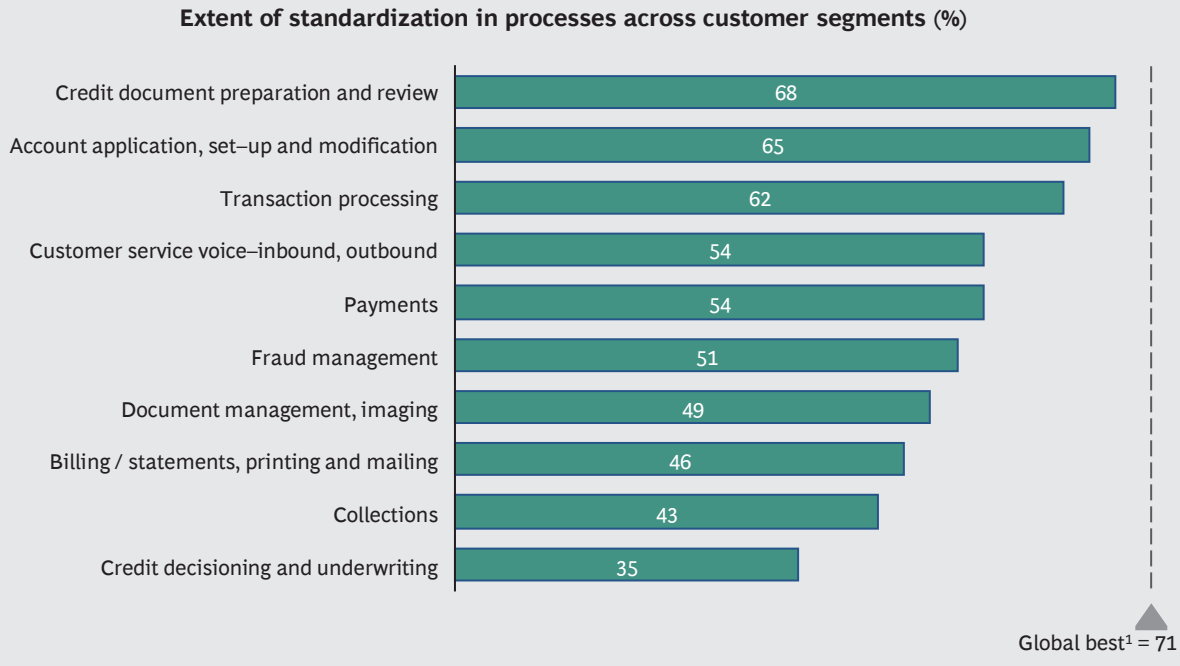
Banks need to adopt a five–pronged approach in order to increase the tooth–to–tail ratio.

- Ensure instant customer on–boarding and real–time resolution: Break the compromise between cost, customer and control
- Implement lean processes in a customer–centric way
- Foster collaboration and alignment across organizational silos
- Unleash full potential of technology for operational improvement
- Smart source: Outsource low value–add activities, develop vendor partnerships

No Back Office: Operations Paradigm Comes Full Circle?

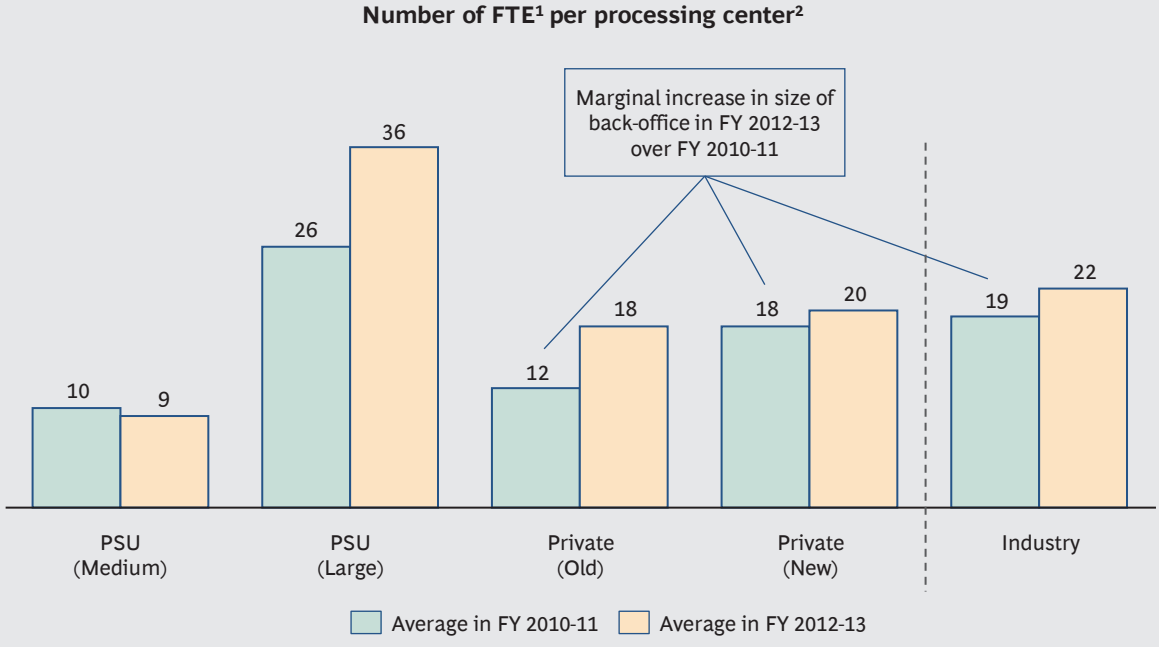
The single most leveraged initiative is to reduce the operational workload in branches, either by regionalizing or centralizing activities. Account opening, cheque clearing, delivery of statements / cheque book, etc. are the most common processes that undergo

Exhibit 5.2 | Room to Improve Standardization in Processes



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG Retail Banking Operational Excellence Survey 2012; BCG analysis.
Note: Data of 2 Private (Old) and 3 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
[1]Global best is for FY 2011–12.

Exhibit 5.3 | Room to Improve Centralization and Standardization



Source: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (Old) and 3 PSU (Medium) banks excluded from the (Number of FTE / processing center) analysis because of data consistency issues or data unavailability; FTE: Full time employee.
[1]Includes in–house FTE, captive subsidiary and outsourced FTE.
[2]Processing centers include credit processing centers and operational back–office processing centers.

this treatment. In most cases, such initiatives have lowered the costs and delivered relief to the branches. However, customer service has suffered more often than not, and risk has not reduced, as paper moves from customer to branch to regional center to central offices and then back. This results in high turnaround times, multiple back–and–forth between banks' offices, errors in processing, and an increase in risk through multiple manual hand–offs.

Advanced banking operating models have come a full circle—providing instant customer on–boarding, facilitating limited to zero middle—or back–office processing, and ensuring resolution at first point of contact. More importantly, this is happening at lower costs, and with improved controls—breaking the eternal compromise between cost, customer service and control.

Banks will have to draw up a comprehensive roadmap to design and execute the new operating model. However, they could take many simple steps now, as shown in Exhibit 5.3, to initiate the model that on–boards customers instantly and provides real–time resolution at low cost, and with tighter controls. Adoption of this operating model will result in virtual elimination of regional processing centers and very thin to no back–offices. The few starting steps toward new operating paradigm could be:

- Tablet–driven account opening—taking pictures at customer premises, data entry by the customer in many cases, taking scans of important documents at the spot
- Potential of e–KYC and authentication through Aadhaar
- Instant kits in the branches that could be activated once proper KYC is done
- Enhanced use of scanning at the branches to truncate paperwork
- Straight–through processing enabled by use of technology, smart rule engines, and use of credit information bureaus
- Incentivizing customers to move to self–service

New Paradigm In Process Optimization: End–To–End and Customer–Centric

Traditional BPR and lean efforts focus on finding and eliminating waste in individual departments and sub–processes. Take, for example, an initiative focused on lean account opening process. Traditional lean efforts will focus on optimizing one or a few elements at a time, for example, improving the turaround time and reducing cost for producing and delivering personalized welcome kits after the opening of the account in Core Banking System (CBS). Other elements typically targeted for optimization include speeding up the process of opening the account in CBS after the documentation arrives in back office, or improving the "First Time Right" (FTR) at the customer interface.

While such efforts do deliver some improvements and many departments improve their metrics, the overall process is only marginally better off. Most unproductive delays, inefficiencies and costs are incurred when paper or process moves from one department to the next, or during hand–offs within the departments. A better way to lean processes is to take the "end–to–end" view—starting from the customer and ending with the delivery of product or service to the customer. In case of the account opening process, this would mean that the workflow is mapped out—all the way from first point of contact with the customer (could be physical or virtual, like online) to activation of customer transactions through multiple channels. This would require bringing the people from sales, branch, middle–office processing units, central processing units, outsourced vendors (for example, data entry, courier services), compliance, on–boarding teams (for example, product specialists, call–center people) into one room, and discuss threadbare the target outcome, issues and opportunities for leaning the process. The most impactful recommendations will be those that straddle organizational boundaries, for example, sales and front–office committing to capture data at the point of sale through use of tablet or other mechanisms—thereby eliminating entire functions in the back office, enhancing accuracy, improving speed, and tightening controls.

The former approach to executing BPR is a customer–centric and an end–to–end lean process (as shown in Exhibit 5.4). As compared to the traditional lean approach, it delivers multifold impact—best customer experience, high employee engagement, high efficiency, and a culture of performance and continuous improvement.

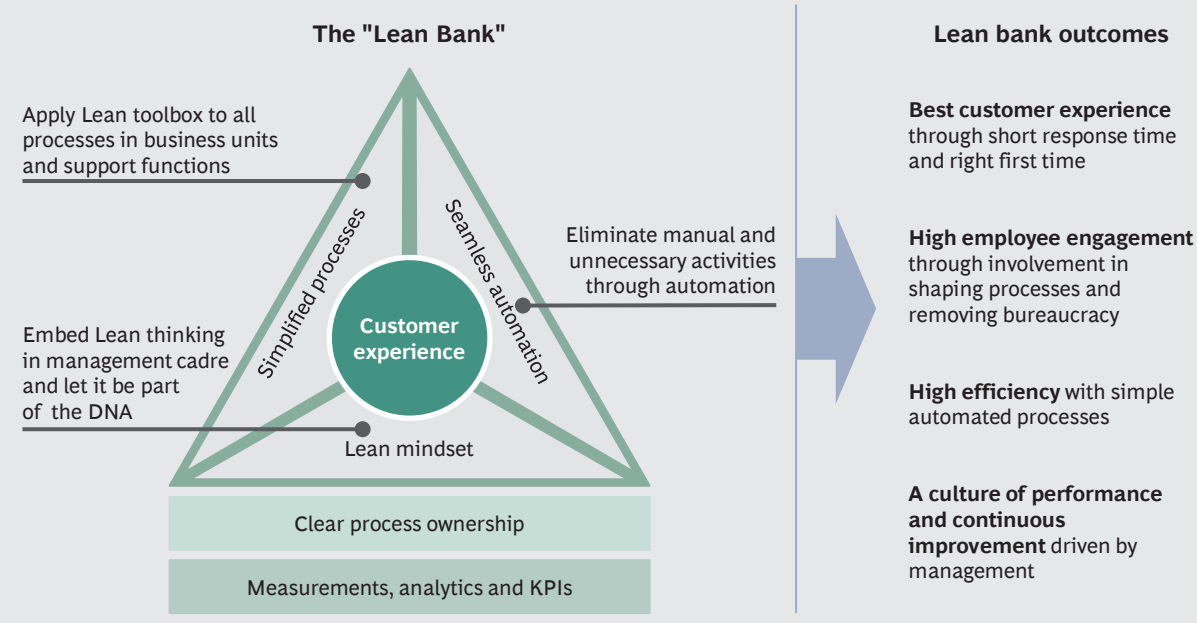
Performance Indicators: Fostering Collaboration Across Silos

Take the example of the account opening process. In a typical bank with a reasonable level of centralization and sophistication, up to eight different departments are involved in the end–to–end process. This is illustrated in Exhibit 5.5.

Each department will have its own Key Performance Indicators (KPIs), and targets will be fixed for those metrics. As a simple illustration, assume that each department has turnaround time as its KPI and that the target is to achieve a 96 percent accuracy on this KPI. In other words, a given department will have to ensure that 96 percent of the applications it receives are processed within the prescribed TAT. The best–in–class mathematical outcome of such a set–up will be multiplication of 96 percent across eight departments, or 72 percent accuracy. Add to it the complexity derived from other metrics like KYC accuracy and cost, and it is easy to see that the designed accuracy of such a system will be even lower. Moreover, individual departments regularly blame the upstream or downstream department for issues caused in their own department. Back offices complain that front offices send incomplete and erroneous documents downstream. Front offices, on the other hand, complain that back offices are inflexible and return the documents for frivolous reasons to optimize back–office TATs. The overall outcome is poor customer service, finger pointing across organizational silos, and employee dissonance.

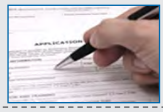
The typical organizational response to such problems is more checks, more KPIs and more departments. These would invariably be counterproductive. Instead, organizations need simpler KPIs that cut across organizational boundaries, rationalization of organizational structure to reduce boundaries, and lean processes to reduce hand–offs. Targets, objectives and role mandates of people will

Exhibit 5.4 | Core of the Lean Program is to Drive Customer Experience
All other targets of secondary priority (for example, FTE reduction, etc.)



Source: BCG analysis.

EXHIBIT 5.5 | Conventional Account Opening Process Straddles and Departments
Hand off across department is a big source of inefficiency

1		Sales sources the account, gets the customer to fill the application and collects the documents
2		Branch operations does first level checks, completes the documentation and sends the documents to scanning hubs
3		Regional hubs scan the documents and do one more check
4		A back-offices department checks the final KYC and give a go-ahead to open the account
5		Data entry department opens the account in CBS
6		Printing and deliverables department prepares welcome kits, PINs, cards, etc.
7		Courier delivers the client documentation
8		On-boarding teams initiate contact with the customer to get them to transact in multiple channels

Source: BCG analysis.
Note: KYC: Know your customer; CBS: Core banking solution.

have to change; new dashboards and metrics will have to be created; cooperation mechanisms will have to be fostered. However, cooperation cannot be decreed. It is not a matter of structure, processes or systems alone. Cooperation happens only when the work context makes it individually useful for people to cooperate. By leveraging the state–of–the–art of social sciences, notably organizational sociology, BCG has developed a set of "Smart Rules" to create such work contexts[1] (refer Exhibit 5.6).

