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Indian Banks' Association

Productivity in Indian Banking: 2012

From 5 Star to 7 Star in Productivity

Excellence in Banking with Customer and Employee Centricity

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EXCELLENCE IN BANKING WITH CUSTOMER AND EMPLOYEE CENTRICITY

SAURABH TRIPATHI

BHARAT PODDAR

ASHISH GARG

AVARTAN BOKIL

GAURAV MALHOTRA

September 2012 | The Boston Consulting Group

दो॰ – भाग छोट अभिलाषु बड़ करउँ एक बिस्वास ।
पैहहिं सुख सुनि सुजन सब खल करिहहिं उपहास ।।

(Humble is our lot and ambition high; our only hope is that all good men will be gratified to hear what we say, while the evil–minded may laugh)

— Legendary Poet Tulsidas
in the preamble to The Ramcharitmanas

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WHY 5 STAR TO 7 STAR?

In 2011 we published a report called "Being 5 Star in Productivity". That study investigated five areas where banks should strive for excellence in productivity — front office sales efficiency, back office operational excellence, high performance organization design, new channel excellence, and bad debt management. This study takes the next step and addresses two more powerful levers which can provide a boost to productivity — richer customer understanding leading to customer centric approach and deeper engagement with employees for higher efficiency. Hence 5 Star to 7 Star.

EXECUTIVE SUMMARY

Productivity of Indian banks can be significantly increased with more customer centric and employee centric approach. This is much easier today than before through the use of technology. BCG research spanning 14,000 customers and over 50,000 bank employees has highlighted an action agenda for the industry.

Customer Centricity: More Business per Customer

CASA is the Holy Grail for banks. It is top of mind. Some banks are contemplating costly price war for growth. Instead, deeper engagement with customers can provide more sustainable results.

Engagement of customers has three stages — retention, satisfaction, and advocacy. Transacting through multiple digital channels makes customers less likely to shift and more likely to keep higher balances. Some people believe that higher usage of digital channels will eventually eradicate floats enjoyed by banks due to efficiency. Others believe that customers who transact more are loss making. These wrong notions need correction.

Not surprisingly, satisfied customers keep much higher balances than others. Satisfaction is critically linked with usage and satisfaction with all channels. Newer digital channels are double edged swords. Poor quality there has disproportionate impact on dissatisfaction. Today, adoption of digital channels (other than ATM) is low (30 percent or below) and dissatisfaction with digital channels is very high. Cutting across bank types, the more customers use digital channels, the more dissatisfied they are. Lack of awareness is surprisingly the most common reason for non adoption followed by inconvenience, safety concerns, poor usage experience, and fear of hidden charges. All reasons are addressable by banks. Given the size of benefits, quick pay back and low investment & effort, excellence in digital channels should be prioritized by banks.

Among the digital channels, debit cards and call center are lowest on satisfaction. Debit card usage in India suffers from structural gaps. Merchant discount rates have been as high as that for credit cards. We need to embrace the system adopted by some European countries like The Netherlands where appropriate pricing has led to a massive increase in electronic payments. This is an industry imperative.

One lever that is even more powerful than channel satisfaction for customer satisfaction is their experience with "non–routine transactions". Customers who have poor experience with such transactions are highly dissatisfied irrespective of everything else and vice versa. Bank's branches and call centers need to be standardized but not so much that employees cannot understand customer's infrequent requests.

All highly satisfied customers are not their bank's advocates. The single most powerful lever to make a bank customer its advocate is to delight her in resolving her complaint. That is the moment of truth.

So what happens to branches? Branches of all types of banks continue to be used over 90 percent of the time for transactions. This is a very costly drain on the system. Research has shown that branches are critical for emotional engagement with customers to convert them into advocates. Customers who come to branches often are more likely to be advocates for their bank. We are not arguing that customers should be asked to come to branch for carrying out transactions. Rather, banks need to get customers to transact through digital channels and get them to visit the branch for advisory purposes and sales counseling. Branch organization needs to be strengthened to be able to deliver proper advice. Such interactions will lead to new sales. Further, the advocate customers will act as the bank's honorary sales force.

Overall, Indian banks' score on customer centricity is quite low. Customers also gave poor feedback on loans and advisory. There is a lot of room for improvement. Certain ignored customer segments like businessmen keep higher balances. Some banks can differentiate themselves through a more customer centric approach.

Employee Centricity: More Customers per Employee

BCG research has proven that people practices have a huge impact on financial performance. Engagement levels vary across Indian banks and there is huge scope to share best practices.

Our survey of 57,205 employees across 31 banks shows an encouraging overall picture of engaged employees who have faith in their bank's HR practices, believe in composite goals that include customer service & contribution to society, and look forward to next day at work. More than any other industry, banks need a balanced people strategy to create a composite and responsible culture that fosters harmony between personal goals, financial targets, customer service and contribution to society / economy. The Indian banking industry is by and large on the right side of the balance. Years of conservative regulation have set the right conditions to foster such culture. Biggest challenge is to nurture this composite performance culture in light of massive induction of talent. Our study estimates that Indian banks will need to hire 9–11 lac new people in next 5 years. Banks need to manage productivity as they onboard massive number of new hires and simultaneously inculcate values of responsible banking.

Overall attrition in the industry at 9 percent is reasonably low. It is considerably high in Private Sector. Attrition in Private New banks for employees (excluding frontline staff) is 23 percent while including frontline sales staff, it is 35 percent. Public Sector Banks (PSB) have unprecedented challenges — massive retirements (22 percent of current employees will retire by 2017), generation gap (new hires will have bosses 15–20 years older) and serious shortage in middle management (experienced people will retire, new hires will not be ready soon enough). What works for Private Sector will not necessarily work for Public Sector in HR practices.

We identify seven pertinent and strategic HR imperatives for Indian banks.

1. Technology enabled versatile manpower planning: Less than 30 percent banks are creating 5 year manpower plans and these plans are underestimating people needs. Banks have heaps of transaction data which should be leveraged to scientifically estimate manpower needs by level, by skill and by branch. Public Sector seems to be hiring at about half the required rate.

2. Round the year recruitment engine backed by employer brand: Public Sector needs to beef up recruiting departments, re–engineer recruiting process to reduce time lags, recruit year round and tap new sources of talent pool. Their conversion

rates on offers made are lower than that of their private counterparts by 10–40 percent. Primary recruitment pitch has to shift from job security and compensation to personal growth and employer brand. Banks need to invest in building their brand amongst recruits.

3. Intrusive learning as new training and onboarding paradigm: Making new hires productive fast is a top priority. Employee feedback on training and onboarding is not good. Intrusive training technique leverages insights into human learning behaviour and retention of knowledge. E.g. make it relevant, provide choice, create rewards, test post-training, and teach. This is a paradigm shift. Only 36 percent banks currently give choice, only 40 percent test. Private Sector has over 10 times more trainers per employee than Public Sector by using line staff as trainers. Public Sector can emulate to capture its fast retiring knowledge base. New hires need to be culturally integrated to sustain right culture. Less than 50 percent banks do significant cultural onboarding currently.

4. Talent management: Getting line to do HR: Line managers groom talent — not the HR departments. Mentorship in banks is not where it should be. It needs more focus in both Public and Private Sector. Placing right people in the right job at the right time can enhance employee productivity by up to 30 percent. Indian banks are transferring 30 percent of officers / managers every year. This provides an opportunity to groom talent by using technology to find optimum postings rather than adhoc trial & error method. 20–25 percent top talent should be identified and groomed with attention. This will need massive commitment from top management. Public Sector needs to emphasize professional growth as an attraction for talent retention rather than special trainings or international postings.

5. PMS: Balance the score card and do not forget the feedback: We notice cynicism in larger banks regarding fairness in performance assessment. Objectivity in performance measurement has to go up across the board. While 83 percent employees agree that assessment is timely, only 59 percent remember having detailed feedback discussions. Grade inflation and avoiding feedback conversation are natural human tendencies. Public Sector and Private Sector have different answers to these problems in tune with their cultures.

6. Technology enablement of all aspects of HR: All aspects of HR should be e–enabled — scientific and automated manpower planning, onboarding process tracking, algorithm based transfers and postings, online Performance Management System (PMS) and incentives system, e–learning and training calendar, etc.

7. Smarter work environment: Reduce employee time wastage: Work environment has to be made simpler. Employee morale and productivity gets hit by wasteful work. Indian banks need three approvals on an average for any decision, 3–7 days Turn Around Time (TAT) on decisions, 5–10 hours of meetings every week per employee of which only 36 percent is useful. Improved employee empowerment will lead to faster decisions and more productive and engaged staff.

Technology Maturity: Accomplish More in Less Time

A mature technology model can make the ambitious initiatives in customer and employee engagement reasonably effortless. Indian banks operate at less than half the technology cost of western banks. Some of it is due to lower maturity level of their technology. Banks need to act in three areas:

1. Technology strategy: Have more functionality but with simple architecture: Number of IT applications that run in banks is very low (lowest only 13 compared to average 1,700 globally and 707 highest in India). Few technology projects are delivered in a year (lowest only 2 compared to approximately 500 as global average and 621 highest in India). Beyond core banking platform, technology is under penetrated in many aspects of bank operations. Banks

need to adopt technology in many areas and do it in a manner that their overall architecture stays simple. Banks need IT strategy.

2. Smart sourcing: Develop vendor management capability: Vendor management is inevitable in modern banking. A mature technology model will require managing 4–5 times more number of vendors per bank. Many banks manage only 16 vendors compared to average 400 in banks globally. Concentration risk on few vendors is high. Banks need to build specialist skills in contract management. Many banks are dissatisfied with what they are able to get from vendors.

3. IT governance: Ensure business ownership and adoption: A governance model for IT has to be designed in such a way that businesses take more ownership for design specification and adoption of IT by employees. Research has highlighted major gaps in business — IT relationships. This leads to very low return on IT investment.

Overall, the industry has right objectives from technology. The larger Private Sector banks stand out by far in their lead on IT architecture and vendor management. Others have significant ground to cover.

Imperatives for the Government and the Regulator

Government, the majority share holder of Public Sector banks, should ensure proper focus on employee and customer engagement at the PSB Board level. It needs to enable PSBs to manage new technology purchase processes with sufficient emphasis on quality. In broader public good, the Government needs to invest in market development initiatives on electronic channel adoption. Reserve Bank of India (RBI) needs to evaluate measures to unlock the latent potential in electronic payments through further regulatory interventions, so as to spur development in electronic payments. RBI should encourage partnerships between banks & telecom companies and incentivise banks on technology maturity & electronic channel usage.

CUSTOMER CENTRICITY

Productivity Enhancement with Better Customer Engagement

A bank's productivity can be enhanced with better customer understanding. It's relationship with existing customers can be even more profitable. Acquiring new customers can be much easier. This study examined such possibilities in Indian retail banking.

The hottest topic in retail bank productivity is low cost deposits (or CASA in industry jargon). The new post crisis banking paradigm places an even higher emphasis on stable low cost retail deposits. In the liberalized savings bank interest rate regime in India, a price war has been initiated by some banks to increase their retail deposit base. However, price competition is costly. Customers acquired on price are rarely loyal and thus usually unprofitable. This study has demonstrated scientifically significant evidence of the relationship between profitability and quality of relationship in Indian savings bank market. Deeper the level of engagement of customer with her bank, the more profitable the relationship. The most engaged customers tend to be advocates of their banks. Advocates are highly effective honorary salesmen.

So what determines quality of relationship of a savings customer? How to gauge customer engagement with the bank? What can banks do for fostering this engagement?

Three Levels of Customer Engagement: Status of Indian Banks

A customer's engagement with her savings bank grows in three stages. The first stage is retention. The customer is satisfied enough with the service provided and does not actively consider switching. Offer of better interest rates by competition is not enough to move her. A retained customer may switch to another bank for reasons other than price. For example, if a competing offer which addresses an area of dissatisfaction, is made to her. The second stage of customer engagement is satisfaction. Satisfied customers stay with the bank, do more business with the bank, but are not always the bank's vocal advocates. Advocacy — the third and highest stage of engagement requires deep emotional engagement. Advocates actively refer their bank to friends and family. Each of these levels of customer engagement has been systematically measured and the drivers analyzed in this study.