- *Improve knowledge of others:* Knowing each other's strengths
- *Reinforce integrators:* Giving to management, notably field managers at the most operational levels, power and interest to make their teams cooperate
- *Increase total quantity of power:* This allows reconciliation of power at the center for consistency with power at the customer interface for responsiveness—breaking the compromise between centralization and decentralization
- *Enlarge the domain of reciprocity:* Removing resources that fuel internal monopolies and dysfunctional self–sufficiency
- *Expand the shadow of the future:* Exposing people to the consequences of their actions, for example, posting them in downstream departments through rotation policy
- *Modify the pay–off matrix:* Reward those who cooperate and put the blame on those who don't; creating management

Exhibit 5.6 | Smart Rules to Enhance Cooperation, Leadership, Engagement



Improve knowledge of others
- Their work, strengths
- Management to recognize performance



Expand the shadow of the future
- Adjust duration
- Increase frequency
- Promote inversion



Reinforce integrators
- Remove rules
- Remove dimensions in the matrix, delayering
- Refuse escalation



Enlarge the domain of reciprocity
- Set rich objectives
- Cut resources
- Eliminate internal monopolies



Increase total quantity of power
- To give all actors enough cards to play a more collective game



Modify the pay-off matrix
- Make those who don't cooperate bear the cost

Source: Y. Morieux (2011), 'Smart Rules: Six Ways to Get People to Solve Problems Without You', Harvard Business Review, volume 89, n°9, September: pp78–86.

dialogues and performance criteria, that make those who do not cooperate bear the cost

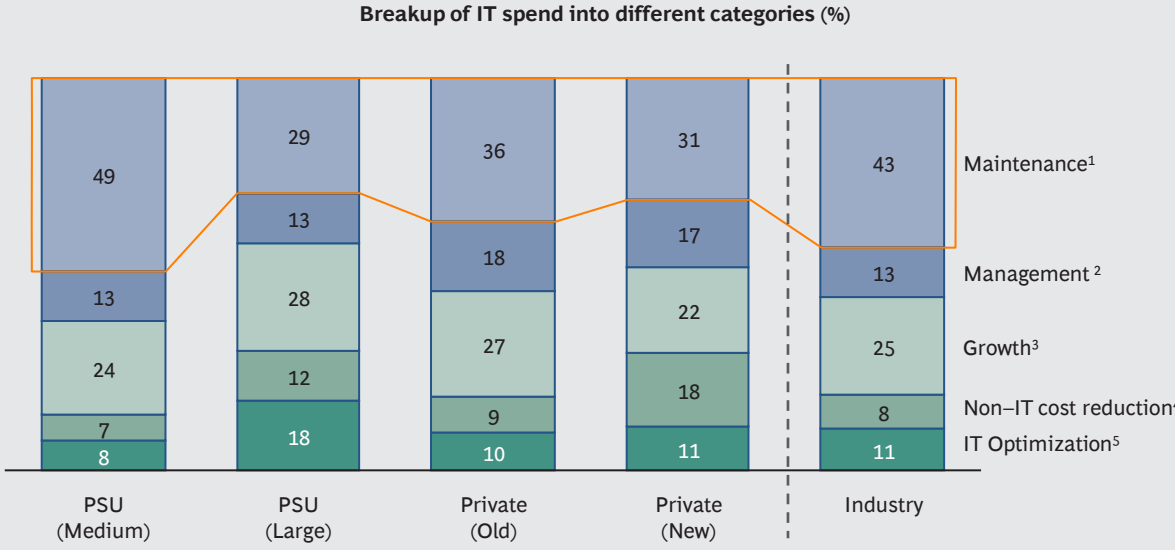
Because these rules help companies deal with the new complexity of business without organizational complicatedness, BCG calls this approach "Smart Simplicity". Every time these rules have been implemented in banks the result has been enhanced cross–functional efficiency, with a simultaneous improvement in employee engagement and performance—notably operational excellence and commercial effectiveness.

Low IT Spends in Indian Banking: Pride or Prejudice?

Almost all banks in India have achieved close upto 100 percent implementation of the Core Banking System (CBS). What next? Exhibit 5.7 shows the break–up of IT spend across categories. A significant 43 percent of the IT budget is spent in "maintaining" the bank and 13 percent on management of current IT infrastructure. In a growth–oriented economy like India, and in a scenario where banks have not yet fully leveraged IT, this suggests underinvestment in developing IT capabilities of the future. In fact, as Exhibit 5.8 shows, the IT spend of about 2 percent (as a proportion of banks' revenue) is less than a quarter of the global median. Indian banks need to triple or quadruple their non–maintenance IT spend. Mix of this investment needs to shift toward projects that help optimize the operations and IT of the bank.

The current mix of top ten projects, as shown in Exhibit 5.9, suggests that only 30 percent of the new projects are targeting IT and operational improvements—with more than 50 percent eyeing growth (new products, channels) and management reporting. This probably reflects the relative weight of various organizational silos in allocating the limited IT budget, with business unit—and management–led IT projects taking precedence over projects that deliver improved operations and IT capabilities. Launching new products, creating better reporting platforms and optimizing channels will not lead to tangible results unless the operations and back–end IT capabilities are robust, scalable and up to date. In fact, banks need to build operations and IT capabilities first before launching into

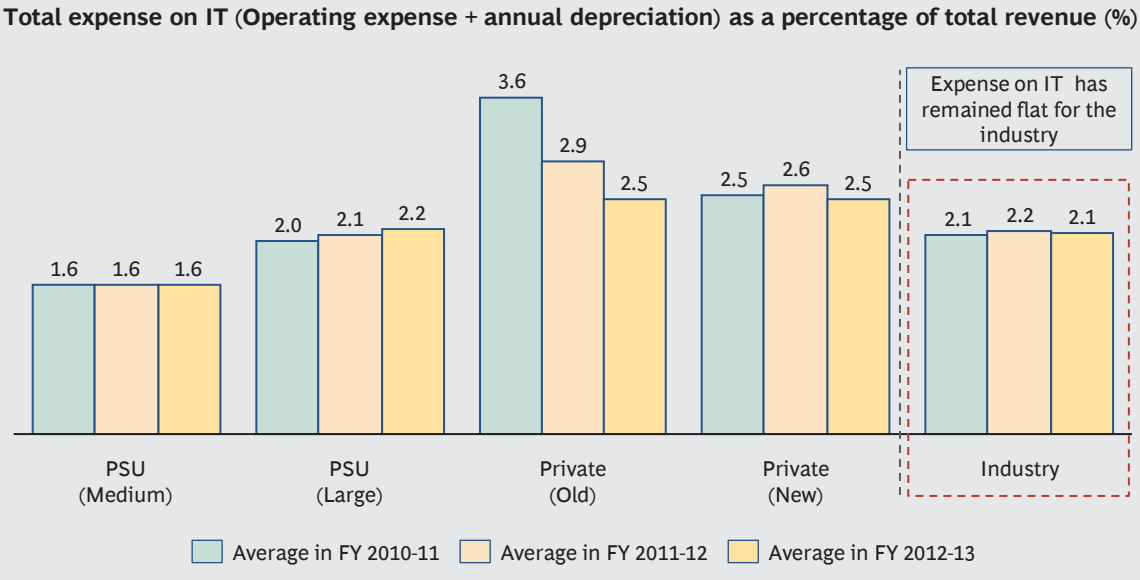
Exhibit 5.7 | Mis–directed IT Spend: Highest Spend on Maintenance Projects; Growth Projects and IT Optimization Being Ignored



Sources: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (Old) and 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
[1]Maintenance projects include projects needed to sustain the day–to–day operations.
[2]Management projects include projects related to reporting, controlling, risk management, business intelligence and implementation of legal and regulatory guidelines.
[3]Growth projects include projects related to growth in products and channels.
[4]Non–IT cost reduction projects include projects related to standardization, automation and centralization of back–office processes and other business simplification and optimization initiatives.
[5]IT Optimization projects include projects related to optimization of the architecture ,application landscape, application development processes and IT organization.

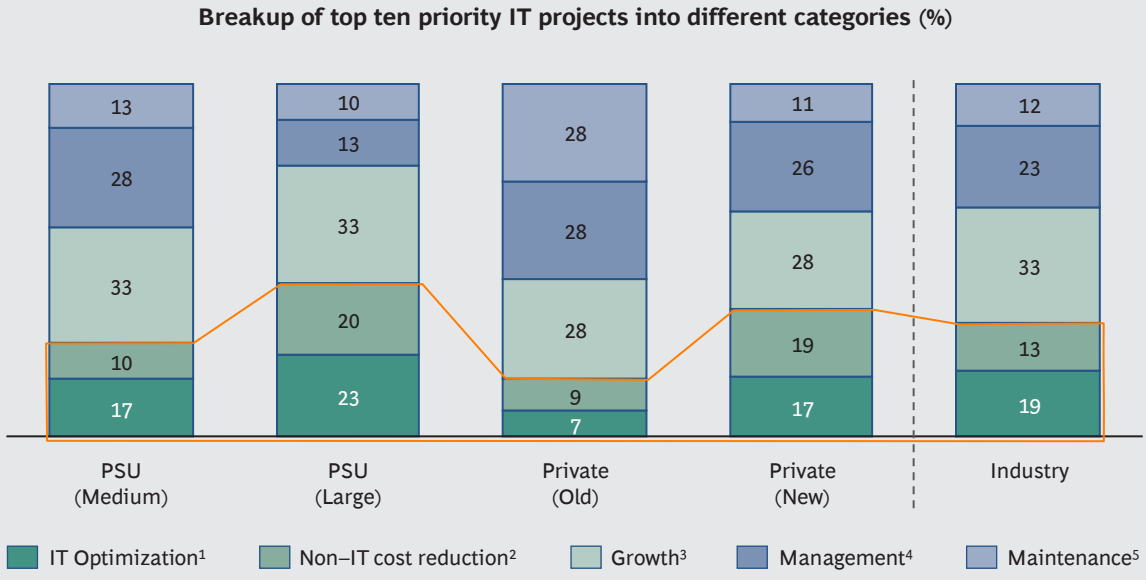
Exhibit 5.8 | Overall IT Expenditure as Proportion of Revenues Unchanged

Private old banks have reduced spend on IT



Source: FIBAC Productivity Survey 2013; BCG analysis.
Note: Expense on IT includes investment in hardware and software related to IT / technology. Expenses incurred on self–service machines like ATMs are excluded; Data of 4 Private (Old), 2 PSU (Large) and 8 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

EXHIBIT 5.9 | Mis–directed IT Effort: IT Optimization Projects Being Ignored By All Bank Segments



Sources: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (Old) and 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
[1]IT Optimization projects include projects related to optimization of the architecture, application landscape, application development processes and IT organization.
[2]Non–IT cost reduction projects include projects related to standardization, automation and centralization of back–office processes and other business simplification and optimization initiatives.
[3]Growth projects include projects related to growth in products and channels.
[4]Management projects include projects related to reporting, controlling, risk management, business intelligence and implementation of legal and regulatory guidelines.
[5]Maintenance projects include projects needed to sustain the day–to–day operations.

new front–end capabilities. Banks need to increase their IT budgets and rebalance the IT portfolio in order to improve the mix of projects involving operational and IT capabilities. Design principles for efficient and adaptable IT capabilities will have many of the following elements:

- One front end everywhere for assisted customer sales and service, and for financial transactions in front office, call center and back office
- Eliminate paper in the organization—only let images / data into the organization
- Integrate self–service and assisted channels into a common core, across leads, contacts, applications, service and transactions
- Enforce unique identifiers for people (customers, staff and third parties), places (channels, branches, customer premises) and things (accounts, products, tasks, documents); index and link all information to these identifiers
- Define the golden sources of truth for operational and analytic data, and strive for coverage, completeness and accuracy
- Fulfil requests immediately to eliminate waste, rework; Work in progress through real–time banking—open accounts, service clients, and process and post transactions immediately
- Create product configuration engines—configure and launch products in days
- Implement "tick–and–flick" task management (routing, tracking) to move work requests to more skilled, lower–cost staff to free up time in the frontline
- Implement one HR system for staff and contractors that involves a single pro-

cess—linked to role–based authorizations by level and employment status—for hiring, retirements and promotions

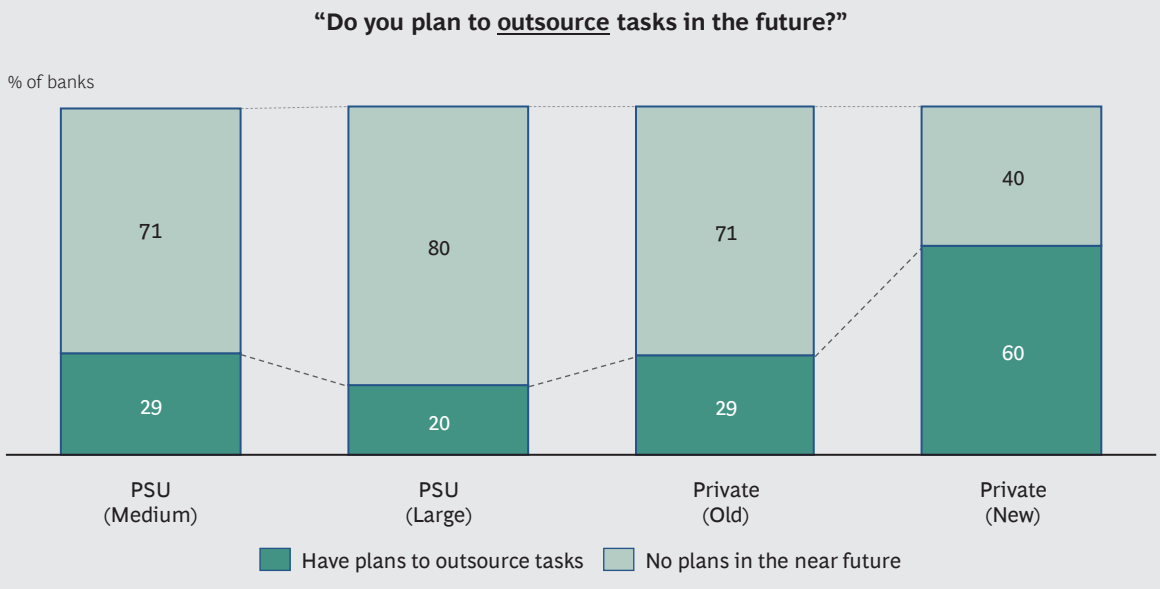
Smart Source: From Vendors to Partners

Consider a list of some of the activities that banks do—data entry, filling ATMs with cash, maintaining self–service machines, delivering documents, maintaining servers, helping employees with basic computer–related issues, maintaining IT applications, securing premises, managing records, housekeeping, maintaining facilities, preparing payroll, etc. A large number of bank employees are engaged in carrying out these types of activities. Are these core activities of the bank? Should these be necessarily done by bank employees? Is doing these activities in–house the most productive use of relatively expensive banking talent? Would it dilute control or increase risk if some of these activities were outsourced?

Answers to these questions could vary slightly for different banks, given their starting points, cultures and organizational limitations. However, the fact remains that banks would only benefit from higher levels of outsourcing of low value–added activities. These activities could be done in a cheaper, better way and in many cases, with better controls through use of outsourced agencies. Banks will need to create a framework for outsourcing. To start with, they will have to develop robust capabilities for vendor relationship management in order to realize the full benefits of outsourcing. Also, banks need to choose a select number of vendors who are almost partners in the business, and are as interested in continuous improvement as the banks themselves are. Exhibit 5.10 shows that only about 25 percent of public sector banks are planning to outsource tasks—other banks need to consider this lever as well for improving the tooth–to–tail ratio.

NOTE:
1. **Source:** Y. Morieux (2011), 'Smart Rules: Six Ways to Get People to Solve Problems Without You', Harvard Business Review, volume 89, n°9, September: pp78–86.

EXHIBIT 5.10 | Opportunity to Increase Focus on Outsourcing to Ensure Greater Efficiency



Source: FIBAC Productivity Survey 2013; BCG global enterprise excellence database for banks; BCG analysis.
Note: Data of 1 PSU (Large) and 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

DIGITAL TRANSFORMATION

THE CHALLENGE OF ADOPTION

"You cannot escape the responsibility of tomorrow by evading it today."

— Abraham Lincoln

We established the importance of digital channels and transactions in last year's FIBAC report. Higher use of digital channels and more transactions lead to improved customer retention and higher balances in accounts. At the same time, digital channels do not make branches redundant. Branches, in fact, play a crucial role in developing emotional engagement with customers, and creating advocates among customers.

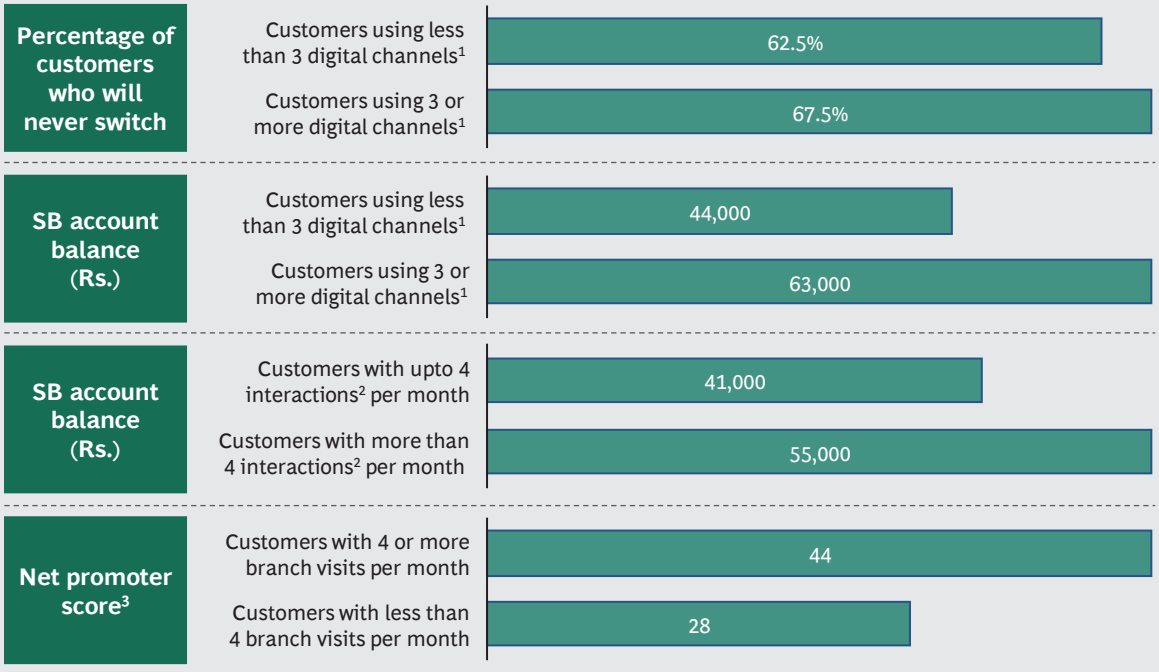
Let us recap the salient insights from the one–of–its–kind survey of about 14,000 bank customers (validated and normalized for socio–economic class of customers) as shown in Exhibit 6.1.

- Propensity to switch reduces by more than 10 percent when customers use three or more digital channels
- Balances are 40 percent higher for customers using at least three digital channels
- Balances are almost 35 percent higher in accounts when customers transact four or more times in a month
- Customers visiting branch at least four times a month have an almost 55 percent higher Net Promoter Score

Banks need to embrace a two–pronged approach in order to retain customers, increase balances and turn clients into advocates. They should encourage customers to carry out transactions on digital channels. Banks should also strive to get customers to visit branches—not to facilitate transactions, but to offer them advice on their banking and investment matters.

This year's banking survey reveals that cash and cheque transactions per account have only marginally come down over the last two years. There has been a steady progress in the adoption of digital channels, but big gains remain elusive. There are new "new" channels on the horizon—like corporate business correspondents, mobile operators and regular business correspondents agents. These new "new" channels present a huge, untapped opportunity. Making the digital and new "new" channels work will require commitment from the top, engagement from within the organization, new mutually beneficial partnerships, user–friendly digital interfaces, attractive use cases, and a concerted customer education and incentivization campaign.

EXHIBIT 6.1 | Higher Customer Interactions Can Lead to Significant Benefits



Sources: BCG's Center for Consumer and Customer Insight (CCI) Survey, Sample size ~ 13,900 customers; BCG analysis.
[1]Digital channels include ATM, Debit card, Mobile banking, Call center and Internet.
[2]Interactions is defined as the number of times any of the 6 channels (Branch, ATM, Debit card, Mobile banking, Call center and Internet) is used.
[3]% of promoters (customers who gave scores 9–10) minus % of detractors (customers who gave scores 0–6) on a 11 point scale.

Cash: Continue to Hold the Fort, But Cracks Visible

The number of cash transactions per day per branch has increased by 8 percent over the last two years, from 118 to 127, as shown in Exhibit 4.4. However, the number of cash transactions per active SB account per annum has fallen by 12 percent, from 4.9 to 4.3, with the corresponding figure for current account declining by 8 percent, from 30.1 to 27.6 (as shown in Exhibits 6.2 and 6.3 respectively). Cash transactions are increasing because the growth in new CASA accounts is faster than the growth in the number of branches, as shown in Exhibit 6.4. Compounding the problem is the fact that the new accounts are more mass market, semi–urban and rural, where the prevalence of cash is higher.

Bankers, betting on cash disappearing or reducing in branches, will need to rework their strategies. The number of cash tellers will not come down any time soon. Unless, of course, cash deposit machines are installed in the branches, or at off–site locations co–located with ATMs. One cash deposit machine could free up 1 to 1.5 tellers in the branch. Freed–up manpower could be more productively deployed for higher value–add activities like sales, service, advisory, or for training customers on how to use digital channels.

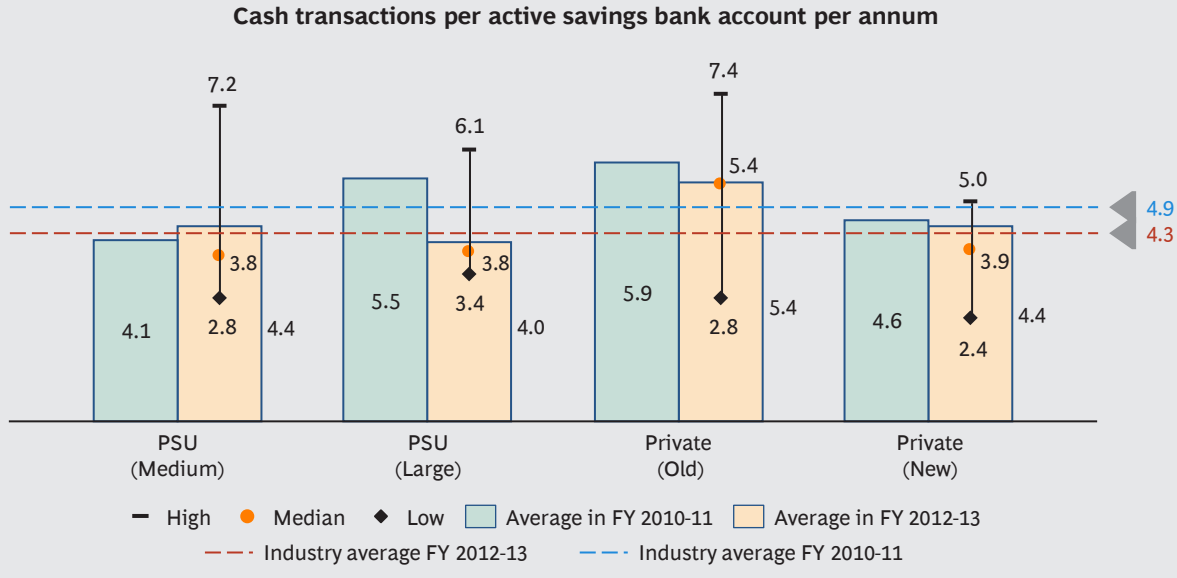
Cheque: Retail Customers Letting Go, Businesses Holding on

The number of cheque transactions per branch per day has decreased by 10 percentage, from 79 to 71 as shown in Exhibit 6.5, in the last two years, with cheque transactions per active SB account per annum declining by a whopping 35 percent, from 2.3 to 1.5 (as shown in Exhibit 6.6). However, the number of cheque transactions per active current account per annum is only marginally down, from 73.6 to 72.7 (as shown in Exhibit 6.7).

Retail customers are adopting digital channels for transactions at a much faster pace than businesses. In fact, many retail customers still using cheques have businesses on the other leg

EXHIBIT 6.2 | Concerted Effort Required From Indian Banking Industry

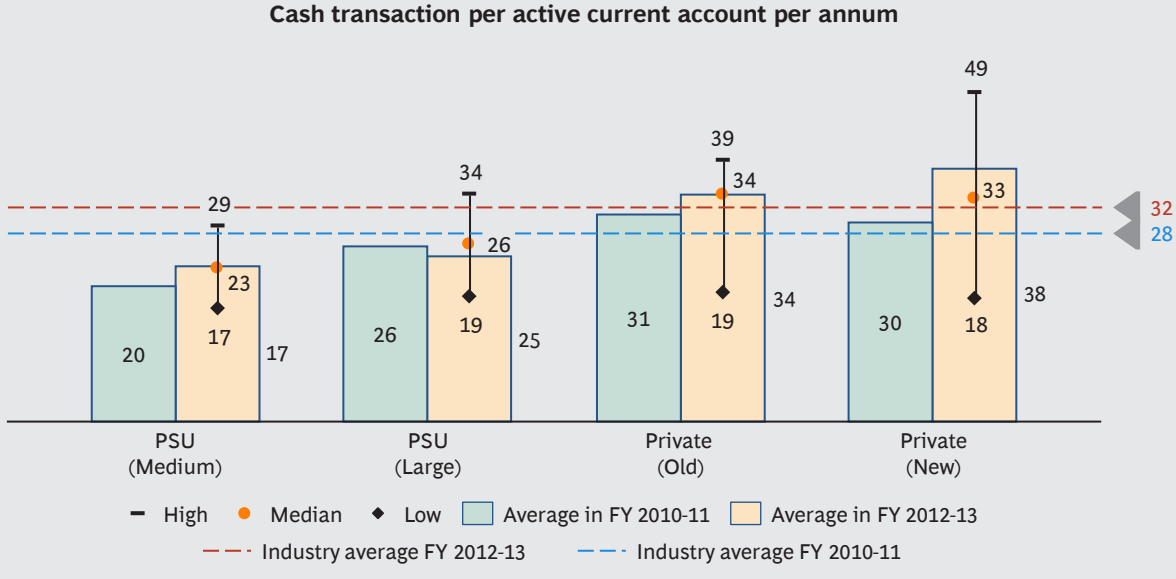
Cash transaction per active savings bank account per annum marginally decreased in FY 2012–13 over FY 2010–11



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 1 Private (Old), 3 PSU (Large) and 14 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

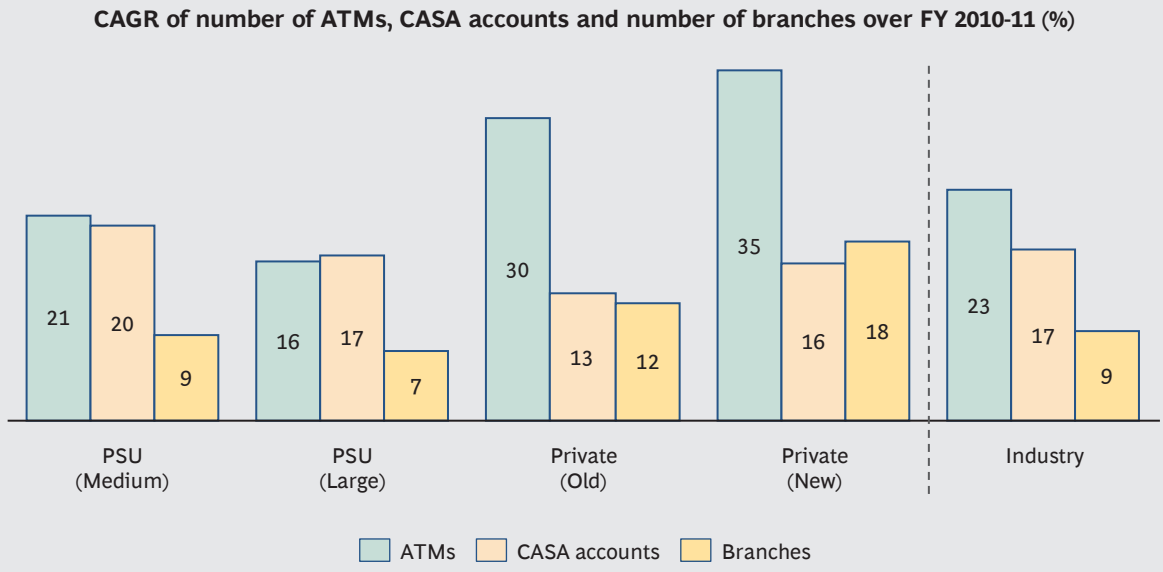
EXHIBIT 6.3 | Concerted Effort Required From Indian Banking Industry

Cash transaction per active current account customer per annum increased in FY 2012–13 over FY 2010–11