Exhibit 1 lays out the overall framework for customer engagement along with the metrics that measure each stage and drivers for each stage of engagement. Stage 1 — Retention is measured on the basis of percentage of customers who would never switch their accounts due to higher interest rate from a competitor. Customers who switch leave

EXHIBIT 1 | Three stages in customer engagement

Stages in customer engagement	1 **Retention** Preventing account from becoming dormant	2 **Satisfaction** Meeting customer's expectations	3 **Advocacy** Getting customers to recommend
Measures in the survey	% of customers who will never switch[1]	Net satisfaction score[2]	Net promoter score[3]
Drivers	• Channel penetration • Being primary bank for customer — Number of interactions with bank	• Channel satisfaction • Quality of non–routine transaction satisfaction	• Branch interactions • Complaint resolution satisfaction

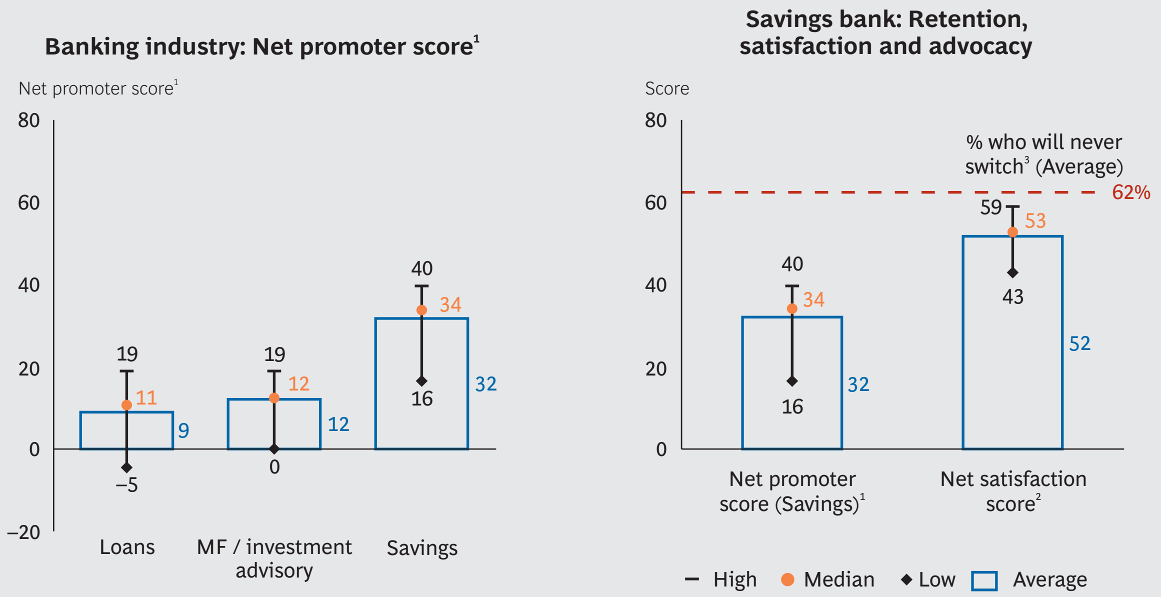
Source: BCG India Customer Survey 2012; BCG analysis.
[1]% of customers who will never switch to another bank despite increase in savings account interest rates.
[2]% of highly satisfied customers (score 5) *minus* % of highly dissatisfied customers (score 1) on a 5 point scale.
[3]% of Promoters (customers who gave scores 9–10) *minus* % of Detractors (customers who gave scores 0–6) on a 11 point scale.

behind a dormant account in the old bank. Stage 2 — Satisfaction is measured through an index called 'Net Satisfaction Score' (NSS). It is the percentage of people who are highly satisfied with the bank overall less the percentage who are highly dissatisfied. Compared to a simpler metric such as percentage of satisfied customers, we have found NSS to be more discriminating between banks as it penalizes dissatisfying a number of customers even as it rewards having satisfied customers. Stage 3 — Advocacy is measured by a metric called Net Promoter Score (NPS). Customers were asked how sure they were that they will refer their friends and family to the bank on a scale 0 to 10. NPS is the difference between percentage of customers who rated 9–10 and customers who rated 0–6. NPS is a standard metric to measure advocacy across industries.

Exhibit 2 demonstrates the overall performance of Indian banking on various stages of customer engagement. Overall, the advocacy level is not encouraging for banks as captured by NPS chart on the left hand side. While advocacy for Savings Bank is reasonably high at 32 percent, that for loans or investment advisory is quite low at 9 percent and 12 percent respectively. It is important to note the significant variation between banks. NPS for savings bank ranges from highest of 40 percent to lowest of 16 percent. Lowest NPS among banks goes to as low as (–)5 percent and 0 percent for loans and advisory respectively. Even the best banks on lending and advisory are not good enough to create advocates in large numbers. Indian banks need to evaluate their business models in retail lending and advisory. That is not the focus of this report.

The right hand side graph of Exhibit 2 delves into details of customer engagement with the Savings Bank. Average NSS at 52 percent is higher than average NPS of 32 percent as would be expected. Overall, 62 percent of customers said that they would never switch their saving bank relationship due to higher interest rate from another bank. The range in satisfaction level across banks as measured by NSS was lower (43 to 59) as compared to the range in advocacy levels as measured by NPS (16 to 40).

Exhibit 2 | 62% of customers will not switch banks for price; overall advocacy low though satisfaction is high



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
[1]% of Promoters (customers who gave scores 9–10) *minus* % of Detractors (customers who gave scores 0–6) on a 11 point scale.
[2]% of highly satisfied customers (score 5) *minus* % of highly dissatisfied customers (score 1) on a 5 point scale.
[3]% of customers who will never switch to another bank despite increase in savings account interest rates.

Getting Basics Right: Trust and Transparency

Savings Bank is a special business dealing with customer's precious money. Customer's trust is paramount. It is a basic need. In the post crisis banking paradigm, it is even more crucial for banks to win the trust of customers through highest levels of transparency and fairness. The study has tried to identify ways to evaluate the trust that banks enjoy based on the customer's perception of transparency their banks live up to. Exhibit 3 captures the evaluation of banks in different categories on their transparency as perceived by their customers. The customers were asked five questions shown in the Exhibit 3. A bank's score is the percentage of that bank's primary customers who said "never" to all the five questions.

On an average 60 percent of customers perceive their bank as absolutely trustworthy. The range between banks is high. The best rating that any bank has got is 71 percent and worst is 55 percent. No category of bank does singularly well. Worst performers in each category have got similar ratings. As one would observe in Exhibit 3, on an average, larger banks (PSB or Private Sector) have got lower rating on transparency. Is it due to diseconomies of scale?

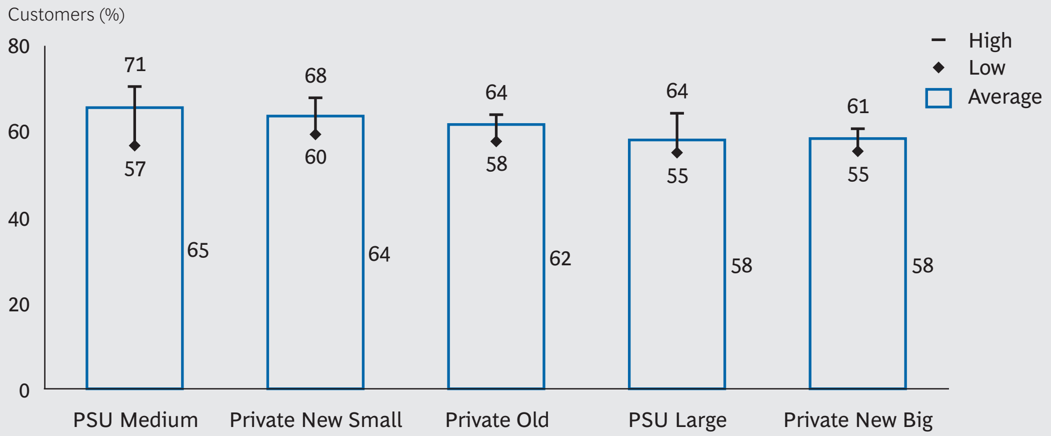
Putting the picture together, Indian banking customers have a high level of satisfaction and inertia with their current banking relationships. However, banks have yet to convert their satisfied customers to committed loyalists and active advocates.

Digital Channels: Driver (Not Killer) of Retention and Balances

What drives retention and balances? Several factors were analyzed and causal relationships explored. The extent of channel usage emerged as a major driver of retention and balances. The larger the variety of channels used by the customer, the lower the propensity to switch and the higher the average balances (upto 10–20 percent higher). Exhibit 4 and 5 illustrate this point. The percentage of customers expressing loyalty to their bank and unwillingness to switch for higher interest rates increases from 62 percent to 67 percent

EXHIBIT 3 | Trust in Indian banks

Percentage of customers that regard their primary bank to be highly trustworthy[1]



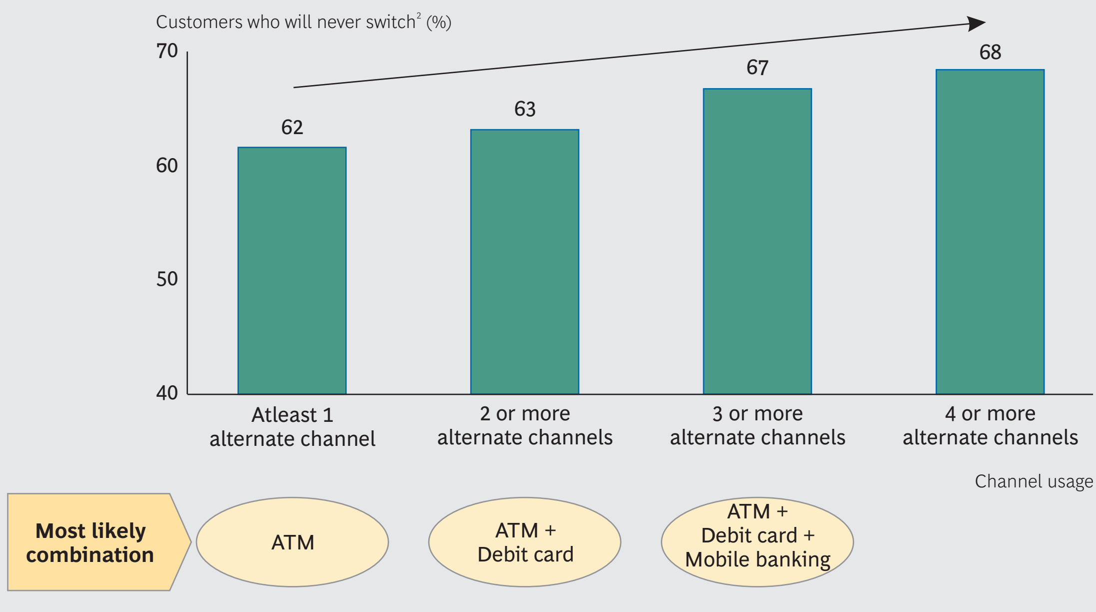
Trust parameters:

- The bank bounces cheque without intimation
- Debits money and / or penal charges without intimation
- Hides charges on products and services
- Pushes unwanted products
- Make promises and campaigns they cannot deliver

Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
[1]% of customers who have said "never" for each of the 5 parameters pertaining to trust.