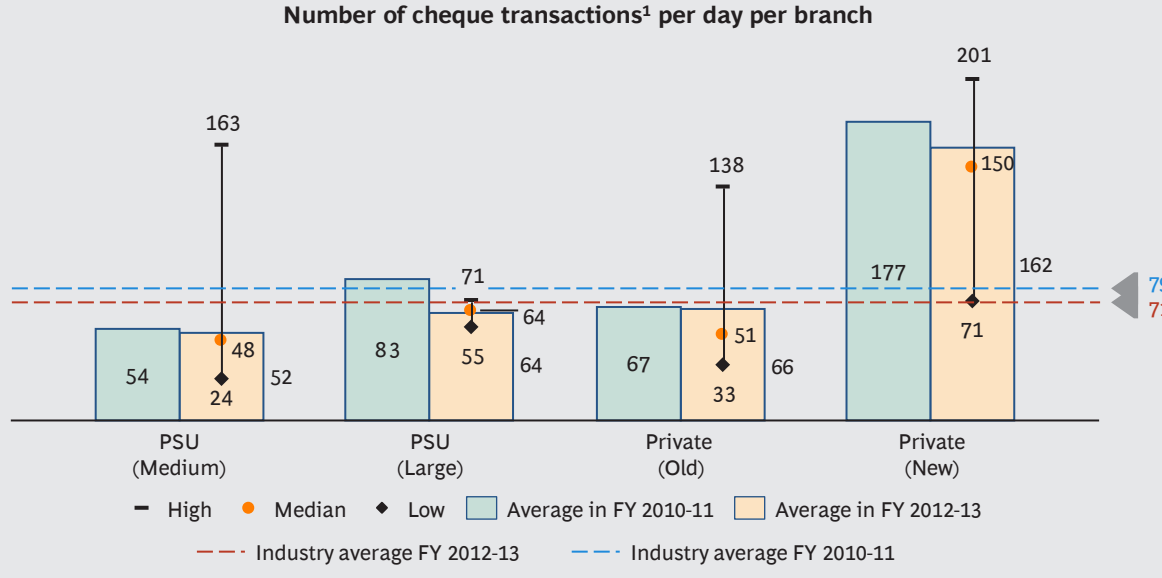
Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 1 Private (Old), 3 PSU (Large) and 14 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

EXHIBIT 6.4 | CASA Customers Growing Faster Than Number of Branches for PSU Banks, Thereby Potentially Increasing Cash Transactions Per Branch



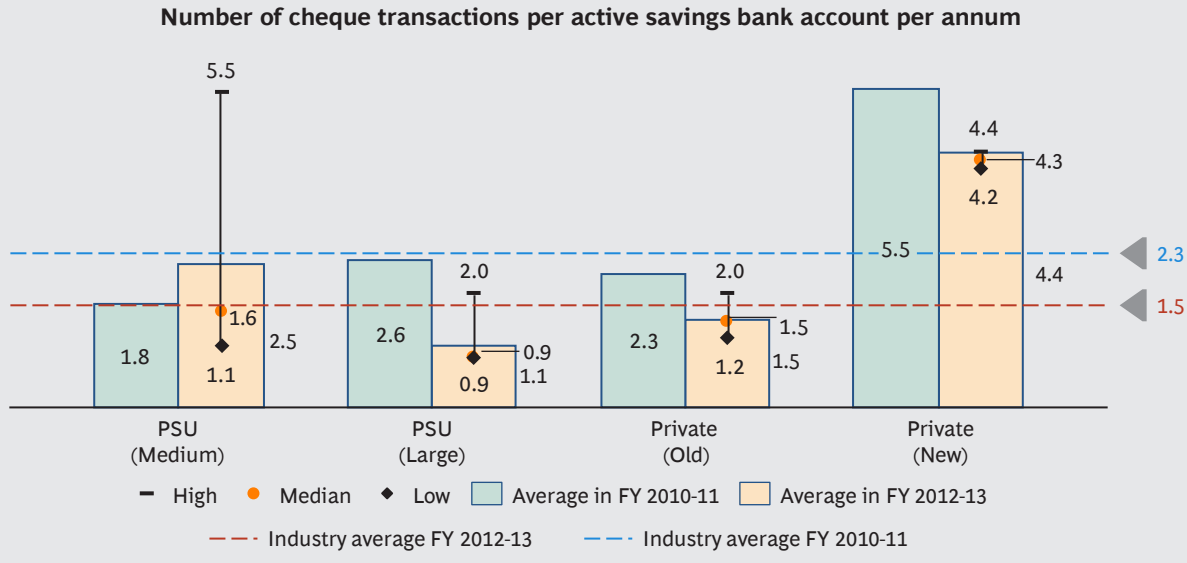
Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 6 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; CASA: Current account and savings bank account.

EXHIBIT 6.5 | Number of Cheque Transactions Per Day Per Branch has Decreased For All Bank Categories



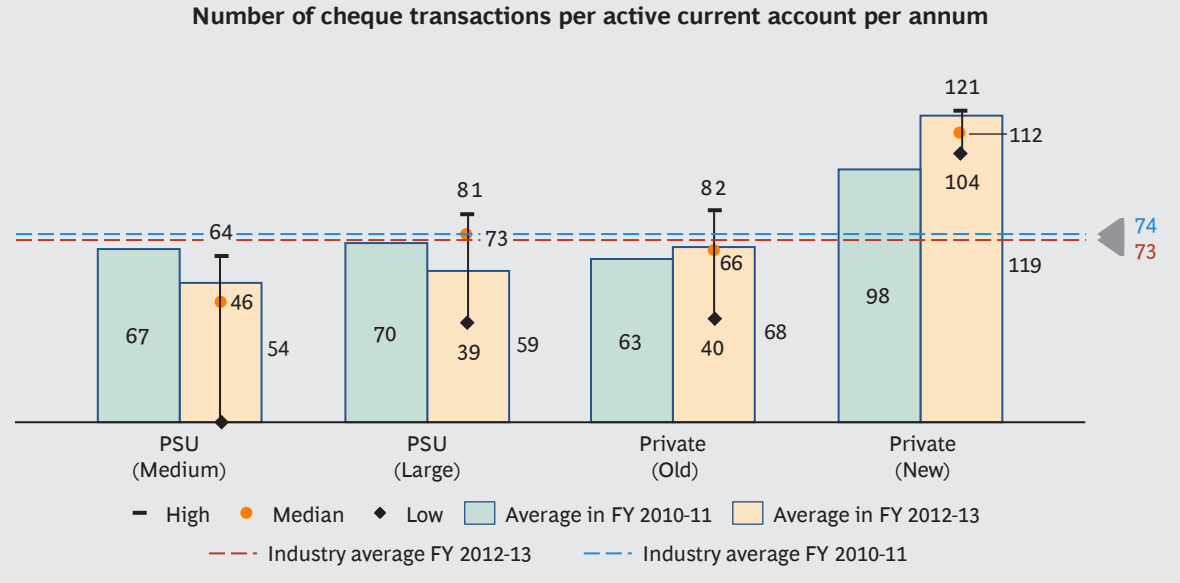
Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 2 Private (Old), 2 PSU (Large) and 13 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; A year is assumed to have 300 working days.
[1]Cheque transactions include total cheques cleared (inward + outward) at branches as well as processing centres.

EXHIBIT 6.6 | Cheque Transaction Per Active Savings Bank Account Per Annum Has Decreased Since FY 2010–11



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 3 Private (New), 3 Private (Old), 3 PSU (Large) and 18 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability..

EXHIBIT 6.7 | Cheque Transactions Per Active Current Account Per Annum Has Remained Stable Since FY 2010–11



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 3 Private (New), 3 Private (Old), 3 PSU (Large) and 18 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

of the transaction. Banks need to incentivize corporates to increasingly use channels other than cheques, make it easy for corporates to shift, and fully leverage the new payment infrastructure getting built in the country, like IMPS, ACH and GIRO. For cheques still remaining in the branches, banks should consider investing in cheque deposit machines that are compatible with CTS clearing standards. This will further free up the valuable manpower in branches and back–offices for use in higher value–add activities of banks.

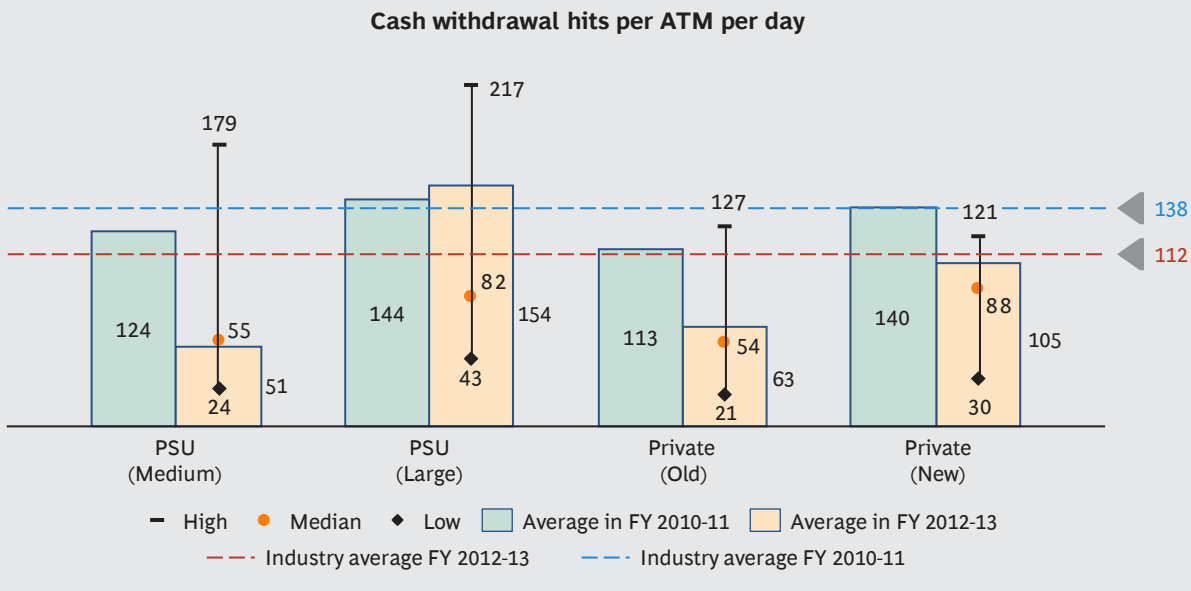
ATM: Easy Pickings are Over, Tighten the Belts

The average number of cash withdrawals per day at ATMs is down by nearly 20 percent, from 138 to 112, as shown in Exhibit 6.8. While ATM transactions per account have only dropped by 6 percent, the rest of the reduction has come from the high growth rate of ATMs. The number of ATMs has increased at a compound annual growth rate of 23 percent over the last two years, while the CASA accounts and branches have grown at 17 percent and 9 percent, respectively. Banks continuing to install more ATMs and white–label ATM operators should take notice of this trend. The answer is not to decelerate the ATM deployment. Rather, operators should:

- Find more viable locations
- Improve uptime
- Find alternate sources of revenue, and
- Take drastic steps to become more cost–efficient

Banks have achieved varied levels of success with ATM adoption and migration of transactions. Exhibit 6.8 illustrates the number of cash withdrawal transactions per ATM for banks across different categories. Some banks have achieved very high levels of transactions (200 transactions per day per ATM, which is close to the highest in the world). However, there is no scale evident in the level of usage in ATM network. A few banks with small networks are as successful as a few banks with large networks in achieving high usage. The leading public sec-

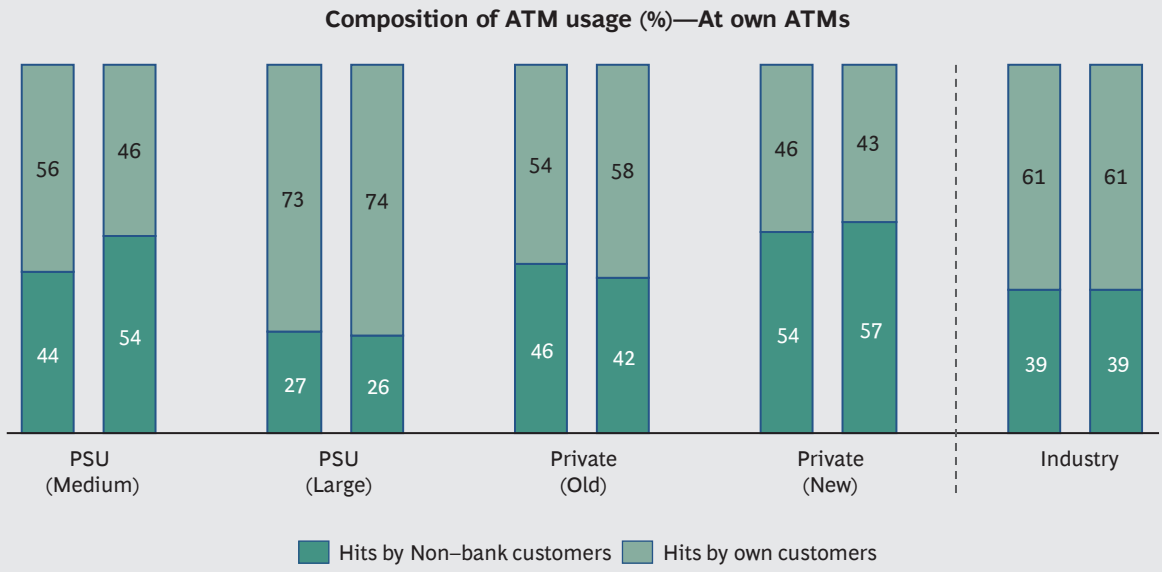
EXHIBIT 6.8 | Number of Cash Withdrawal Hits Per ATM Per Day Down by ~20%
PSU large banks winning back share from other categories



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (Old), 1 PSU (Large) and 6 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

Exhibit 6.9 | Varying Patterns of ATM Usage

PSU large banks leveraging huge ATM network; ~74% of hits at own ATM by own bank customers



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (Old), 1 PSU (Large) and 6 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

tor bank in this regard is more successful than the most successful private sector bank. There is an interesting pattern, however, in the usage of a bank's ATM by non–bank customers. More than half of the transactions on ATMs of new private sector banks are from customers of other banks, as seen in Exhibit 6.9. For large public sector banks, this number is just about a quarter.