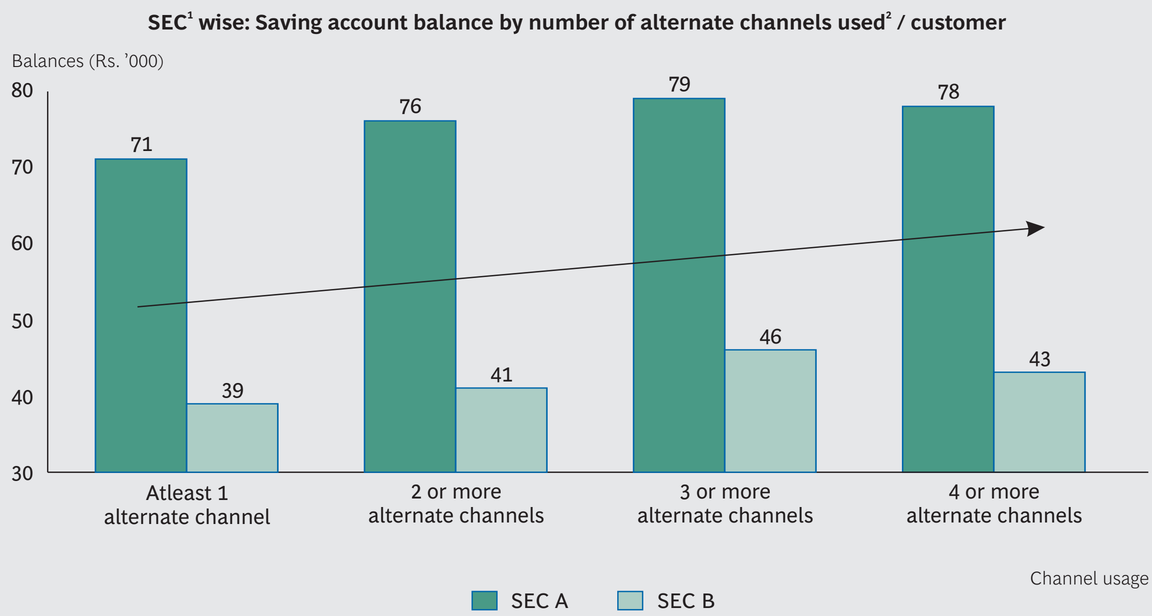
EXHIBIT 4 | Usage of more channels increases retention

Channel usage[1] wise: Percentage of customers who will never switch[2]



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
[1]5 alternate channels (ATM, Debit card, Mobile banking, Call center, Internet) included in analysis.
[2]% of customers who will never switch to another bank despite increase in savings account interest rates.

EXHIBIT 5 | Multi channel customers keep higher balances — up to 10% higher



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
¹SEC – Socio–Economic Classification based on education and occupation of the chief wage earner in the household.
²5 alternate channels (ATM, Debit card, Mobile banking, Call center, Internet) included in analysis.

as the number of alternate channels used by the customer increases from one to three. Usage of three or more channels appears to be the crucial tipping point. Similarly, the average balance maintained by customers who use three or more alternate channels is 10–20 percent higher than that maintained by customers using only one channel. Exhibit 5 demonstrates this effect for Socio–Economic Category (SEC) A and B customers separately thus normalizing for income effect on balances maintained.

So how are the various banks doing on the extent of multi channel usage by their customers? Exhibit 6 demonstrates the number of channels used on an average (and the best and worst) by the customers of various banks in five bank categories. No bank has attained a score close to tipping point of 3. The best score is 2.3 channels per customer. While there are differences between banks, there is opportunity for massive improvement across the board.

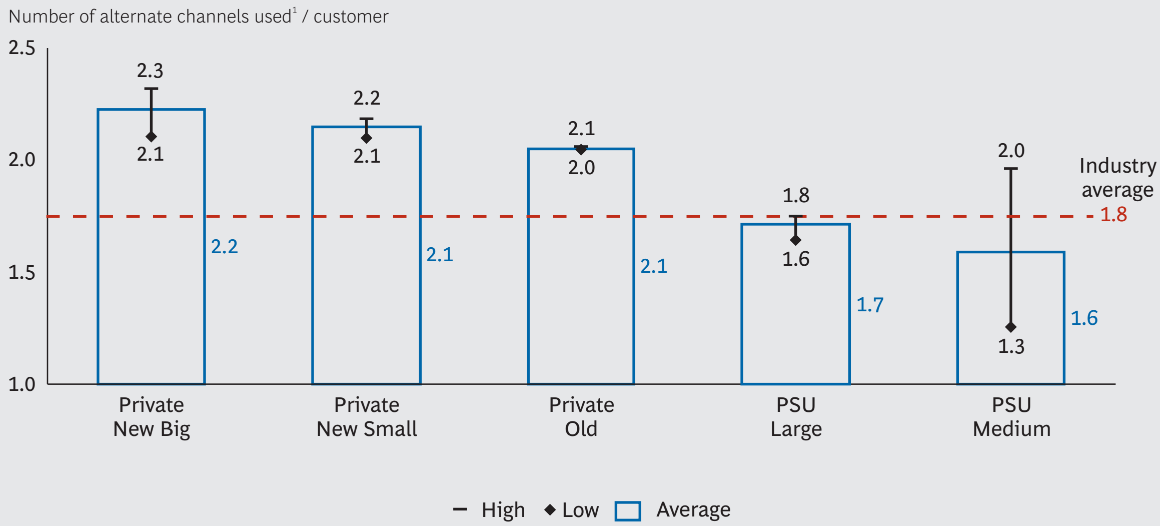
Most banks have struggled to extend the reach of alternate channels beyond the first wave of ATM and Debit cards that customers adopted. Digital channels like mobile banking and internet banking have a long way to go. Some customers use a lot of alternate channels. However, the average Indian banking customer (with average alternate channel usage of 1.8) has not tread beyond ATM too much.

Transactions: More the Merrier

At this stage it is worthwhile to reflect on customer behavior. While banks would like customers to keep balances in savings account and not move them for extended periods of time, the fact is that customers use savings account for transactions. Thus logically, higher transaction needs should drive higher balances. This seemingly counterintuitive, but logical conclusion holds up to the scrutiny of the data collected. Exhibit 7 shows that across Socio–Economic categories, the more interactions customers have with the bank, the more balances they are likely to keep. We found that a tipping point exists at about four interactions per month. Customers who had a behavioral pattern of interacting with their bank more than four times in a month on

EXHIBIT 6 | Extent of multi channel usage in India remains low across categories of banks

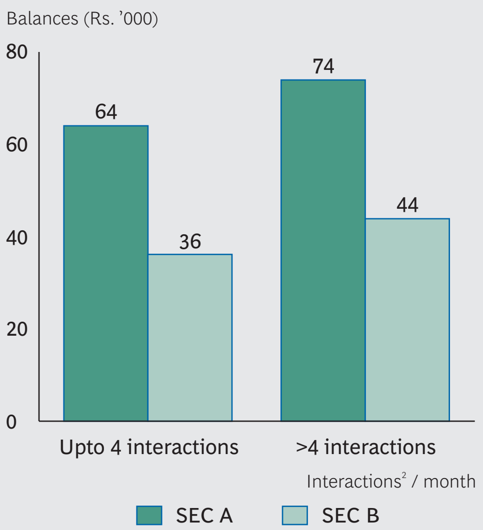
Number of alternate channels used[1] / customer



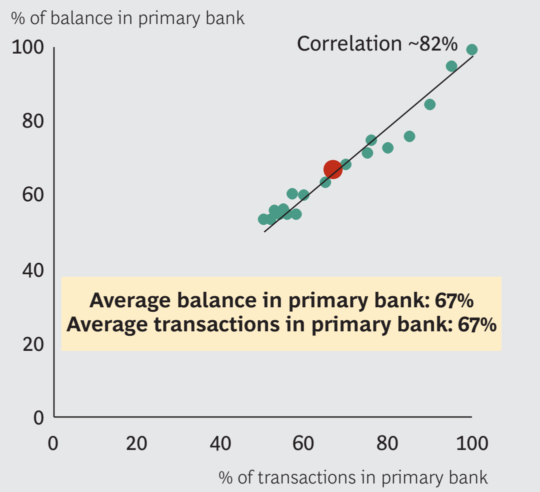
Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
Note: Data labels have been rounded off to one decimal point.
[1]5 alternate channels (ATM, Debit card, Mobile banking, Call center, Internet) included in analysis.

EXHIBIT 7 | Balances increase with increase in number of interactions

SEC[1] wise: Savings account balance by interactions[2] / month (per customer)



Linear relation between % of transactions in primary bank and % of balance in primary bank[3,4]



~88% customers keep maximum AUM (fixed deposit + savings balance) with primary bank[3]

Source: BCG India Customer Survey 2012; Sample size: ~13,900 & ~1,700 respondents with a secondary account; BCG analysis.
[1]SEC – Socio–Economic classification based on education and occupation of the chief wage earner in the household.
[2]Interaction is defined as the number of times any of the 6 channels (Branch, ATM, Debit card, Mobile banking, Call center, Internet) is used.
[3]Analysis only includes customers with 2 or more accounts.
[4]Distinct points of % of transactions in primary bank are plotted against average % of balance in those accounts (balances include only savings account balances).

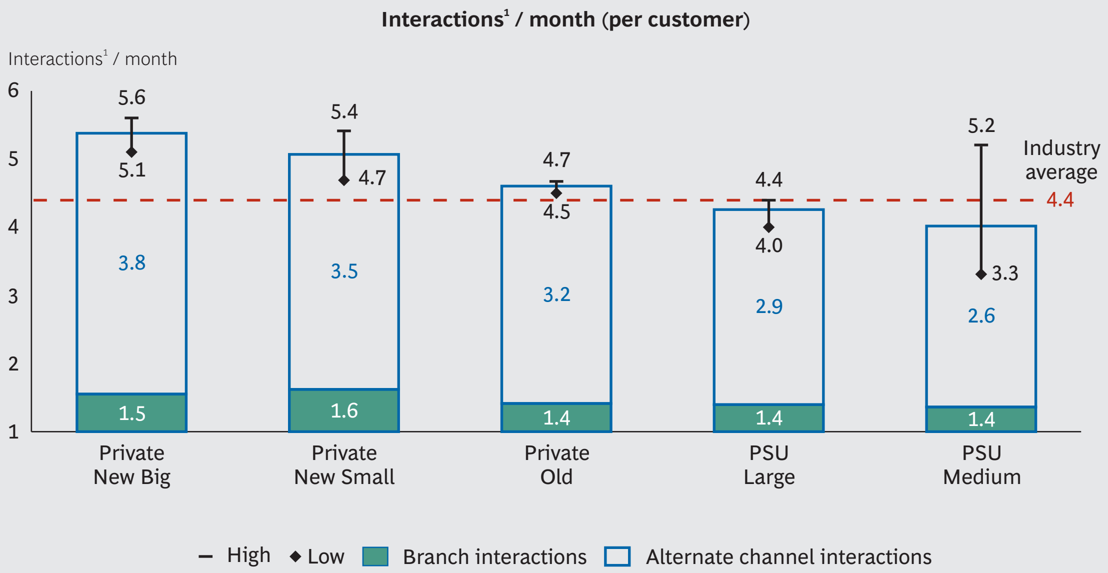
average had a 15 percent higher average balance in their savings account compared to other customers in their Socio–Economic category. This insight is true across Socio–Economic categories.

Being the primary bank of a customer is thus a very valuable goal. About 12 percent of customers interviewed for this study maintained two accounts — primary and secondary. The percentage of balance maintained with primary account is directly linked to percentage of transactions conducted through the primary bank as shown in Exhibit 7. This impact is not limited to savings account only. The study has revealed that about 90 percent of customers keep a disproportionate share of their overall balance (Savings Bank, Fixed Deposits, etc.) in their primary bank. Clearly it makes strategic sense for banks to ensure that all their customers find the bank to be most convenient primary bank for transactions.

Bankers have in the past been wary of customers that transact a lot on their accounts. Rightly so, as each transaction has a cost and the benefits of a higher float can soon be outweighed by the costs, and the account can turn unprofitable for the bank. However, with the advent of digital channels, this compromise can be broken. We found that while the base load of transactions is borne by branches, the incremental transactions are all taken up by alternate channels. Exhibit 8 shows that the number of interactions per month for all categories of banks is taken up by alternate channels beyond the base load of about 1.4 to 1.6 interactions. Interestingly, for Private Sector banks, the overall number of interactions with the bank is higher than other banks, both for branches and for alternate channels. Contrary to popular belief, a customer of New Private Sector bank, on an average, visits branch marginally more (not less) than that of a PSB. The New Private Sector bank customer uses alternate channel on an average 30–40 percent more than a PSB customer.