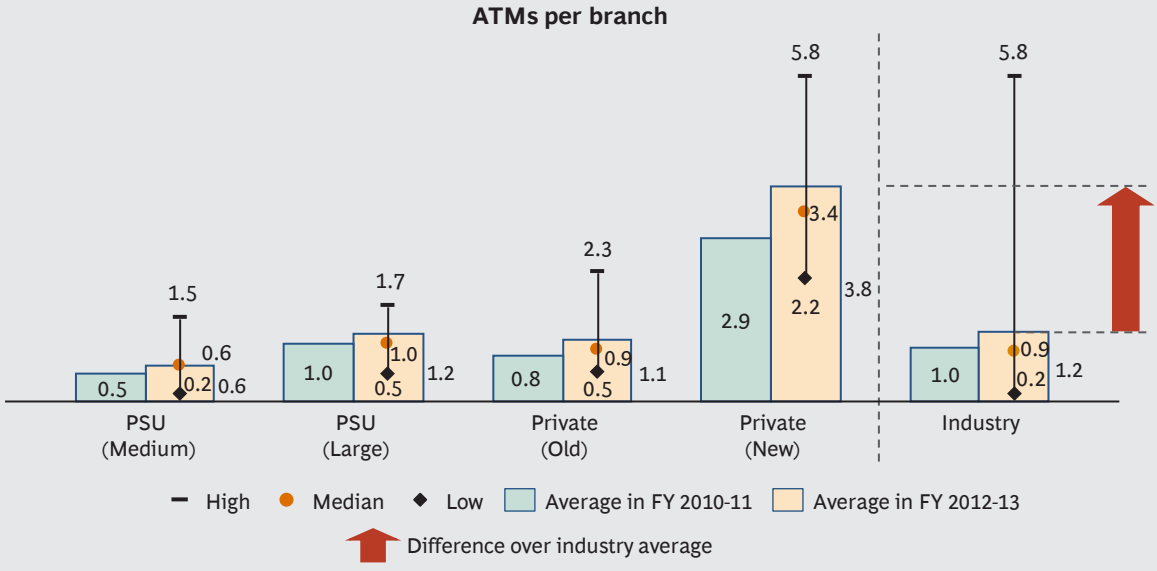
Some new private sector banks are known for using their ATMs as a primary vehicle of service. This is a simple yet powerful fact. Banks can use ATM networks to extend the catchment area of branches, as well as to enhance the perception of their presence—even when they have only a limited number of branches. New private banks have, on an average, 3.8 ATMs per branch while the industry average is close to 1.2 (as seen in Exhibit 6.10).

Digital Channels: Making Inroads, but Too Early to Declare Victory

The number of transactions per active CASA account per annum has remained the same over the last two years, at 24 (refer to Exhibit 6.11). However, the mix has changed in favor of digital channels. The number of digital transactions (excluding ATM) per active CASA account has risen by a whopping 69 percent, from 2.6 to 4.4. This is already higher than cheque transactions per active CASA account, and within striking range of cash transactions per active CASA account. Cash, cheque and ATM transactions per active CASA account are down 16 percent, 6 percent and 6 percent, respectively, making way for the digital channels (POS / NEFT / RTGS / Online / Mobile transactions). NEFT / RTGS transactions per active CASA account have doubled, mobile transactions have grown multifold from a very small base, online transactions have increased slightly, and POS transactions are just about holding the fort, as shown in Exhibit 6.12.

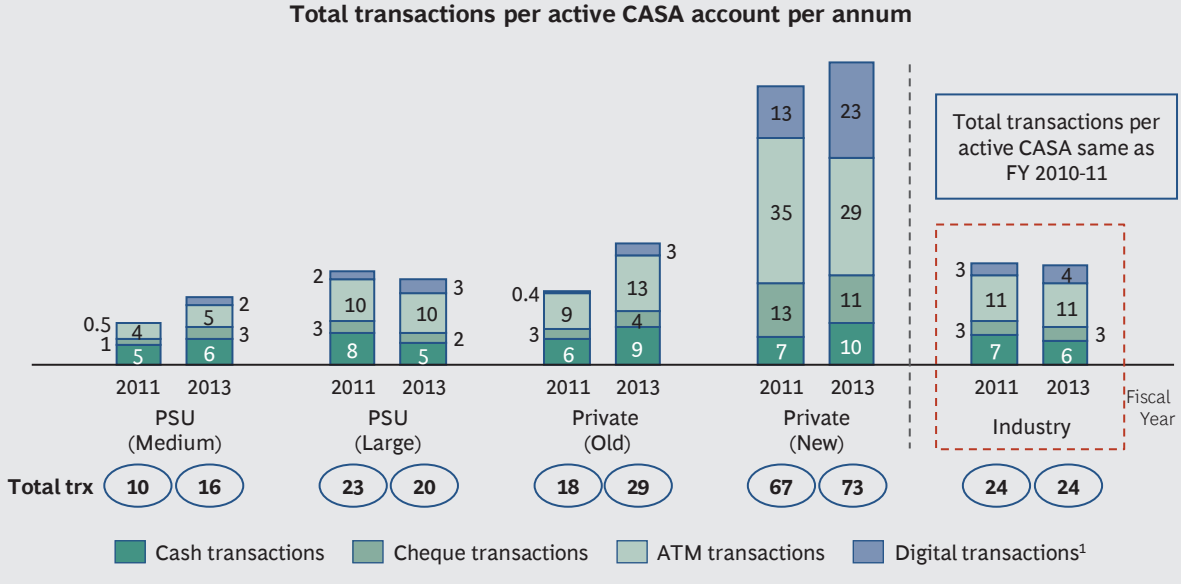
A recent BCG study estimates that there are 125 million Internet users in India, and projects the figure to increase to 330 million by 2016. The popular belief is that most of the new netizens will be young and metro–dwellers. A BCG survey of over 25,000 Indian consumers reveals that 57 percent of current In-

EXHIBIT 6.10 | Private New Banks Have a Significantly Better Network of ATMs Per Branch Than Other Banks



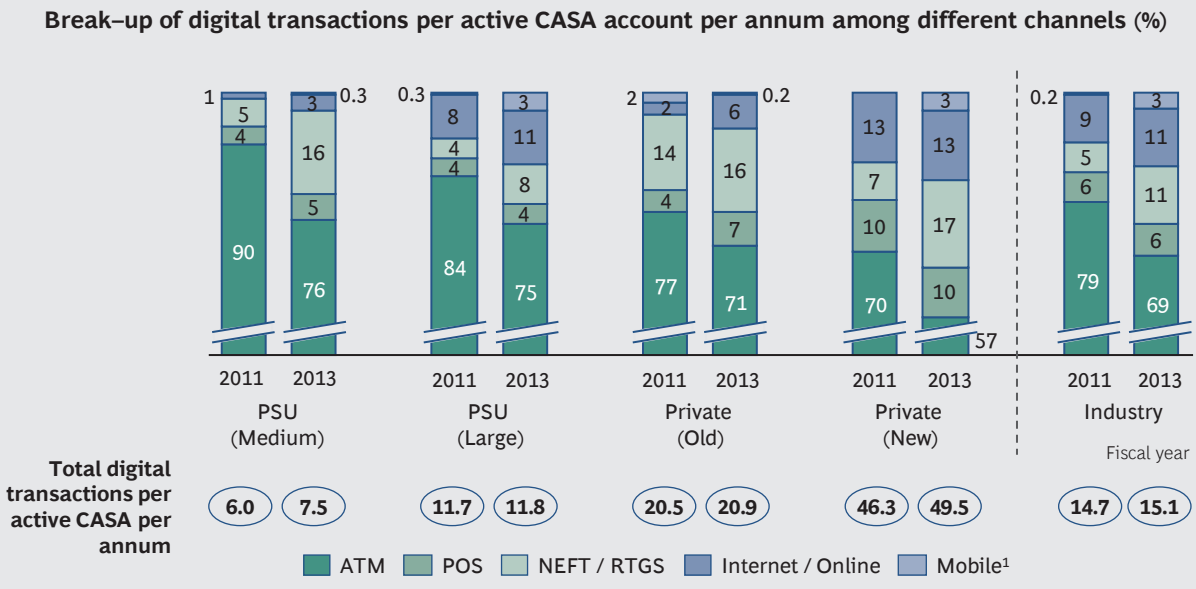
Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.

EXHIBIT 6.11 | Although Penetration of Digital Channels is Increasing, Total Transaction Per Active CASA Account Has Remained the Same



Source: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (New), 5 Private (Old), 3 PSU (Large) and 17 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; CASA: Current account and savings bank accounts.
[1]Digital transactions include online / internet, NEFT / RTGS, POS (point of sale) and mobile transactions.

EXHIBIT 6.12 | Digital Transactions Per Active CASA Customers Increased Marginally
Share of NEFT / RTGS, online and Mobile transactions increased at the expense of ATM transactions



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 5 Private (Old), 1 PSU (Large) and 15 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; CASA: Current account and savings bank account; POS: Point of sale.
[1]Mobile transactions include both financial and non–financial transactions.

ternet users are over 25 years old, with the number expected to grow to 70 percent by 2016. Almost 60 percent of Internet users are in sub–urban and rural areas. These customers, on an average, are more affluent, and value convenience and variety more than discounts on Internet. Customers with access to the Web currently control close to a third of the urban consumption, and this figure will grow to almost 60 percent by 2016. Nearly half of these people are accessing the Internet through mobile devices, and Internet on mobile will only grow. Almost a third of consumers of financial services firms currently have access to the Internet, with the figure expected to grow to about 50 percent by 2016. Indian banks cannot ignore this digital customer—if they do, they might very well ignore 50 percent of the customers and almost 60 percent of the banking pool by value.

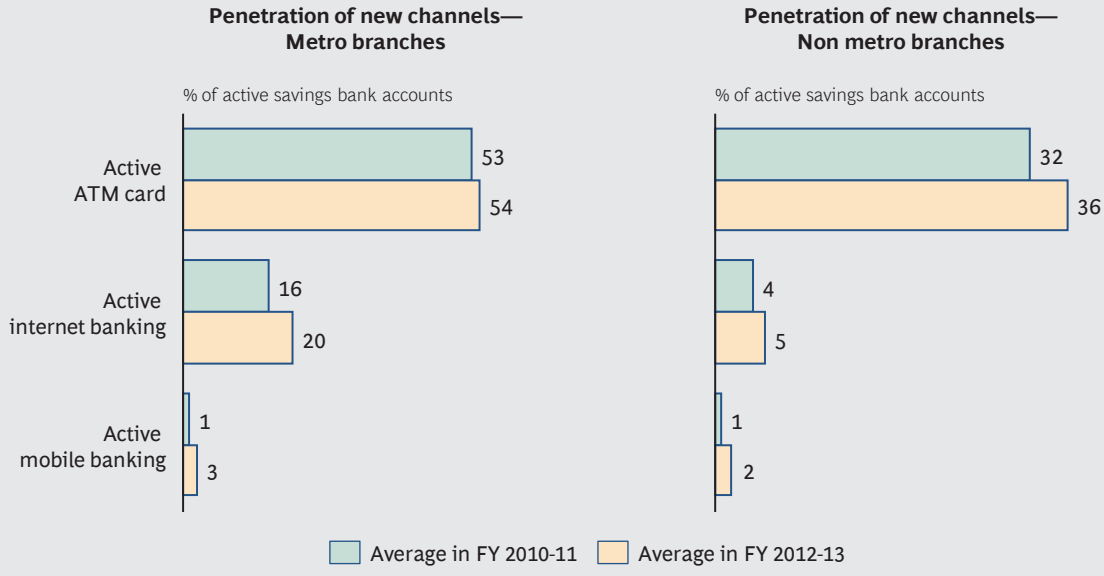
Internet adoption by active SB customers has increased by 25 percent in both metro and non–metro locations in the last two years. SB accounts with active Internet banking is up, from 16 percent (as a proportion of total active SB accounts) to 20 percent, in metro branches, and up from four percent to five percent in non–metro branches, as shown in Exhibit 6.13. Mobile banking activation has surged by between 200 and 300 percent. While this is encouraging, it is too early to declare a victory. Virtually all banking customers have a mobile phone, but still only three percent are using mobile for transactions. Almost 35 percent of banking customers in metro and semi–urban areas have access to the Internet, but less than half of them are using Internet banking.

Even when banks have managed to persuade customers to use digital channels, spends by clients on these channels have yet to pick up. New private banks have been more successful at activating customers and having them spend using digital channels, as shown in Exhibit 6.14. The amount of digital spend per SB account is seven to eight times at new private banks, as compared to the industry average.

The banking industry's Return on Investment (RoI) on the massive infrastructure it has set

EXHIBIT 6.13 | Active Savings Bank Accounts Using Alternate Channels: Increase Over FY 2010–11 For Metro as Well as Non–Metro Branches

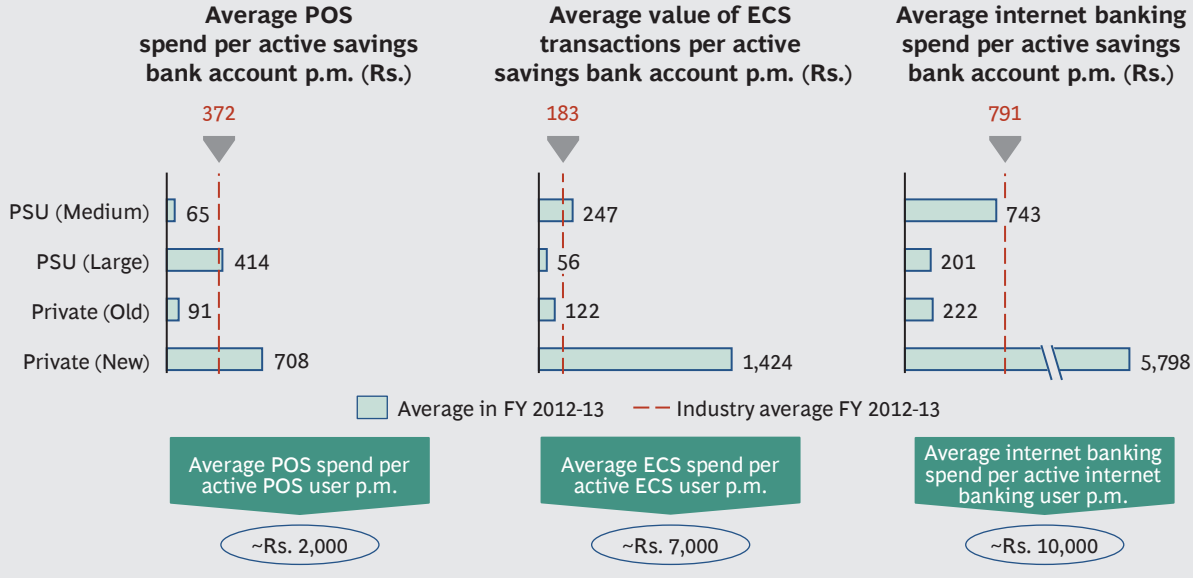
Increased adoption of alternate channels across the board



Source: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 1 Private (New), 4 Private (Old), 2 PSU (Large) and 12 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.

EXHIBIT 6.14 | Indian Banks Need to Discover a New Approach for Alternate Channels

Average spend per new channel low



Sources: FIBAC Productivity Survey 2013; BCG analysis.
Note: For POS spend, data of 1 Private (Old), 1 PSU (Large) and 9 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; For ECS, data of 2 Private (New), 3 Private (Old), 1 PSU (Large) and 12 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; For Internet banking spend, data of 2 Private (New), 3 Private (Old), 1 PSU (Large) and 15 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; POS: Point of sale; p.m.: Per month; ECS: Electronic clearing system.