Creating avenues for customers to transact conveniently is a great logical way for banks to improve their overall balances.

Exhibit 8 | Private Sector bank customers interact more with their banks — through alternate channels and even through branches



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
Note: Data labels have been rounded off to one decimal point.
¹Interaction is defined as the number of times any of the 6 channels (Branch, ATM, Debit card, Mobile banking, Call center, Internet) is used.

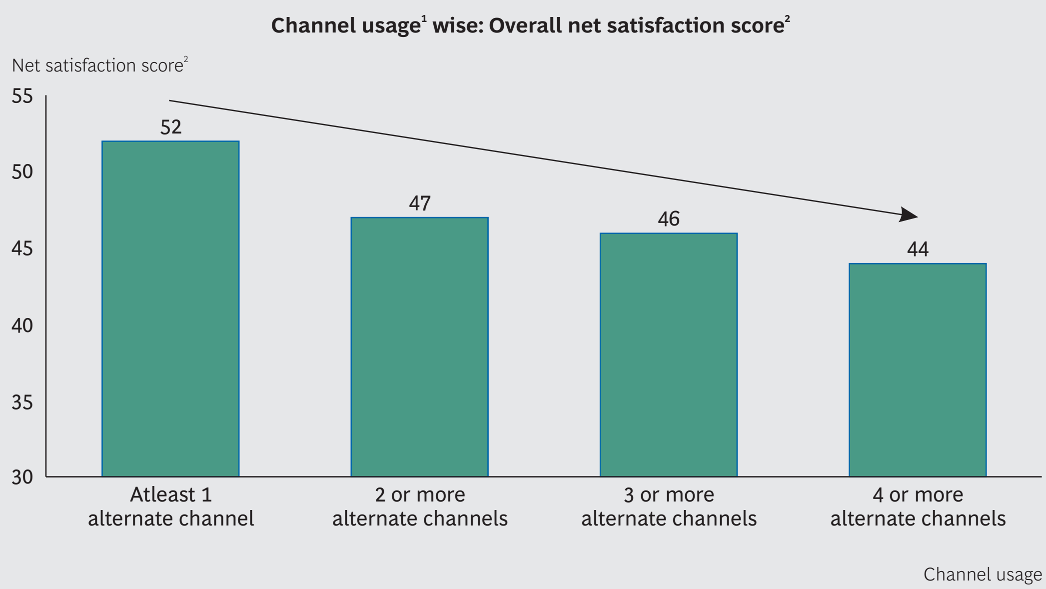
Channel Usage and Satisfaction: Opportunity to Stand Out

We have established that increasing the variety of channel usage is important for banks to increase their levels of loyalty and retention. It is vital to point out that currently the industry does not do a good job of satisfying the multi–channel customer. While the multi–channel customer tends to maintain higher balances, Exhibit 9 shows that she is significantly less satisfied compared to the customer who uses fewer of alternate channels available. Ironically, more the number of alternate channels used, lower is the customer satisfaction. This is reflective of the relative immaturity of the alternate channel offerings in India. Banks must do much more to set up and deliver services through alternate channels effectively and intuitively.

As might be expected, a satisfied customer for a bank is more likely to express a desire to stay with the bank and also to maintain higher balances. This was empirically shown in our analysis of customer responses — as shown in Exhibit 10. Customers who were overall highly satisfied with their experience tended to have more than 10 percent higher balances and about 20 percent higher retention. Creating satisfaction is even more powerful driver of balances and loyalty compared to number of channel usage.

However, how does one go about creating satisfaction? Logic again drives us to the use of channels. Satisfaction with the various channels of interaction with the bank strongly drives the overall satisfaction of customers. As Exhibit 11 illustrates, this relationship between overall satisfaction with the bank and the channel satisfaction is the strongest for mobile banking, call center and internet banking channels. Their correlations are 70 percent plus. Customers who use these channels are most likely multi–channel customers and their experience with these channels strongly drives overall satisfaction with the bank. Conversely, the impact of getting the channel wrong is also the highest. Customers dissatisfied with the interactions with the alternate channels, tended to be more extreme in their dissatisfaction with the overall institution. Thus the new digital banking channels are double edged swords

EXHIBIT 9 | Currently in India, satisfaction reduces with usage of more alternate channels



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
[1]5 alternate channels (ATM, Debit card, Mobile banking, Call center, Internet) included in analysis.
[2]% of highly satisfied customers (score 5) *minus* % of highly dissatisfied customers (score 1) on a 5 point scale.

FIVE MYTHS

There are five beliefs related to customers and channels that are held deeply by some sections of the banking industry. These beliefs influence business choices and productivity of liability franchise of banks. Challenging the beliefs can lead to significant uptick in bank productivity.

Myth #1: Usage of digital channels will destroy float in the bank:
Some executives mistakenly believe that floats in CASA stay due to inefficiencies in system. As system becomes efficient with use of digital channels, bank floats in CASA will come down. This is not true. Usage of digital channels reduces wasteful cash in economy outside banking system and consequently increases the balance with the banks. Customers do not have to withdraw money in advance to spend as cash. They can keep it in account till the time of expenditure.

Myth #2: Customers who transact more are bad customers:
Some executives believe that if a customer transacts more, she is a high cost customer and hence unprofitable. On the contrary, we find that high transaction customers typically keep higher balances. Banks have to navigate transactions to the right channel for profitability. New Private Sector banks have managed to get relatively high balance customers. Contrary to popular perception, New Private Sector bank customers not only transact more on alternate channels but also in branches.

Myth #3: Branch is redundant with digital channels:
Some executives go to the other extreme of writing epitaph of branches with the adoption of digital channels picking up. We find that branches are crucial to create emotional engagement with customers and create advocates among customers. Advocates are necessary to get the crucial new customer referrals. It is important for banks to get customers to come inside the branches — not to transact, but to get advice on their banking and investment matters.

Myth #4: Salary account is the only Holy Grail for savings:
Many banks believe that the only way to increase savings balances is to sign up salary account mandates with corporate clients. While this is indeed a powerful strategy, it is not the only strategy. We find that self employed customers typically keep higher balances compared to salaried customers. India has very small fraction of its workforce in organized labor. Majority are self employed small businessmen!

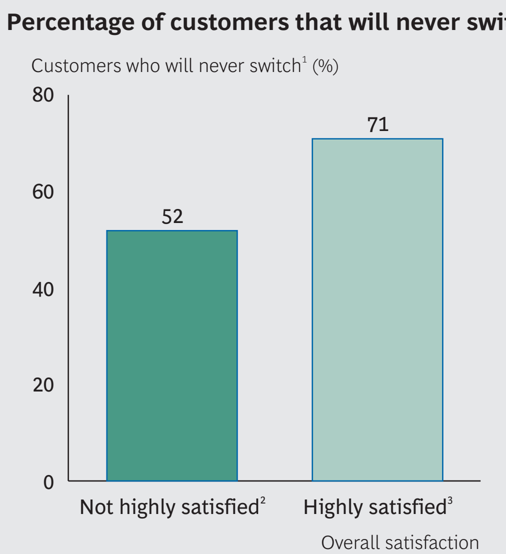
Myth #5: Investment advisory will destroy SB balances:
Some believe that if customers are advised to buy investments and insurance, their float in savings accounts will go down. We find that investment advisory is a genuine need of customers and Indian banking sector is getting very poor advocacy scores on advisory due to half hearted approach to this crucial (and profitable) service.

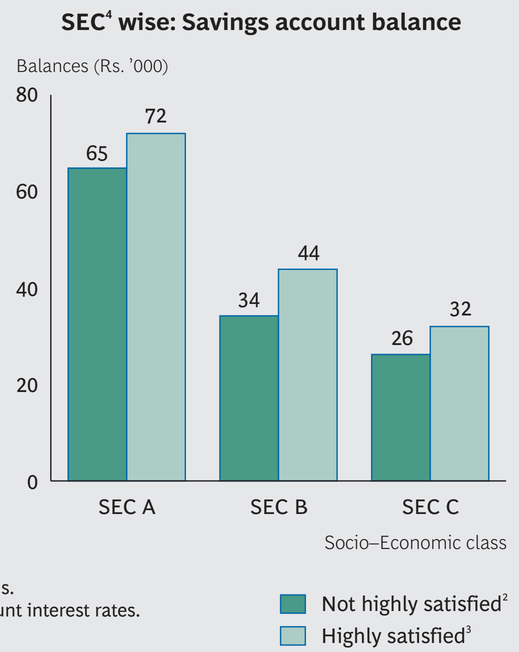
with regards to customer engagement. The users of new channels are more demanding tech savvy customers who have higher expectations.

Exhibit 12 showcases the Net Satisfaction Scores of individual channels by customers using those channels. Branch and ATM get high scores on satisfaction. Digital channels get low scores. Debit cards and call centers have the lowest satisfaction scores by far. Clearly, the more customers use digital channels, the more dissatisfied they are overall. The primary reasons for dissatisfaction with debit cards are perceptions of high annual fees and safety concerns. Call center satisfaction levels are low due to poor experience of customers with call center staff who are not able to promptly resolve the queries to customer's satisfaction. Wait time in queue on call center line is another significant issue. Clearly, there is a major action agenda for industry as regards digital channels. The satisfaction levels in Public Sector and Private Sector are not very different.

Low adoption of digital channels by customers is even more worrisome than the dissatisfaction with digital channels. Exhibit 13 demonstrates the adoption rate of various banking channels for Public Sector banks and Private Sector banks. Branch and ATM are adopted almost universally now with roughly 80 percent or

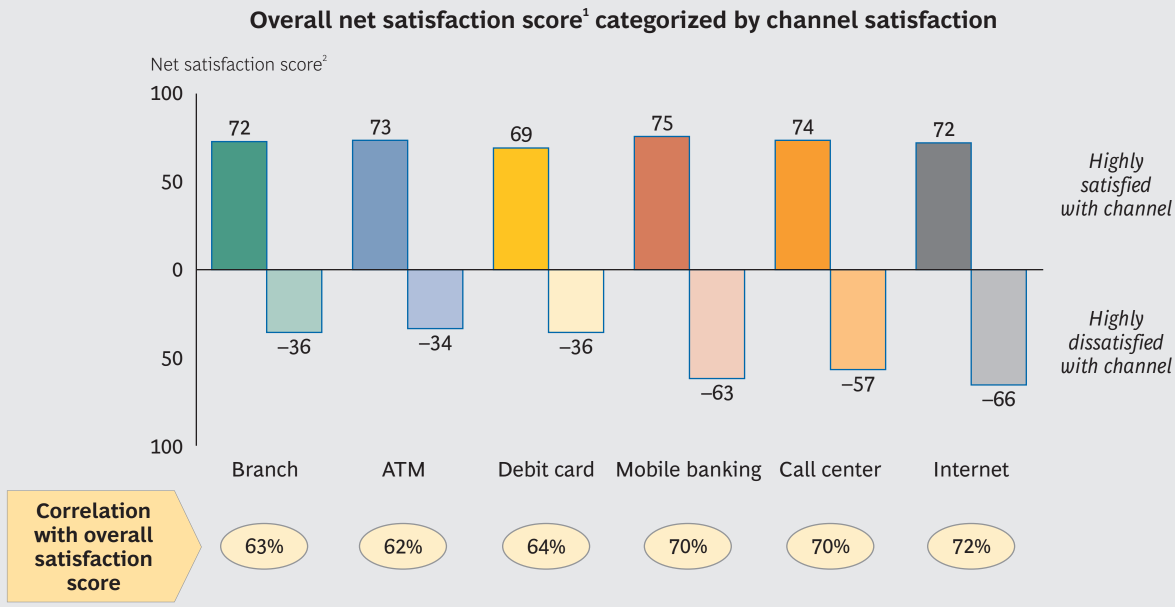
Exhibit 10 | Satisfaction is even more powerful than channel usage in influencing retention and balance growth