EXHIBIT 6.15 | Reasons for Poor Channel Adoption

Channel	% not using	Reason # 1	Reason # 2
 ATM	18%	Not aware	Do not know how to use
 Debit card	72%	Not aware	Safety concerns
 Mobile banking	72%	Don't feel the need	Not aware
 Call center	77%	Not aware	Bad experience in past
 Internet	77%	Not aware	Inconvenience

xx% Percentage of users not using the channel

Source: BCG India Customer Survey 2012; BCG analysis.
Note: Sample size used in this analysis is 13,900 bank customers.

up for digital payments will be difficult to defend with such adoption and spend rates. As highlighted in Exhibit 6.15, the foremost reason cited by customers for non–adoption is the lack of awareness / education. Debit cards suffer from the perception of security risk, while customers find the Internet to be inconvenient. Mobile customers do not feel the need to use digital channels—the use case is unclear.

However, none of the reasons for non–adoption are seemingly insurmountable for banks. The importance of digital channels for improving overall productivity and creating loyalty and satisfaction among customers cannot be overstated. The current situation must change for the better, before banks can declare victory on the digital front.

How to Turbo Charge Digital Adoption: Four Pronged Approach

BCG experience suggests that banks need to fire on all cylinders to drive an increase in adoption and spend rates, as far as digital channels are concerned. As shown in exhibit 6.16, we recommend a four pronged approach to be undertaken by banks to ensure that they do not miss the digital wave.

COMMIT TO DIGITAL

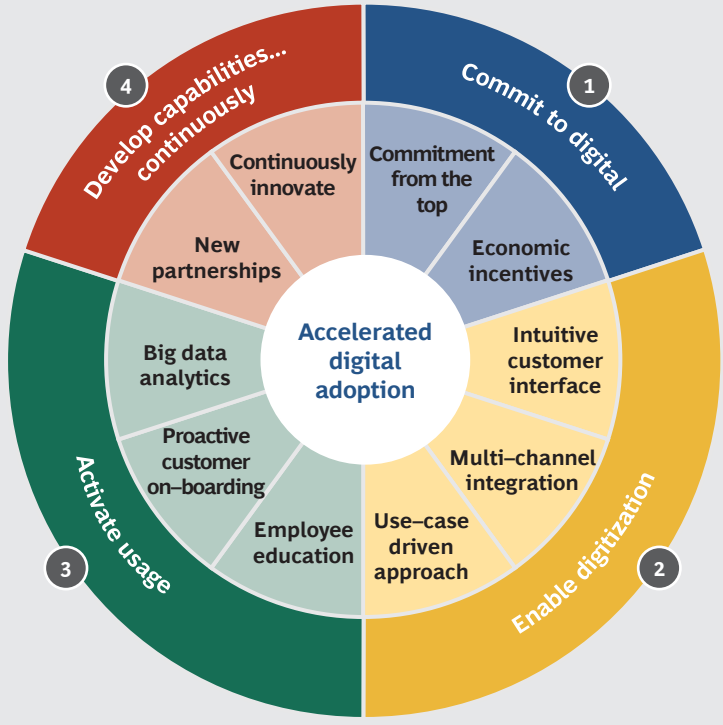
Commitment from the top

The top management needs to commit to digital for adoption and spend rates to really go up. And for that to happen, three issues need to be tackled.

- Top management needs to fully understand what is digital and what it can do
- Digital needs to be among the top three to five items on the senior leadership's radar
- Top management needs to have a medium– to longer–term perspective

As the saying goes, charity begins at home. Top management needs to be "reverse–mentored" for them to be able to fully grasp the potential of digital. Banks should leverage their young and new employees to hold "reverse–mentoring" sessions for the top man-

EXHIBIT 6.16 | How to Turbo Charge Digital Adoption?



Source: BCG analysis.

agement. In these sessions, the young employees show executives what they are doing on Internet and mobile–what do they do on Facebook, Twitter; how do they buy movie tickets using mobile; how do they search for information, etc. Top management should also plan tours of digitally advanced companies to get a real sense of the digital opportunity. Executives need to ensure that their calendars have time for "Digital", and that they review the progress periodically with their teams. Digital strategy should be periodically reviewed in board meetings. Most often, top management has a much shorter tenure than the time required to fully develop Digital. Therefore, the next–level executive, who can see through the digital transformation of the bank over a longer–term horizon, should to be given charge of leading the initiative.

Economic incentives

Banks should not shy away from providing some economic incentives to customers to use digital channels. This will be a "win–win" scenario for both banks and customers. Digital adoption and subsequent digital spend create significant value for the bank.

ENABLE DIGITIZATION

Intuitive customer interface

In most banks, digital channels are built by IT departments, without the involvement of the business units. While the technology could be spot–on, its usability from customers' point of view might not be. Business departments need to take "ownership" of the user experience in a digital channel. Since business units understand their customers best, they can help create more intuitive customer interfaces. Only if the interface is easy to use and provides the requisite functionality, will the customers start leveraging it fully.

Multi–channel access

Banks need to have one single view of the customer accounts and transaction–both for the employees and for the customers accessing the bank through multiple channels. For example, if a customer is making bill payments to a set of merchants through one channel, the same list of merchants should be available on other channels as well. If a customer changes account information in one channel, it should reflect on all channels. Such functionalities require banks to

develop seamless multi–channel access capabilities. The core back–end processing and rule engine need to be common across channels, with only the front end changing for each channel.

Use case–driven approach

The "inside–out" approach to the development of digital channels results in a plethora of initiatives, with banks delivering a host of technological solutions–a functional website, a mobile platform for transactions or for enquiries, etc. However, banks fail to track the activation and usage of these channels. One common cause is that customers are not aware of what to use these capabilities for. So, just offering a mobile platform is not enough. Banks need to create initial use cases for customers, for example, "pay your telephone bill using mobile", "buy your rail ticket using net banking on our website". This creates a "trial" of the service for customers. Once the customer starts using one service, he/ she gets hooked, and finds it much easier to use other digital functionalities and services.

Activate usage

Big data analytics

Banks have reams of data on their customers' transaction patterns. Seldom is this data mined to serve the customers better. For example, banks could very easily identify customers who have an active digital account, but have not carried out enough digital transactions. Banks could then send targeted messages to these customers to increase their digital usage.

Employee engagement and education

Our survey of more than 40,000 banking employees last year revealed that only about 50 percent of the respondents themselves use digital channels like mobile. Banks need to undertake massive internal training and sensitization programs to get their own staff on–boarded, with regard to digital channels. Only the employees who are using such platforms themselves can truly and confidently influence customers to embrace digital channels. Frontline employees' key performance indicators should have explicit weightage and targets for on–boarding existing and new customers to digital channels.

Proactive customer on–boarding

Banks should not consider a new account opening process complete until they have on–boarded the given customer to at least three digital channels (including ATM). This process will ensure that the customer has information like PIN numbers easily available when the account is opened. Outbound call centers could contact the customer to hand–hold him/ her through the on–boarding process.

Develop capabilities continuously

New partnerships

Unlike branch banking, digital banking will require banks to forge new relationships. For example, they will need to develop mutually beneficial partnerships with telecom operators to fully leverage the potential of mobile banking. Banks could also look at signing up businesses and merchants (directly, or indirectly through intermediaries) to develop a robust bill–pay network for their customers. Another way for banks might be to tie up with numerous nimble non–banking organizations to bring innovative value propositions to customers.

Continuous innovation

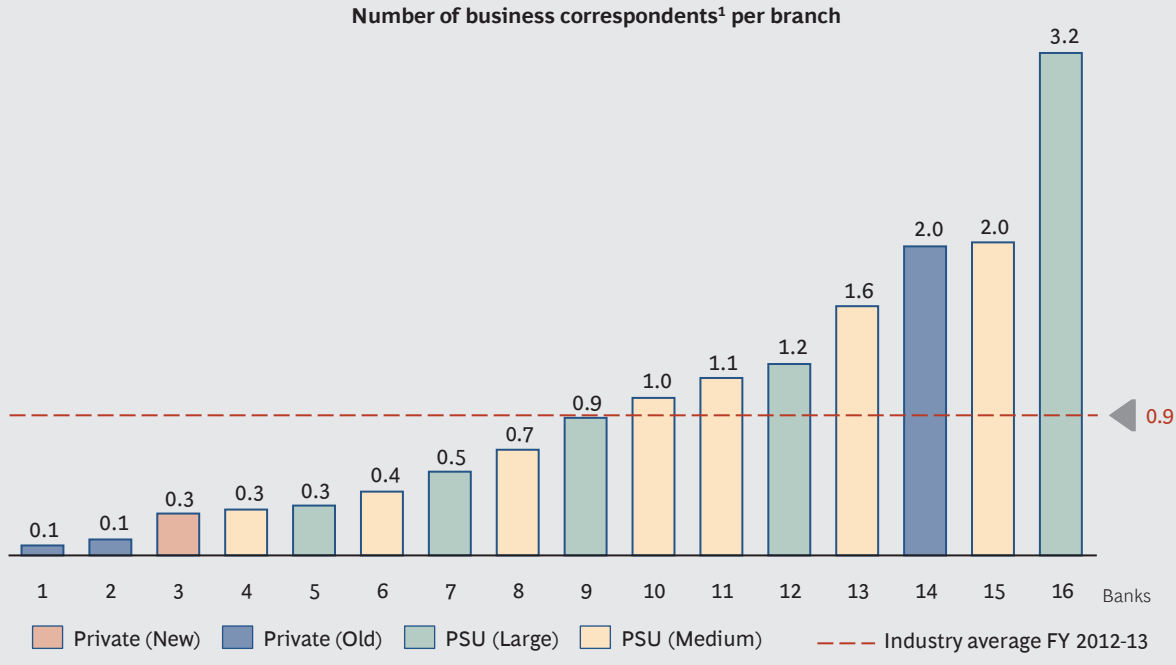
Someone said that traditional banking is and should be boring. Digital banking is anything but boring. Continuous change and innovation are integral to digital banking. Banks that do not embrace continuous change will tend to lose out to competition much faster than they did in the traditional banking era.

New "New" Channel: Realizing Potential of Business Correspondents (BC)

'Business correspondents' is perhaps one of the most under leveraged banking channel in India. FIBAC 2013 survey shows very low penetration of business correspondents across bank types. As shown in Exhibit 6.17 Indian banks have an average of 0.9 BCs per branch with minimum being 0.1 and maximum being 3.2.

However, global experience in countries such as Brazil or Kenya reveals that BCs can be an extremely successful alternate channel for extending banking services, which is economically attractive for both for the bank and the

EXHIBIT 6.17 | Number of BCs Per Branch Range From 0.1 to 3.2 For a Sample of Branches



Source: FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 4 Private (New), 4 Private (Old), 1 PSU (Large) and 13 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability.
[1]BCs (Business correspondents) include both individual and institutional business correspondents.

EXHIBIT 6.18 | Equity Bank Executing BC Model Profitably in Kenya

Context

- In 2010 Central Bank of Kenya (CBK) rolled out guidelines for agency banking
- Financial institutions were allowed to conduct banking transactions through agents
- Access to formal financial institutions low at 40% till 2009
- People had to travel to long distances to get to bank branches involving cost and time

Overview

Equity bank started it's agency banking model using mobile phone and Point of Sale (POS) technology

Initial rollout began in Dec 2010

By Dec 2011, rollout was successful–

- Number of agents increasing from 875 in beginning of the year to 3,339 by the end of year
- Agents account for 20% of all cash transactions of bank

Key features

An Equity Bank agent is a–

- Commercial entity
- Contracted to offer banking services like account opening and savings
- At his / her outlet
- Duly approved by Central Bank of Kenya

Mobile phones used along with POS for transactions–

- Customer to submit account opening form to agent who submits data to centralized backend team through mobile
- Photo and ID proof captured through mobile camera and sent through phone to backend
- Customer receives account opening confirmation and MPIN in 2 working days

Transaction fees and compensation–

- No charges on customers for deposits
- Charges on withdrawals higher than those on ATMs
- Bank pays agents on deposits

BC. For example, as shown in Exhibit 6.18, Equity Bank in Kenya uses franchisees which are commercial entities which are contracted by the bank to offer banking services like account opening and savings at his / her outlet. Equity Bank uses a thorough certification process to certify the BC. In fact the BC of Equity Bank is also expected to invest own capital to become a BC. Once a BC is accredited it is treated as a remote outlet of the bank. The Equity Bank model is a savings led model where Mobile phones along with PoS are used to carry out transactions. The customer pays a transaction fee for withdrawal but not for deposit and the bank also pays the agent on sourcing deposits. On the whole as a result of this model, Equity Bank has grown much faster than its peers in Kenya with improvement in NIMs, reduction in CIR and a strong growth in low cost deposit base.

Globally, different BC models are found to be successful provided the intent, economic rationale and right mandate is provided to the BCs. For example, in Brazil, individuals on a part time basis are used as BCs and help in remote collections as well as distribution of financial products.

In the next few years more customers are going to join the banking fold in India than ever before. Organically growing the physical Branch—ATM network is challenging. Progressive banks (new as well as existing) are expected to take the lead in rapidly expanding their BC network to serve these new customers ahead of other banks and in a profitable manner. As the BC model gains prominence, the laggard banks may lose the first mover advantage. It is crucial for Indian banks and BCs to seriously consider how to build a model that is of the right scale and is economically viable for all stakeholders—as global experience has shown, it can be done and we expect to see it taking shape soon.

HIGH PRODUCTIVITY ORGANIZATIONAL DESIGN

"Nothing is less productive than to make more efficient what should not be done at all."

— Peter Drucker

The paucity of talent is a fairly consistent lament you hear across several banks. In such an environment, nothing can be more harmful for a bank than having its manpower work at low levels of productivity. Where and how a bank gets its people to focus their energies significantly impacts the efficiency and effectiveness of the organization. Therefore, a careful design of the organization structure is a crucial lever in taking enterprise productivity to the next level.

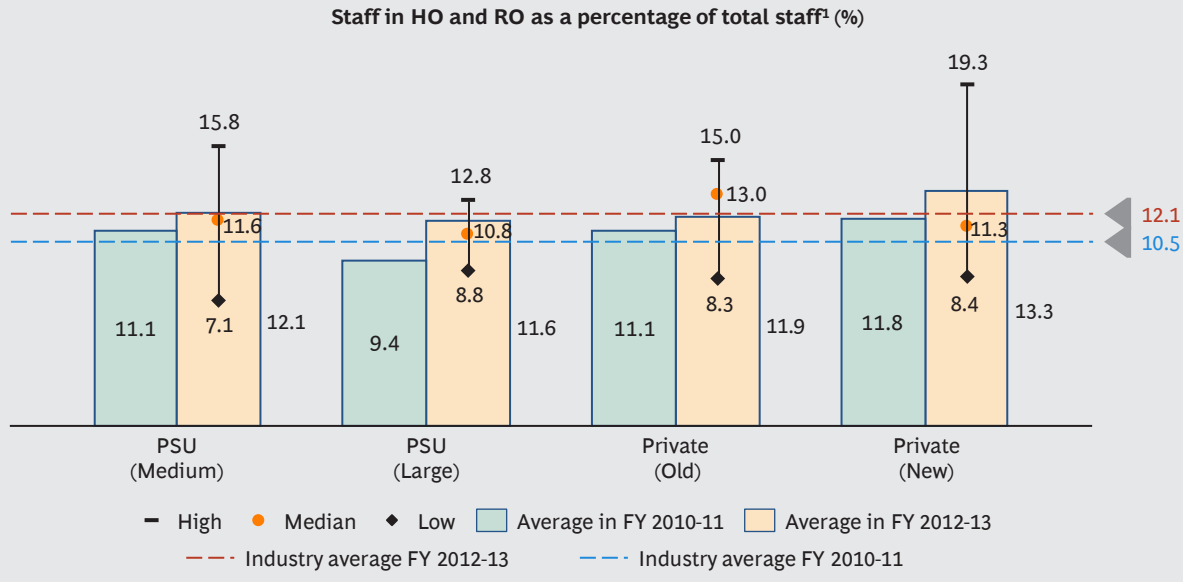
However, as we had noted in the FIBAC 2011 report, changes in organizational structure should be made only after careful thought because organizational changes are not easily reversible—these tend to endure in the perceptions of people. Perceptions take a lot longer than reality to change.

Overheads: Bulge at the Top

Exhibit 7.1 illustrates administrative full–time–equivalent as a percentage of total FTE in Indian banks. Administrative staff which used to account for about 11 percent of total employees in Indian banks has increased marginally and now accounts for about 12 percent from FY 2010–11 to FY 2012–13. The trend is same across the four categories of banks. Administrative staff includes employees working in head office, regional offices, and other such layers above branches. It does not include workers in back–office processing centers and business development teams that are not based at the branches. Some banks in India have as low as seven percent administrative staff. Others have as high as about 19 percent. Clearly there is a wide range in productivity of administrative staff. Scale effect is not visible. Large banks, on an average, do not have lower administrative overheads. It can be argued that there is a case for many banks to enhance productivity significantly by optimizing their central overheads.

Nonetheless, optimization in overheads has to be carried out with great caution. Wrong cuts can be retrograde and debilitating. A common mistake (which was cited in the previous FIBAC report published in 2012) made by some organizations is to pursue a blanket reduction of one tier in the organization hierarchy ("four–tiers to three–tiers"). This is often found to be counterproductive. Different businesses require different number of tiers to provide effective spans of control. Corporate banking needs a two–tier structure; SME banking needs a three–tier structure; retail needs a four–tier structure or more. Organizational tiers have to be aligned to the economics of the different businesses.

EXHIBIT 7.1 | Percentage of HO + RO Staff in Indian Banks has Increased



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 5 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; HO: Head office or corporate center of the bank; RO: Regional offices / zonal offices / divisional offices of the bank.
[1]The total staff includes the staff of captive subsidiary company as well as the outsourced staff. Administrative offices include head office and regional / zonal / circle offices. It does not count staff in processing centres, direct sales and business development teams not sitting in branches.

BCG's proprietary delayering methodology for the creation of lean organization design with optimum administrative overheads is based on the idea of optimum span of control at every level in the organization. On an average, a span of control of seven is considered optimum (unless the role is too simple and can afford more, or is too complex and deserves less). Often, bloated administrative offices have many positions with spans of control as low as two or three. Optimum spans of control at each level ensure that all managers are optimally stretched and there is no micro management.

Exhibit 7.2 captures the methodology used by BCG to bring about a balanced reduction in overhead costs and, at the same time, enhance the quality and speed of decision making in the organization. Three primary drivers of overhead cost reduction also lead to faster and better decisions. Focus on reducing the number of meetings and increasing the number of decisions made per meeting leads to better utilization of top management time. Similarly, focus on elimination of "double work" (once in the BU and then at the corporate center) leads to higher empowerment of employees. Removal of wasteful reviews increases speed of decision.

Functional Excellence: Smarter Decision Support

Exhibit 7.3 shows the finance, accounts and planning manpower of banks in Indian banks as a percentage of total manpower. These functions are critical for providing the right MIS for operating a complex organization. For example, for taking the right resource allocation decisions, the finance function needs to provide the right management accounting MIS to the bank leadership and the board, at the right time. This is a rather sophisticated albeit value adding exercise, if conducted appropriately. To name a few benefits, a smart Management Information System (MIS) can help decide the right transfer pricing, product profitability, branch profitability, customer profitability etc. Similarly a complex and highly sensitive exercise is the performance appraisal process and incentives assessment. Therefore, these functions play a crucial role in enhancing the

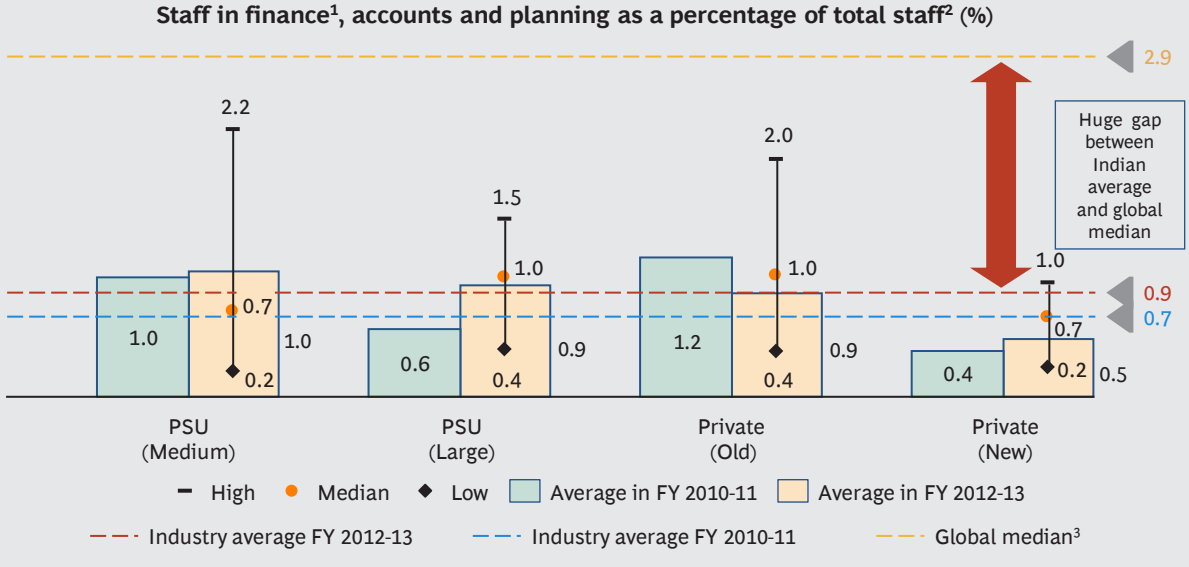
EXHIBIT 7.2 | Overhead Efficiency by Better Decision Making Processes

Drive to a lower cost structure		Enable and accelerate effectiveness and growth
• Fewer meetings, more decisions • More decisions focused on customer, revenue or cost actions	1 Better decision making	• More intense customer focus throughout the organization • Senior leaders closer to the customer
• Removal of double-work due to multiple decision nodes • Fewer ad hoc low-value-added requests	2 Enhanced accountability	• Employees empowered with broader, clearer mandates • Fewer "blockers" to say no • "Shadow organizations" eliminated • Limited micro-managing
• Path-to-outcome requires fewer resources, less time • Reduced waste from order-taking mentality; employees ask "why" and "how"?	3 Faster decision to action	• Decisions communicated and implemented more rapidly • Ideas from line less distorted as they move up the organization

Source: BCG analysis.

EXHIBIT 7.3 | Scientific Decision Support System Capabilities Need to Improve

Finance, accounts and planning staff increased post FIBAC 2011 but still below global standards



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG global enterprise excellence database for banks; BCG analysis.
Note: Data of 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; A year is assumed to have 300 working days.
[1]Finance staff does not include staff involved in assessment of risk.
[2]Total staff includes the staff of captive subsidiary company as well as the outsourced staff.
[3]Global median is for FY 2011–12.

overall efficiency and productivity of the bank. It is heartening to note that there has been an upward bias on the average number of finance, accounts and planning staff as a percentage of total staff. On average, the finance, accounts and planning staff has grown from 0.7 percent in FY 2010–11 to 0.9 percent in FY 2012–13. However, this trend is not true across the bank segments, with private old banks having witnessed a reduction in percentage staff in all these important functions.

Notwithstanding the marginal improvement overall, as an industry, Indian banks at 0.9 percent are significantly below the global median of 2.9 percent.

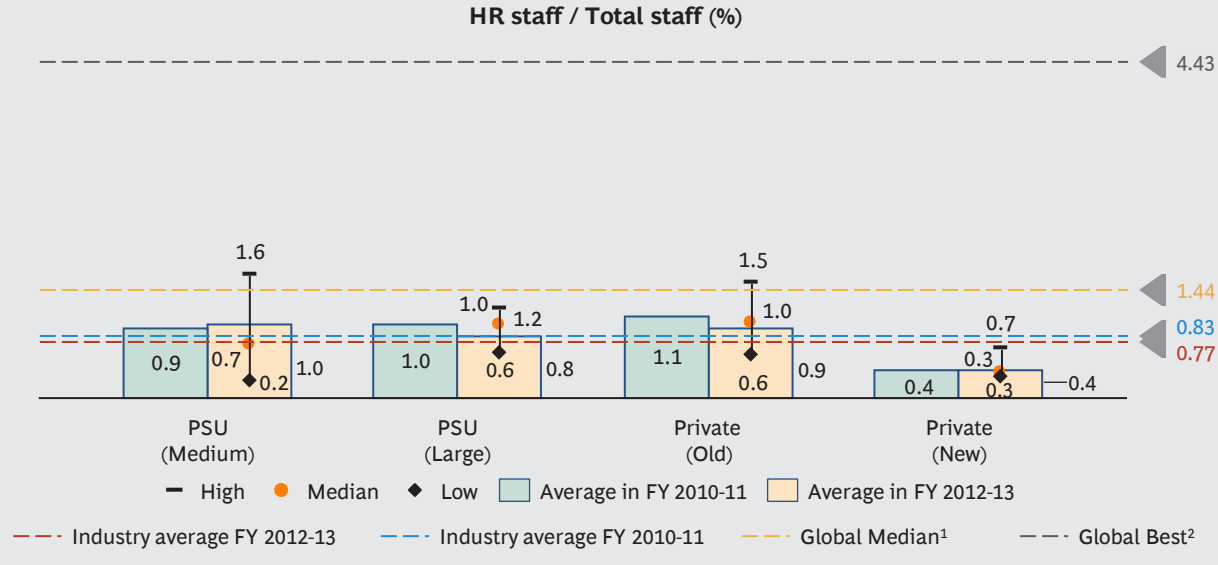
The key issue in these functions is not about cost reduction but expertise and capability enhancement to implement best–in–class practices to improve employee productivity. Considering current levels of underinvestment, many banks will benefit by continued augmenting of their finance, accounts and planning teams with expert manpower.

Investing in Performance Management: Business of People

We had noted in FIBAC 2011 survey that the functional expertise in the HR function in Indian banks needed to be improved significantly. FIBAC 2013 survey reveals that the percentage of HR staff as a proportion of total staff at an industry level has depleted marginally from 0.83 percent in FY 2010–11 to 0.77 percent in FY 2012–13—still well below the global average of 1.44 percent (as shown in Exhibit 7.4). It is interesting to note that except for private new category of banks, the remaining three categories of banks have a few banks which are near the global average.

A strong HR function plays a crucial role in operating an organization that is performance oriented with the right performance management systems. Compromising on the HR function can put the entire performance culture at risk. In the HR function as well, Indian banks would benefit significantly from strengthening the skills in their HR function.

EXHIBIT 7.4 | HR Department Still Understaffed; Around Half of Global Average



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG global enterprise excellence database for banks (2012); BCG analysis.
Note: Data of 2 Private (Old) and 4 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability; HR: Human resources.
[1]Global median for FY 2011–12.
[2]Global best for FY 2011–12.

Performance Culture: the Holy Grail

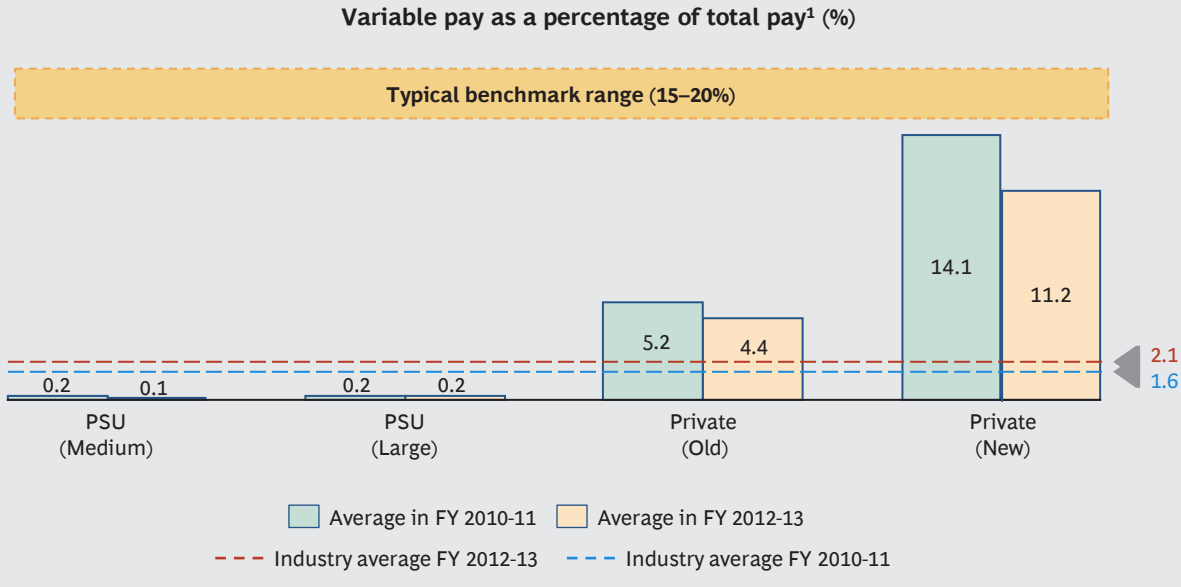
The ultimate objective of all manpower transformation efforts is to generate performance culture. BCG experience suggests that organizations struggle from two structural challenges that undermine the creation of a performance culture (a) proliferation of complexity and (b) weak performance management system.

As organizations grow and become more complex the typical response of dealing with complexity is to create more complexity in the organization structure. The fall out of this complexity is that people get confused about their mandate and often stop thinking of the organization as a whole, instead focusing only on their daily routine leading to lack of genuine team work. In chapter five, we have explained the six smart rules that can help break down the silos and enhance collaboration or team work.