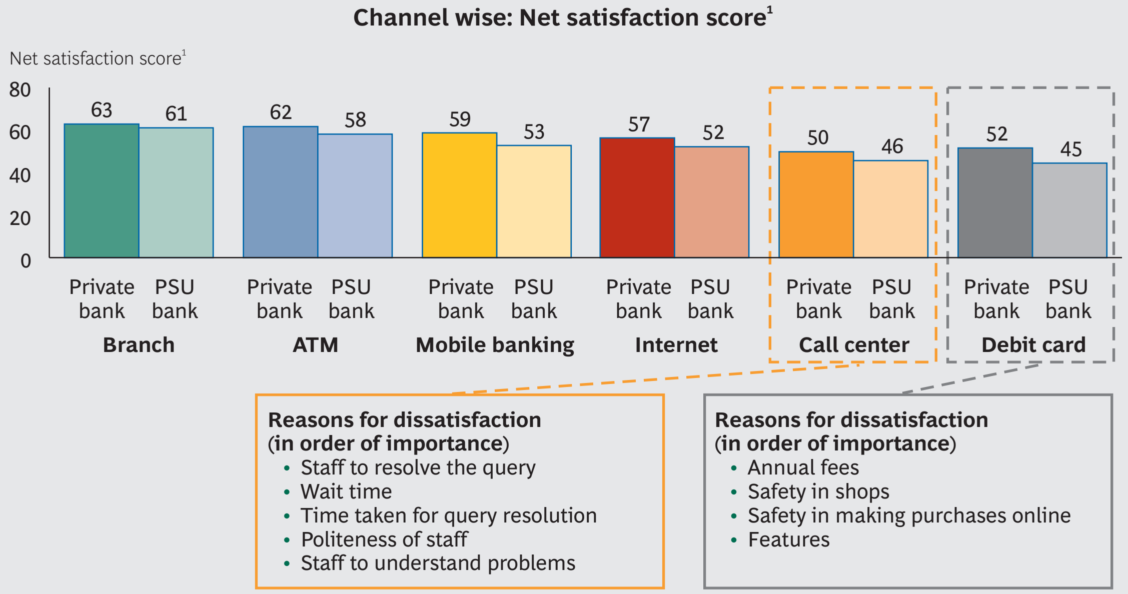
Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
¹% of Customers who will never switch to another bank despite increase in savings account interest rates.
²Customers who have given a rating of 1–4 on a 5 point scale.
³Customers who have given a rating of 5 on a 5 point scale.
⁴SEC – Socio–Economic classification based on education and occupation of the chief wage earner in the household.

Exhibit 11 | Customer satisfaction linked strongly to channel satisfaction — newer channels are double edged sword



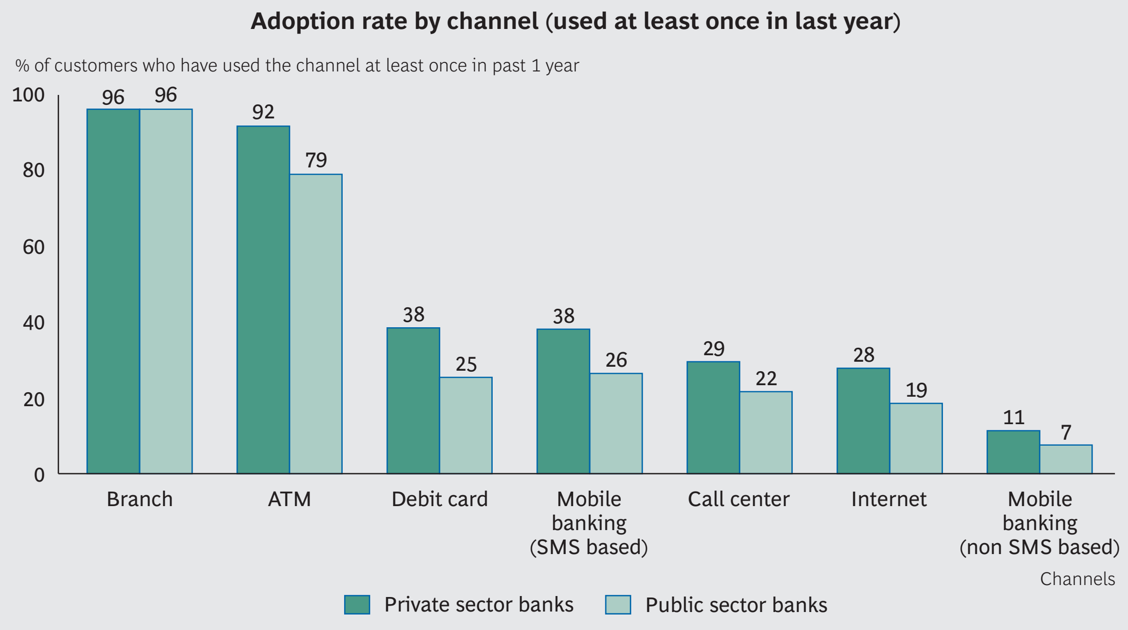
Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
¹% of highly satisfied customers (score 5) *minus* % of highly dissatisfied customers (score 1) on a 5 point scale.

EXHIBIT 12 | Worst customer feedback on call center and debit cards



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
[1]% of highly satisfied Customers (score 5) *minus* % of highly dissatisfied Customers (score 1) on a 5 point scale.

EXHIBIT 13 | Massive room for improvement in channel adoption in India — significant productivity gains to be tapped



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.

more adoption. Adoption falls from 80 percent to 30–35 percent range beyond ATM. As can be seen in the chart, the adoption rate in Private Sector banks is only marginally higher than that of Public Sector banks and follows the same pattern. SMS based mobile banking penetration is already higher than internet banking. This demonstrates the power of mobile phone as the medium of digital banking reach in India.

So why is the adoption of digital channels so low? Exhibit 14 highlights the reasons for non adoption by channel. 18 percent of sample does not use ATM. For internet, call center, mobile banking and debit cards the non using population ranges from 70 percent to 80 percent. This is a massive marketing failure. The return on investment of the banking industry on the massive infrastructure set up for digital payments will be difficult to defend with such adoption rates. The first most important reason provided for non adoption is lack of awareness / education. 25–50 percent of non users attribute it to lack of awareness. Debit cards suffer from security risk perception. Internet is found to be inconvenient by customers — owing perhaps to the lack of internet access to majority of customers. Call centers have given a bad experience to customers sometime in the past and that prevents adoption. None of the reasons for non adoption seem to be insurmountable for the banks.

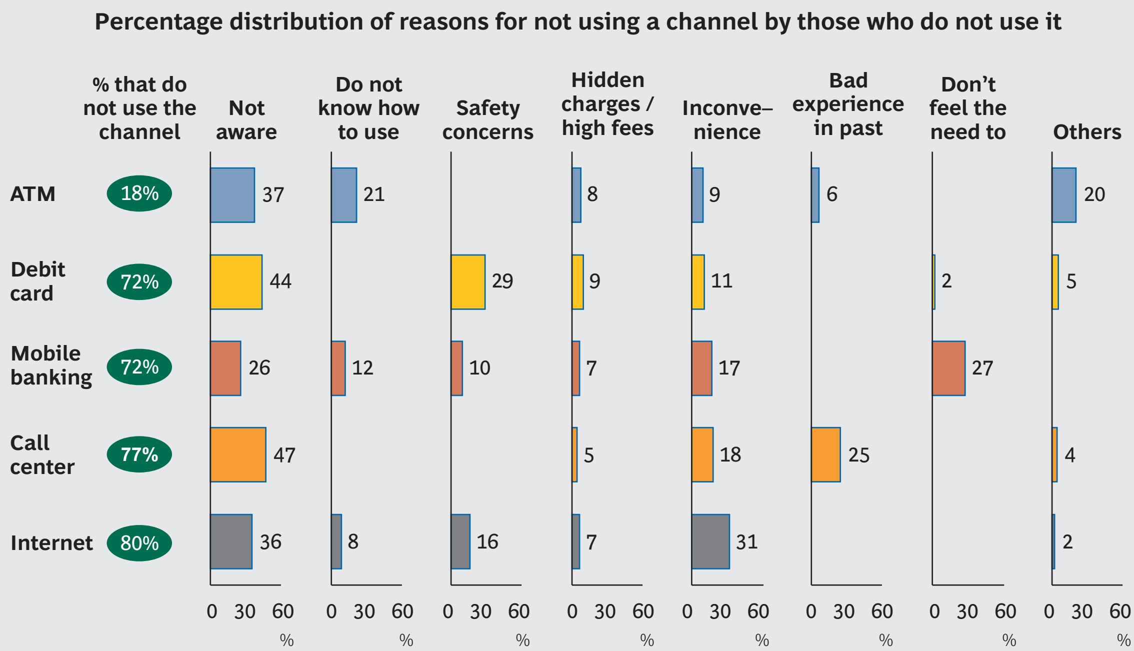
The importance of alternate channels for overall productivity and the loyalty & satisfaction of customers cannot be over stated. The current situation must change for the better, with banks making efforts to improve the customer satisfaction levels with key alternate channels.

So what is the action agenda for banks for improving the alternate channel customer experience and indeed the overall customer experience?

Banks can pursue a five pronged campaign:

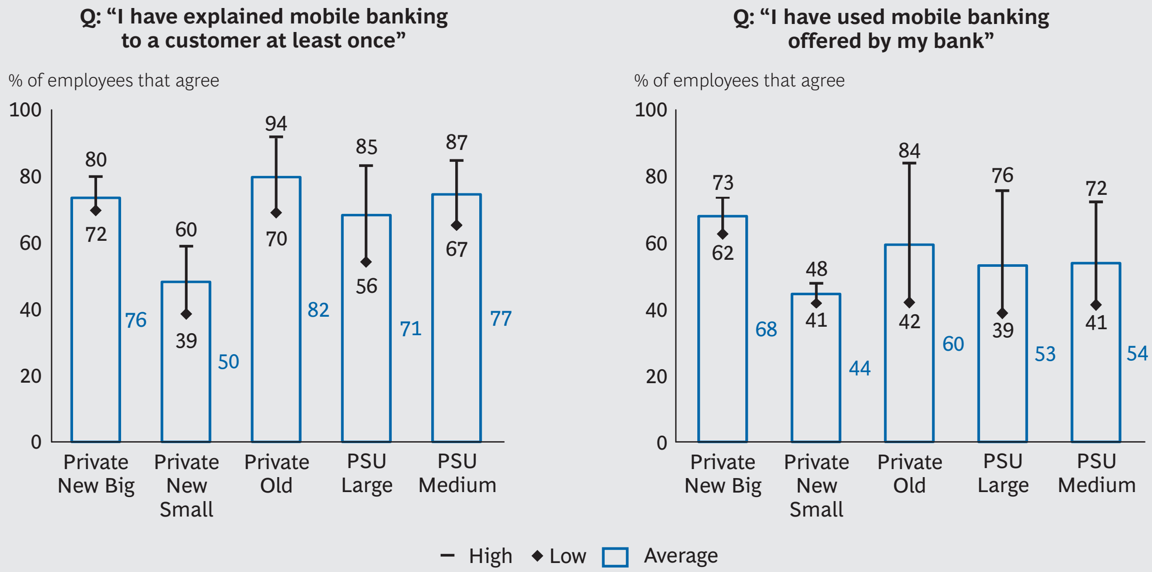
Adoption by employees: As shown in Exhibit 15, a large proportion of bank employees admitted to never having used the mobile banking facilities themselves. A higher

Exhibit 14 | Several hindrances to channel adoption — ignorance stands out as most prominent across channels



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.

Exhibit 15 | Employees have explained mobile banking to customers but have not used it themselves



Source: FIBAC Survey 2012; Sample size: ~57,000 Employees; BCG analysis.

proportion of employees claim that they have taught mobile banking to a customer. Clearly a number of employees are advising usage without using the channel themselves. This is true for most digital channels. Banks need to create a concerted campaign to ensure that all bank employees understand the nuances of digital channels through personal usage.

Creating the right customer onboarding process: Research has demonstrated that customers are most willing to listen to banks within 30–60 days of opening an account. If digital channel usage were to be triggered within this time frame, it can ensure adoption by the customer. Banks need to have an onboarding process wherein an account is not considered fully open unless a minimum number of alternate channels are activated.

Lean processes for alternate channel service delivery: As mentioned earlier, the benefit of using alternate channels to increase interaction levels comes because these are by design lower cost channels. Banks must continually redesign processes for alternate channels to ensure that the low cost advantage of these channels is maintained while attempting to meet customer needs.

Intelligent outsourcing: While outsourcing or partnerships to execute certain digital channels may seem like a straight forward solution to get quick rampup, banks need to be smart about the process of outsourcing. A case can be made for keeping some critical elements of the value chain like customer interface decisions, in-house to the bank, rather than outsourcing those too.

Intuitive design of customer interface: As has been seen in other technologies driven by digital channels — for instance tablet PCs, the design of the customer interface can be the crucial differentiator between the best in class and the also ran. Similarly, in digital or alternate banking channels, we believe that banks must keep a tight control on the customer interface and make sure that it is the most intuitive and user friendly for customers across categories to use.

Apart from the above, banks need to educate customers and remove any misconceptions.

Non–routine Transactions: The Moment of Truth for Satisfaction

The study has revealed that the most powerful driver for overall customer satisfaction is excellence in non–routine requests. These requests happen once in a while and not on regular basis. As can be seen in Exhibit 16, the average Net Satisfaction Score for customers who did not have any non–routine requests in the past one year is 53. NSS for customers dissatisfied with non–routine transaction is (–)78. But the NSS for customers who were satisfied with their non–routine transaction is a whopping 90 percent. This NSS is by far the highest in any segment in the sample. Banks who have overly standardized and documented processes, find it difficult to respond promptly to non–routine requests. Banks with young inexperienced staff also find it difficult to respond promptly to non–routine requests from customers.

16 percent of our sample of customers had experienced one such non–routine transaction in the past year. This is a significant number for banks to systematically consider and address.

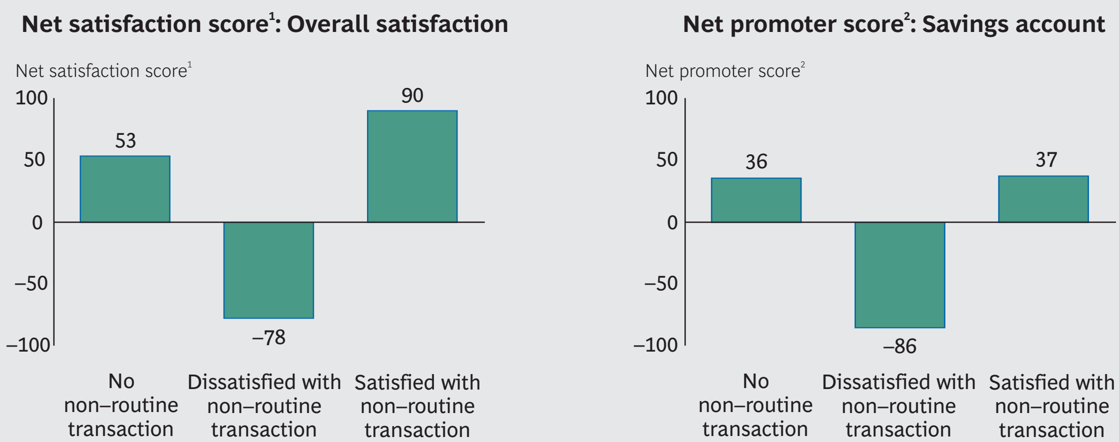
Banks should consider:

- Systematically analyzing and documenting the non–routine transactions commonly and uncommonly used by the customers
- Addressing concerns through codifying the processing rules for such transactions
- Heightening employee awareness of the importance of such transactions for customer satisfaction and training them to be able to address such transactions promptly

Complaint Handling: Moment of Truth for Advocacy

Exhibit 16 also shows that customers with poor satisfaction with non–routine transactions have very poor advocacy (NPS) but customers with good experience with non–routine transactions do not have high advocacy (NPS) despite their high satisfaction. Driver for advocacy is different. Our research with customers shows that handling the complaints of customers well is the key to creating advocates. Exhibit 17 shows that customers who had a positive experience

Exhibit 16 | Excellence in non–routine transactions gives customers satisfaction, but still does not build advocacy

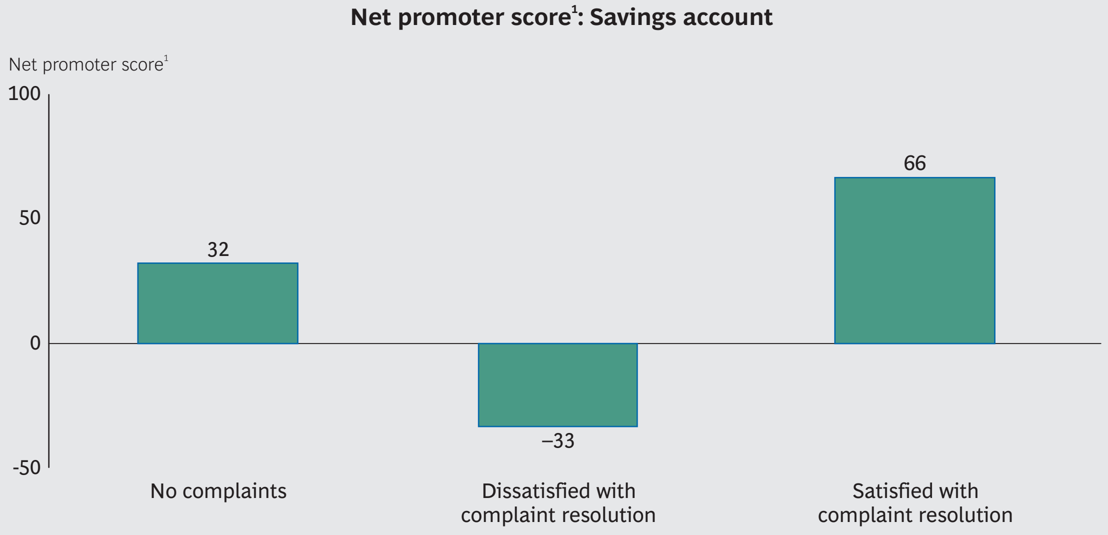


Non routine transactions include:

- Asking for old statements
- TDS certificate correction
- Adding name to joint account
- Adding nominee to account
- Account closure incase of death
- Overdraft on savings account
- Wrong amount dispensed at ATM
- Remittances abroad
- Account transfer to another location
- Open PPF account

Source: BCG India Customer Survey 2012; Sample Size: No non–routine: 9,800 Customers, Dissatisfied with non–routine: 80 Customers, Satisfied with non–routine: 2,200 Customers; BCG analysis.
[1]% of highly satisfied customers (score 5) *minus* % of highly dissatisfied customers (score 1) on a 5 point scale.
[2]% of Promoters (customers who gave scores 9–10) *minus* % of Detractors (customers who gave scores 0–6) on a 11 point scale.

Exhibit 17 | Advocacy built on the back of strong performance in complaint resolution



Source: BCG India Customer Survey 2012; Sample Size: No complaints: 13,200 Customers, Dissatisfied with complaint resolution 22 Customers, Satisfied with complaint resolution: 300 Customers; BCG analysis.
[1]% of Promoters (customers who gave scores 9–10) *minus* % of Detractors (customers who gave scores 0–6) on a 11 point scale.

with their complaint resolution had a significantly higher level of advocacy compared to those that had no complaints as captured by their NPS scores.

2 percent of the respondent sample base of customers had complaints with their primary bank in the past one year. While the relative number of complaints may be small, these have a disproportionate impact on the overall brand image of the bank. In fact, a BCG research had shown that recommendations and reputation of a bank were second only to the network spread of banks as factors influencing choice of bank for customers. This is shown in Exhibit 18.

Banks should consider:

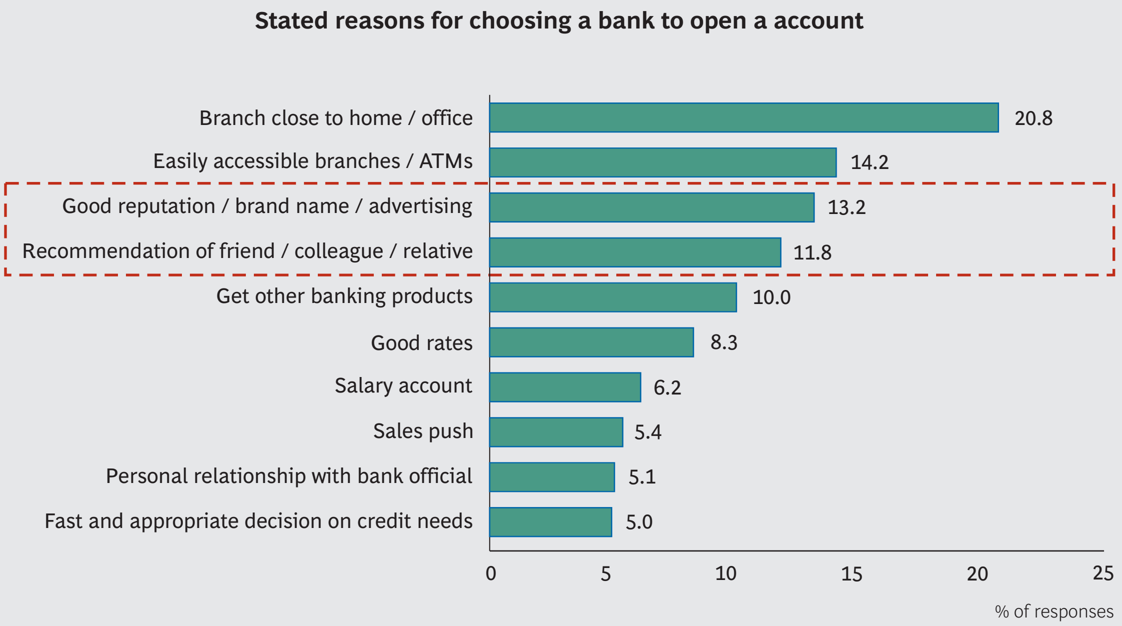
- Simplifying processes and procedures for complaint registering and handling
- Empowering employees at the right levels for resolving complaints — making the appropriate trade–offs
- Create escalation mechanism to ensure timely attention at senior levels

Branch: Instruments to Create Advocates

Research has shown that branches are critical for emotional engagement with customers to convert them into advocates. This study has highlighted that customers who come to branches often are more likely to be advocates for their bank. As shown in Exhibit 19, as the number of visits to branch reduces, the NPS dramatically falls. This further reinforces the point of view that branches are likely to continue to be the mainstay of customer relationships in the future as well. However, the nature of these interactions has to change.