Beyond simplicity in structure, for building a real performance culture it is crucial that role mandates, decision rights and incentives / variable compensation measures are defined considering the right balance between comprehensiveness vs. simplicity and, objectivity vs. subjectivity in criteria. BCG experience has demonstrated that performance incentive is the single most powerful lever to enhance productivity. This is not to say that banks should propagate mercenary behaviour. On the contrary, as explained in Chapter 5, creating a smart pay–off matrix that reinforces the right behaviours is the single most powerful lever for improving productivity.

Typically, variable compensation at 15–20 percent of fixed compensation is found to be effective in providing credible incentive. Exhibit 7.5 illustrates variable compensation as a percentage of total employee cost in Indian banking for various banks. On an average, the percent variable compensation has increased from around 1.6 percent in FY 2010–11 to around 2 percent in FY 2012–13. While the variable pay as a percentage of total pay has come down for all banking

EXHIBIT 7.5 | Variable Pay Has Increased Overall Though it Has Reduced For All Bank Categories



Sources: FIBAC Productivity Survey 2011; FIBAC Productivity Survey 2013; BCG analysis.
Note: Data of 2 Private (Old), 3 PSU (Large) and 14 PSU (Medium) banks excluded from the analysis because of data consistency issues or data unavailability. For PSU banks; Ratio used is variable pay as a percentage of fixed pay.
[1]The total cost attributable to the employees includes fixed salary, bonus, pension and gratuity.

groups, the overall number has increased due to an increase in the weightage of the private banks (in the total pay of all bank employees in India) from 12 percent in FY 2010–11 to 26 percent in FY 2012–13.

Public sector banks are in an urgent need to introduce credible performance–linked compensation. The current spend on variable pay is almost negligible. Existing guidelines from the ministry of finance limit variable compensation to one percent of previous year's PAT, which is roughly one percent of total employee costs. Banks typically find it difficult to distribute even up to this low prescribed limit. PSU banks should expeditiously deploy systems that can facilitate differentiation among employees based on the right pay–off matrix, and award variable compensation to staff. The Government of India should facilitate higher levels of variable compensation to PSU bank employees.

APPENDIX

Introduction to Banking Research

Research was conducted across five key areas of productivity—NPA management, Front–office model, Adoption of new channels, Organization design and Back–office model. Information was captured through 11 forms, which were filled up by each of the participating banks:

- *Form 01:* Head office and Regional office / Zonal office / Divisional office Man–Power Calculations
- *Form 02:* Processing–Centre Man–Power Capacity and Throughput Calculations
- *Form 03:* Branch and Sales Man–Power Calculations
- *Form 04:* Overall Bank Business
- *Form 05:* Fee Income
- *Form 06:* Cost Efficiency
- *Form 07:* Branch Information and Service Maturity
- *Form 08:* Channel Usage and Transaction Profile
- *Form 09:* NPA Management
- *Form 10:* Information Technology Related
- *Form 11:* Qualitative Questions

Methodology of Research

The survey was filled by 38 banks (12 Private Sector banks and 26 Public Sector banks). Responses from these surveys were analyzed collectively to understand the performance of these banks on various productivity metrics.

In order to maintain confidentiality, results and analysis of the survey are presented bank—category wise throughout the report. Banks have been divided into four categories—Private New, Private Old, PSU Large, PSU Medium. Bank category averages along with high, median and low values are presented to show variance amongst peers.

A similar survey was administered in FIBAC 2011. Wherever possible, a comparison between the values in 2011 and in 2013 has been shown to give the readers an idea of the movement in the productivity metrics across bank categories in the last two years.

Participating Banks (as shown in Table 1)

38 banks customers participated in the survey:

- 5 Private New banks
- 7 Private Old banks
- 6 PSU Large banks
- 20 PSU Medium banks

TABLE 1: PARTICIPATING BANKS BY CATEGORY		
Sr. No.	**Bank**	**Category**
1	Axis Bank	**Private New**
2	HDFC Bank	
3	ICICI Bank	
4	Kotak Mahindra Bank	
5	Yes Bank	
6	Catholic Syrian Bank	**Private Old**
7	Federal Bank	
8	ING Vysya Bank	
9	Jammu and Kashmir Bank	
10	Karnataka Bank	
11	Karur Vysya Bank	
12	South Indian Bank	
13	Bank of Baroda	**PSU Large**
14	Bank of India	
15	Canara Bank	
16	Punjab National Bank	
17	State Bank of India	
18	Union Bank of India	
19	Allahabad Bank	**PSU Medium**
20	Andhra Bank	
21	Bank of Maharashtra	
22	Central Bank of India	
23	Corporation Bank	
24	Dena Bank	
25	IDBI Bank	
26	Indian Bank	
27	Indian Overseas Bank	
28	Oriental Bank of Commerce	
29	Punjab and Sind Bank	
30	State Bank of Bikaner and Jaipur	
31	State Bank of Hyderabad	
32	State Bank of Mysore	
33	State Bank of Patiala	
34	State Bank of Travancore	
35	Syndicate Bank	
36	UCO Bank	
37	United Bank of India	
38	Vijaya Bank	

Introduction to Corporate Research

Research was conducted across five areas—Advocacy of Indian banks across customer segments, Importance of being a primary bank and what is takes to be one, Importance of various attributes and satisfaction levels among corporates across these attributes, Pattern in corporate banking relationships in India and Strengths and improvement areas of corporate banks in India. Survey was filled by 503 corporates from 25 sectors.

The survey included topics covering business profile of corporates, their current banking relationships, level of satisfaction with primary banking relationships and their perspective on the banking industry. Responses from this survey were analyzed collectively to understand the dynamics of the corporate banking industry in India.

In order to maintain confidentiality, results and analysis of the survey are presented bank– and corporate–category wise throughout the report. Banks have been divided into 6 categories—SBI and associates, nationalized banks, old private banks, new private banks, foreign banks and others.

Corporates have been divided into 4 categories:

- Based on size: very small, small, medium and large
- Based on type of industry: manufacturing, services and others
- Based on sectors of operation: 25 categories

A brief snapshot of the participating corporates can be seen in Table 2

TABLE 2: PARTICIPATING CORPORATES BY CATEGORY

By size	
Large	142
Very small	129
Small	117
Mid	115
N	**503**

By sector	
Manufacturing	131
Professional services	38
Pharma and Healthcare	34
Power and Energy	34
Real Estate	24
Retail and FMCG	24
Hospitality	23
Telecom and Information Technology	22
Education	21
Logistics	18
Media and Entertainment	18
Financial Sector	16
Infrastructure	11

By sector (cont'd)	
Mining	11
Renewable Energy	11
Trading	11
Metal and Capital Goods	10
Gems and Jewellery	9
Others	9
Oil and Gas	7
Textiles	7
Travel and Tourism	5
Other services	4
Advertising	3
Agriculture and Agri–processing	1
Civil Aviation and Aerospace	1
N	**503**

By industry	
Manufacturing	270
Services	223
Others	10
N	**503**

GLOSSARY

ABBREVIATIONS	
Agri.	Agricultural
ATM	Automated teller machine
BC	Business correspondent
bps	Basis points
CA	Current account
CASA	Current account and savings bank account
CDR	Corporate debt restructuring
CIR	Cost–income ratio
ECS	Electronic clearing system
FX products	Foreign exchange spot, derivatives, and financial risk management products
FTE	Full time employee / equivalent
FX	Foreign exchange
FY	Fiscal year
GNPA	Gross non–performing assets (as per RBI definition)
HO	Head office or corporate center of the bank
HR	Human resources
IBA	Indian Banks' Association
IT	Information technology
LADS	Loan against deposits and shares
MIS	Management information system
MSME	Micro, small and medium enterprises (as per RBI definition)
NEFT	National electronic fund transfer
No.	Number
NPA	Non–performing assets (as per RBI definition)
p.a.	Per annum
PB	Primary bank
p.m.	Per month
POS	Point of sale
RBI	Reserve Bank of India
RO	Regional offices / zonal offices / divisional offices of the bank

ABBREVIATIONS	
ROA	Return on assets
ROI	Return on investment
Rs.	Indian National Rupee
Rs. cr.	Rupees crore
RTGS	Real time gross settlement
SB	Savings bank
SBI	State Bank of India
Telcos	Telecom companies
Tx / Txs	Transaction(s)
vs.	Versus
y–o–y	Year on year

TERMS	DEFINITIONS
Active accounts	Accounts with at least one customer initiated transaction over the past six months
Back–office	Activities like data–entry, filing, daily closing, concurrent checking / audit
Captive subsidiary	Wholly owned subsidiary of the company or of the group of companies
FTE	A full time employee is one who works on an activity full time. For employees with several roles, time spent is split across activities—for example, if a staff spends 1/4th of his time on an activity, 0.25 FTE is attributed to that activity. Probationary officers are considered, but trainees and interns are not considered
FTE from captive subsidiary	Headcount of employees, engaged in activities of the bank, employed by captive subsidiary of the bank / group
GNPA	Gross non–performing assets as a percentage of gross advances outstanding for the corresponding fiscal year
In–house FTE	Employees of the bank who are on the payroll of the bank
Large companies	Companies with revenue more than Rs. 1,000 crore per annum
Mid companies	Companies with revenue between Rs. 250–1,000 crore per annum
Non–branch based outbound sales / marketing force	Employees engaged in sales / marketing and can be present in RO / ZO / HO but not in the branches
Non–metro branch	Includes branches in urban, semi–urban and rural areas
Retail advances	Includes home loan, private car loan, personal / clean / unsecured loan, student / education loan, gold loan, credit card and loan against deposits and shares, unless specified otherwise
Sales	Act of acquiring new customers for any product/service or cross selling / up–selling of new products to an existing customer. This also includes sales pitches and credit origination
Service	Act of resolving queries, grievances of existing customers. This also includes retention related activities
Single window	The system facilitates delivery of all banking services at a single counter, that is, all customer needs are attended to at a single point of delivery
Small companies	Companies with revenue between Rs. 50–250 crore per annum
Financial transactions	Only transactions that include a debit or a credit to a customer account
Very small companies	Companies with revenue less than Rs. 50 crore per annum

FOR FURTHER READING

The Boston Consulting Group publishes other reports and articles on related topics that may be of interest to senior executives. Recent examples include:

Global Asset Management 2013: Capitalizing on the Recovery
A report by The Boston Consulting Group, July 2013

Global Wealth 2013: Maintaining Momentum in a Complex World
A report by The Boston Consulting Group, May 2013

Global Capital Markets 2013: Survival of the Fittest
A report by The Boston Consulting Group, April 2013

Distribution 2020: The Next Big Journey for Retail Banks
A focus by The Boston Consulting Group, March 2013

Committing to Customers in the "New New Normal": Operational Excellence in Retail Banking
A focus by The Boston Consulting Group, February 2013

An Inflection Point in Global Banking: Risk Report 2012–2013
A report by The Boston Consulting Group, December 2012

From 5 Star to 7 Star in Productivity: Excellence in Banking with Customer and Employee Centricity
A report by The Boston Consulting Group in association with The Federation of Indian Chambers of Commerce and Industry (FICCI) and Indian Bank's Association (IBA), August 2012

Customer–Centricity in Retail Banking
A focus by The Boston Consulting Group, March 2012

A New Virtuous Cycle for Banks: Linking Social Media, Big Data, and Signal Advantage
An article by The Boston Consulting Group, February 2012

Operational Excellence in Retail Banking: Raising Performance in Turbulent Times
A focus by The Boston Consulting Group, February 2012

Being Five Star in Productivity: Roadmap for Excellence in Indian Banking
A report by The Boston Consulting Group in association with The Federation of Indian Chambers of Commerce and Industry (FICCI) and Indian Bank's Association (IBA), August 2011

The Mobile Financial Services Development Report
A report by the World Economic Forum, prepared in collaboration with The Boston Consulting Group, May 2011

Financial Inclusion: From Obligation to Opportunity
A report by The Boston Consulting Group, February 2011

Indian Banking 2020: Making the Decade's Promise Come True
A report by The Boston Consulting Group, September 2010

NOTE TO THE READER

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Andhra Bank
PSU (Medium)

Mr. Julius Samson
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Private (New)

Mr. Ajay K. Govil
Bank of Baroda
PSU (Large)

Mr. Rajiv Saxena
Bank of India
PSU (Large)

Mr. G. V. Ramana
Bank of Maharashtra
PSU (Medium)

Mr. Rajib Kumar Sahoo
Canara Bank
PSU (Large)

Mr. Mohan Menon T
Catholic Syrian Bank
Private (Old)

Mr. Ram S. Sangapure
Central Bank of India
PSU (Medium)

Mr. B. V. Baliga
Corporation Bank
PSU (Medium)

Mr. B. M. Nanda
Dena Bank
PSU (Medium)

Mr. Renji Alex
Federal Bank
Private (Old)

Ms. Vanita Das
HDFC Bank
Private (New)

Mr. Laxminarayan Achar
ICICI Bank
Private (New)

Ms. Kiran Balwani
IDBI Bank
PSU (Medium)

Mr. V. Radhakrishnan
Indian Bank
PSU (Medium)

Mr. K. V. Krishnan
Indian Overseas Bank
PSU (Medium)

Ms. Gargi Dash
ING Vysya Bank
Private (Old)

Mr. Layeek Ahmed
Jammu and Kashmir Bank
Private (Old)

Mr. Anantha Padmanabha
Karnataka Bank
Private (Old)

Mr. Dharmarajan
Karur Vysya Bank
Private (Old)

Ms. Shilpa Joshi
Kotak Mahindra Bank
Private (New)

Mr. S. C. Das
Oriental Bank of Commerce
PSU (Medium)

Mr. Deepak Maini
Punjab and Sind Bank
PSU (Medium)

Mr. R. K. Anand
Punjab National Bank
PSU (Large)

Mr. T. L. Babu
South Indian Bank
Private (Old)

Mr. Sushil K. Jain
State Bank of Bikaner and Jaipur
PSU (Medium)

Mr. K. T. Surendran
State Bank of Hyderabad
PSU (Medium)

Mr. Sanjay Kapoor
State Bank of India
PSU (Large)

Mr. Shashikanth Rathod
State Bank of Mysore
PSU (Medium)

Mr. Sunil Kumar Jain
State Bank of Patiala
PSU (Medium)

Mr. K. C. Jayanna
State Bank of Travancore
PSU (Medium)

Mr. H. N. Vishweshwar
Syndicate Bank
PSU (Medium)

Mr. B. Mukhopadhyay
UCO Bank
PSU (Medium)

Mr. Nitesh Ranjan
Union Bank of India
PSU (Large)

Mr. Parameshwar Mishra
United Bank of India
PSU (Medium)

Ms. Manimekhalai A
Vijaya Bank
PSU (Medium)

Mr. Malcolm Athaide
Yes Bank
Private (New)

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