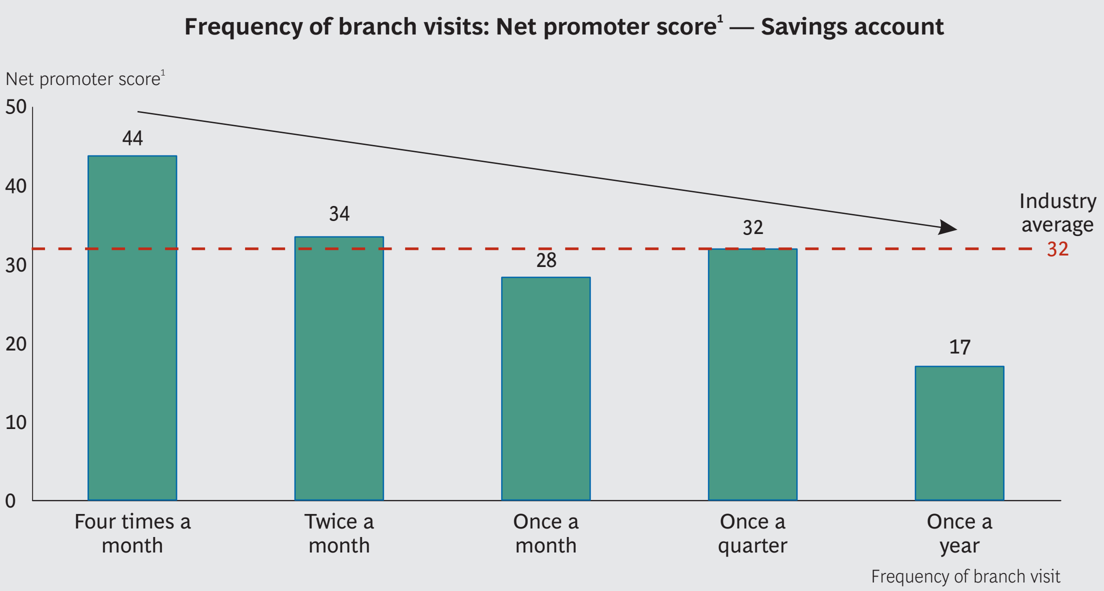
As shown in Exhibit 20, currently customers who visit the branch do so almost exclusively to do transactions. This situation must change. Banks must encourage customers to visit branches, but try to use those visits to establish connects beyond just fulfilling transaction needs. The purpose of the branch visit has to be to seek advice or to close a deal like mortgage or investment product etc. Banks have to develop quality wealth management and advisory business to

EXHIBIT 18 | Advocacy and reputation / brand are key to getting new accounts — comparable to the effect of the physical network



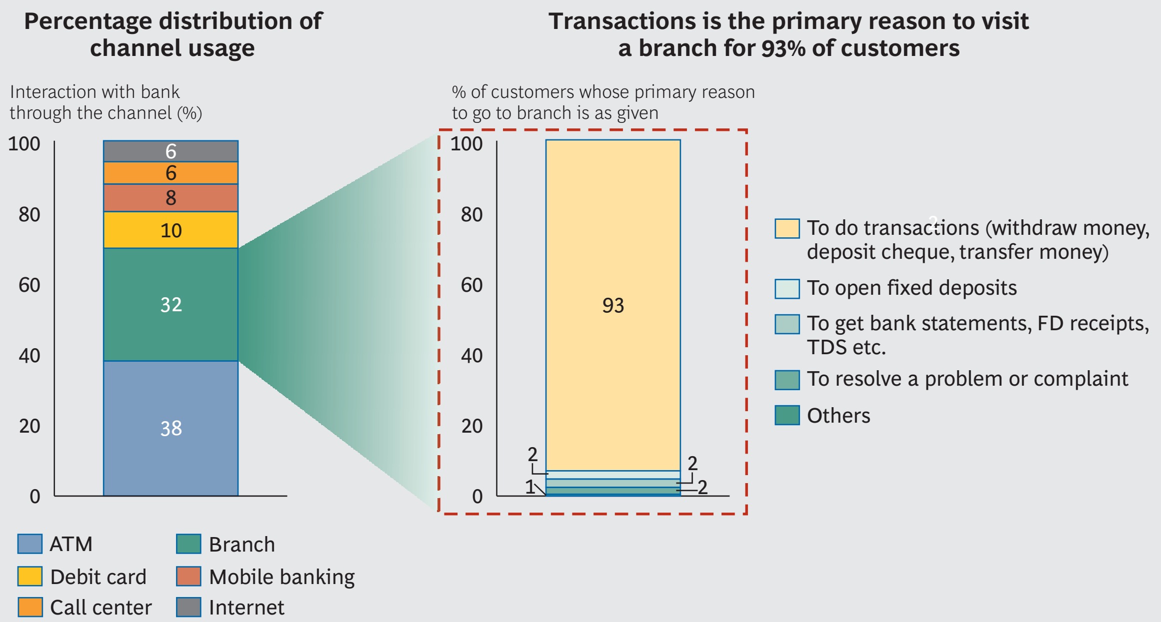
Source: BCG India Customer Survey 2010; Sample Size ~ 4,000; BCG analysis.

EXHIBIT 19 | Low interactions with branch drive advocacy down



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.
[1]% of Promoters (Customers who gave scores 9–10) *minus* % of Detractors (Customers who gave scores 0–6) on a 11 point scale.

EXHIBIT 20 | Over 90% of customers visit a branch for transactions



Source: BCG India Customer Survey 2012; Sample size: ~13,900 customers; BCG analysis.

provide enough reason to customers to come to the branch.

Currently, branches of New Private Sector as well as Public Sector are swamped with transaction requests. Hence, return on investment to set up a branch network is very low. Banks need to migrate transactions to digital channels and yet create opportunities for customers to come into the branch for sales and advisory needs.

Customer Segmentation: What Beyond Salary Accounts?

Our research has shown that there are pockets of customers where advocacy levels are low for industry - irrespective of bank type. Banks can create a differentiation by focussing on creating viable models to serve such segments.

- While salary accounts may be an easy way of getting new customers, our research showed that customers who are self employed or businesspersons in the same SEC category tend to keep higher savings account balances than salaried customers. Banks need to figure out the right proposition for them. Self employed / businessmen in general had higher level of advocacy for their primary banks and they had higher propensity to take additional products like loans from their bank.

- As per the survey results, SEC D / E and customers in Tier 2 / 3 / 4 centers have relatively lower levels of advocacy. Banks need to build the right delivery channels to serve this segment.

- Whether it is Public Sector bank or Private Sector bank, our analysis has shown that advocacy by youth is the lowest among all age groups. This indicates that banks in general have not found a way to focus on youth as a segment, even though the banking industry has been aware of the importance of engaging the young customer for his life cycle value. As this generation will be a lot more connected and reliant on social networks, it will be important for banks to create strong advocates for themselves on social media.

EMPLOYEE CENTRICITY

Productivity Enhancement with Better Employee Engagement

Productivity is traditionally associated with process re–engineering and technology. But research has shown that employee engagement is a major driver of productivity at work place. BCG's research in creating People Advantage found that companies with better people practices consistently outperform others. These 'people companies' outperformed the S&P 500 in eight out of ten years (2001–2011) — and over the course of the decade, they cumulatively beat the S&P 500 by 99 percentage points. This is more valid for banking than for any other business for two reasons.

Firstly, bank's customer engagement levels depend critically on employee engagement. It is a service industry where interaction of customers with employees forms the basis of customer experience and a bank's brand. Banking is further unique among other services. Most customers place their precious savings in their bank's custody on trust. Customers expect their banks to do the "right thing for them". Engaged employees who "believe" in what they are doing, are happy with their work environment, and have faith in their bank to reward the right behaviour, are crucial to be on the right side of the line on all customer interactions. Banks who succeed in this earn customer's trust and more business over time.

Secondly, banking is quintessentially a people business. Banks employ massive number of employees. 60–80 percent of cost is directly or indirectly related to employees. People deployment is crucial. Banks need to place the right person at the right place at the right time.

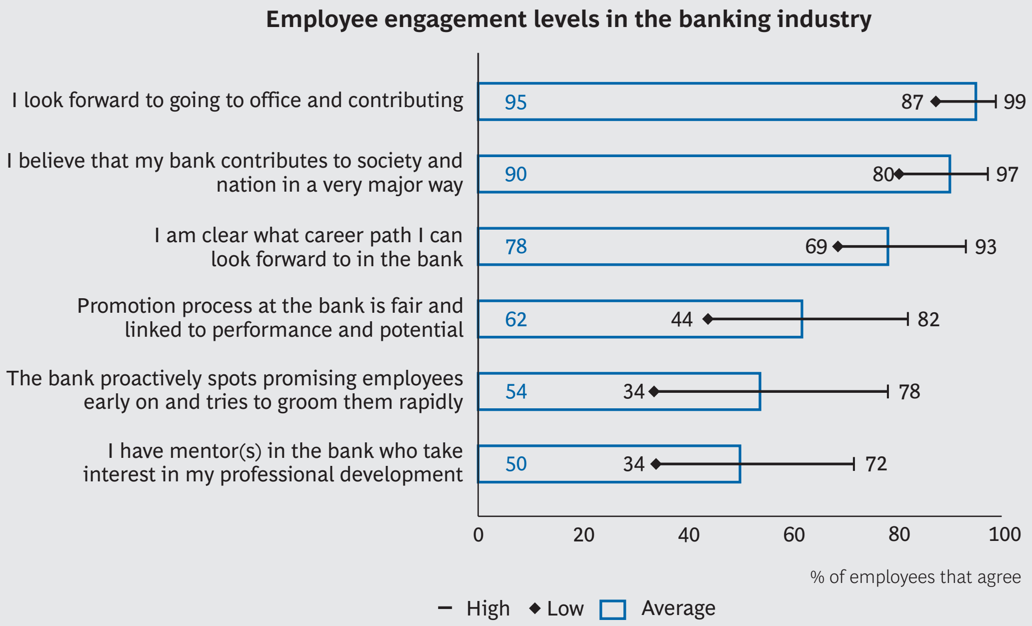
People practices are at the heart of productivity discussion in banks — in softer aspects such as culture and value system and in harder aspects such as performance measurement, talent development and manpower planning.

Employee Engagement in Indian Banks: Composite Culture of Responsible Banking

In this first of its kind extensive study, over 50,000 employees in banking system filled in a survey covering various aspects of people practices in their organizations. The study includes a wide range of topics that cover these practices end to end.

Overall, the engagement level of employees with their banks is reasonable with clear pockets having significant room for improvement. Exhibit 21 captures the employee responses on select set of questions covering broad range of issues. On an average 95 percent of employees agree that they look forward to going to office and contributing and 90 percent of employees believe that

EXHIBIT 21 | Employee engagement in Indian banks



Source: FIBAC Survey 2012; BCG analysis.

their organizations are contributing significantly to society and nation. Even the most cynical responses to these two questions have been over 80 percent. 78 percent of respondents on an average are aware of a long term career path in their organization. Exhibit 22 shows the top three factors rated by employees on an average as determinant of success in their organization. Customer service and relationship management is among the top two in every bank category. Interestingly, meeting financial targets is rated consistently as the No. 1 factor by New Private Sector employees and the No. 3 factor by Public Sector employees. There are some cynical responses like "managing bosses and perceptions" also creeping in Public Sector as well as Private Sector banks. Over 60 percent employees believe that their promotions are fair and over 50 percent feel that their banks take genuine interest in grooming them. Most heartening is the fact that half the employees in the system feel there is a mentor for them in the organization to advice and guide in professional development. Even the worst bank on this dimension has at least 34 percent affirming that they have a mentor to go to.

Overall, the Indian banking industry has maintained an element of composite culture and balanced priorities. Employees value a balance of personal growth, customer service and obligation to society and nation. As the global banking crisis has shown, preponderance of personal growth and success in employee priorities can be disastrous for a bank and banking system as a whole. Maintaining this balance is a crucial priority for people systems in the banking industry even as we look at massive growth.

Maintaining a Composite Culture with Massive Growth: Employee Retention

Banking grows at a multiple of economic growth. Indian banking has been witnessing massive continuous growth over the last decade and is expected to continue to grow at approximately 20 percent over the next decade. Banks need major induction of talent. Exhibit 23 showcases the estimate of hiring need of the industry under two scenarios of productivity improvement. The industry would need to hire 9 to 11 lac employees if productivity measured

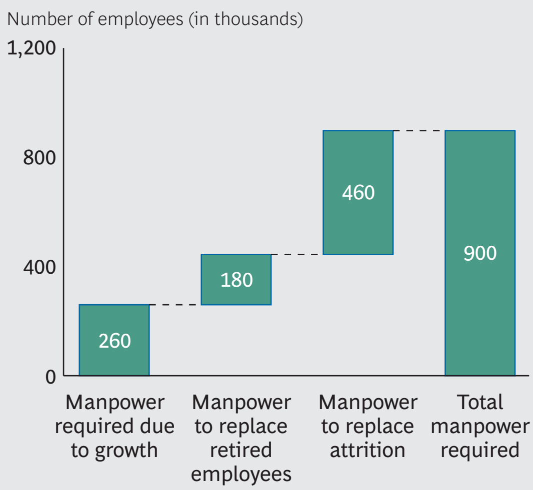
EXHIBIT 22 | Top 3 factors for success — as felt by employees

	Private New Big	Private New Small	Private Old	PSU Large	PSU Medium
Rank 1	Meeting / exceeding financial targets	Meeting / exceeding financial targets	Customer service and relationship management	Managing bosses and perceptions	Customer service and relationship management
Rank 2	Customer service and relationship management	Customer service and relationship management	Meeting / exceeding financial targets	Customer service and relationship management	Managing bosses and perceptions
Rank 3	Managing bosses and perceptions	Process compliance and sticking to rule book	Communication	Meeting / exceeding financial targets	Meeting / exceeding financial targets

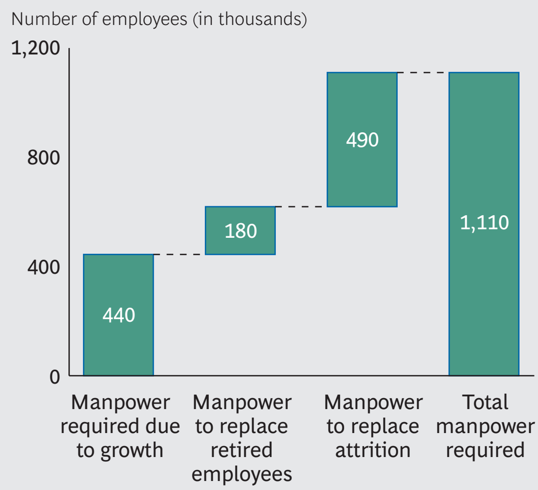
Source: FIBAC Survey 2012; BCG analysis.

EXHIBIT 23 | 9–11 lac people to be inducted in next five years

Gross hiring estimate for next 5 years for the industry at 15% productivity[1] growth



Gross hiring estimate for next 5 years for the industry at 12% productivity[1] growth



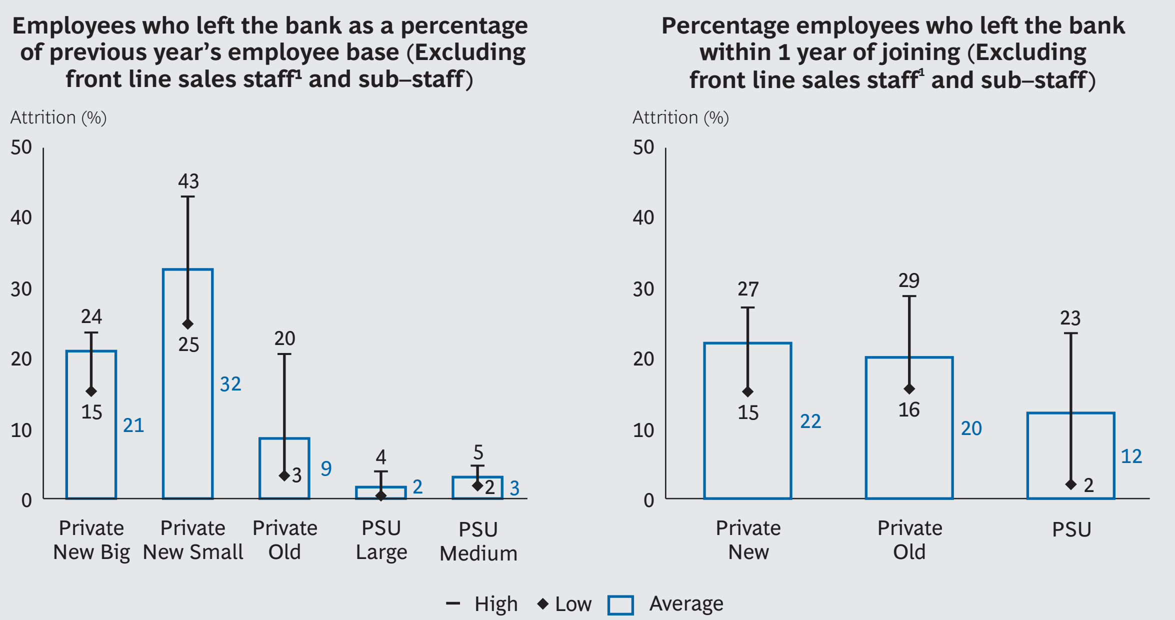
Source: FIBAC Survey 2012; BCG analysis.
[1]Productivity measured as revenue per employee.

as revenue per employee grows at 15 percent or 12 percent per annum respectively for next 5 years. A significant part of this induction is to replace retirements in PSBs. Retirements in PSBs will continue to increase and will peak by 2017. In total 1.8 lac employees will retire and will be replaced. Depending upon productivity growth, industry will need 2.5 – 4.5 lac additional people for growth in business.

At current rates of attrition, industry will need to hire over 4 lac more people. Attrition leads to a direct wastage of time and resources invested in hiring and training the person who has left the organization. It has more debilitating second order consequences. High attrition environments find it difficult to maintain culture and value system. High attrition affects employee morale and hence engagement levels. Exhibit 24 and 25 showcase the levels of attrition in banks in India. It is evident in Exhibit 24 that the New Private Sector banks of the industry have been struggling with attrition much more than Public Sector banks. Their attrition levels are as high as 21 percent for larger ones and 32 percent for smaller banks. If we were to include the frontline Feet on Street (FOS) staff in New Private Sector banks, as demonstrated in Exhibit 25, the attrition numbers of New Private Sector Large and Small banks are 33 percent and 47 percent respectively. There are other industries that sustain such high attrition rates; for example, ITEs, BPO. But for banks, this is a major challenge. The smaller Private Sector banks seem to be facing the brunt of attrition much more. Could it be that larger banks are recruiting laterally from the smaller ones due to better brand?

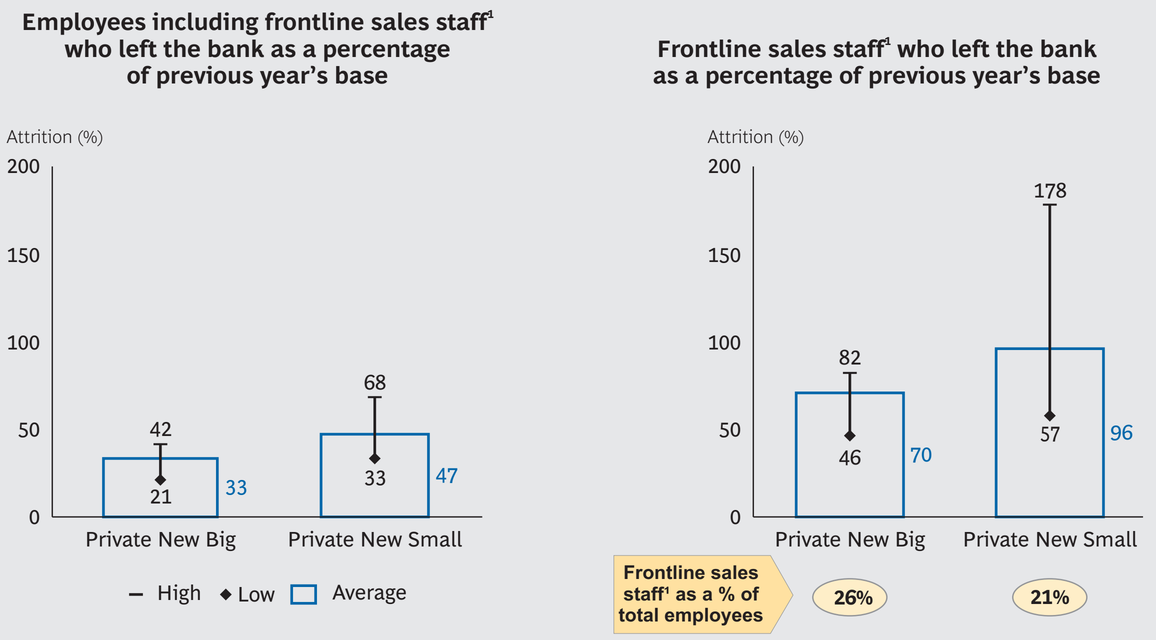
New Private Sector banks use front line sales staff on contract or on different service terms for primarily sales roles. This category of staff has massive turnover rates of almost 74 percent for the industry and as high as 180 percent for some banks. Since such staff is primarily for sales purpose, banks are able to sustain the attrition without a hit on service. However, the employees interacting with customers during the sales process do not have a long term stake in the business. This creates a challenge in ensuring that proper promises are made to customers while soliciting business and that customers are onboarded well at the time of sale.

Exhibit 24 | Attrition in Indian Banks



Source: FIBAC Survey 2012; BCG analysis.
Note: Average for 2012 and 2011.
[1]Front line sales staff includes contract sales employees and in–house feet on street (FOS).

EXHIBIT 25 | Attrition in frontline sales staff



Source: FIBAC Survey 2012; BCG analysis.
Note: Average for 2012 and 2011.
[1]Front line sales staff includes contract sales employees and in–house feet on street (FOS).

Exhibit 24 also shows the attrition in the first year of joining of staff excluding front line FOS. Contrary to popular perception, the Public Sector banks are not losing their fresh hires in large numbers. While there are exceptions, the average loss of fresh talent in first year is 12 percent for PSU banks. These numbers are much better than the comparable figures of 22 percent and 20 percent in New Private Sector and Old Private Sector banks respectively. Clearly there is an element of Public Sector culture and work environment that is working for the fresh hires to stay.

So what are the banks doing to retain staff? Exhibit 26 showcases the responses from banks on what retention mechanisms are deployed by them. The shading of the harvey balls reflects the percentage of banks in each category who claim to use this particular lever as a retention tool. Not surprisingly, the smaller New Private Sector banks, who are suffering from attrition the most, are most alert about using all the levers for retention. The New Private Sector is consistently deploying talent pool program, onboarding of new hires, special trainings and job rotation to keep the new hires engaged. Public Sector is focusing on special training programs, fast track promotions and preferred location posting apart from job rotations. Public Sector's emphasis on talent pool program and onboarding of new recruits as retention tools is low. Public Sector may not be facing attrition today because relative compensation at junior levels is good. As the new hires reach middle management levels, the threat of losing the best people will be very high due to compensation mismatches. PSBs have to get their retention strategy ready now, to face the challenge in 5 years.

Overall, retention of employee is the ultimate acid test. In a competitive market, it is only a matter of time before banks with disengaged work force lose staff to other banks or other industries. Retention needs multi pronged end to end approach. This study has highlighted seven action points in the people agenda for Indian banking industry:

- Technology enabled versatile manpower planning
- Round the year recruitment engine backed by employer brand

EXHIBIT 26 | What do you do to retain talent?

Measures to retain talent	Private New Big	Private New Small	Private Old	PSU Large	PSU Medium
Special training programs	◕	●	◕	◕	●
Talent pool program	●	●	◑	◔	◑
Onboarding of new recruits	●	●	◕	◕	◑
Job rotation	◕	●	◕	◕	◕
Preferred location posting	◑	●	●	◕	◕
Incentives	◑	●	◕	◔	◔
Fast track promotion	◑	◕	◑	●	◕
International postings	◑	○	◔	◑	◔

○ Measure adopted by 0% of banks ● Measure adopted by 100% of banks

- Intrusive learning as new training and onboarding paradigm
- Talent management: Getting line to do HR
- PMS: Balance the score card and do not forget the feedback
- Technology enablement of all aspects of HR
- Smarter work environment: Reduce employee time wastage

Technology Enabled Versatile Manpower Planning

Less than 30 percent of the banks prepare a rigorous 5 year manpower plan. In the context of rapid growth and high attrition this is dangerous. Manpower planning has to sit on the same pedestal as financial planing and should be backed with the same level of analytical rigour and data backup. Further, in the absence of scientific and objective assessment of manpower needs, resource allocation across network ends up being a negotiation between the head office and field. Misallocation of resources is a real business risk. Right number of resources at the right place is a major lever of productivity improvement.

Banks sit on a lot of transaction data that can be used to rigorously predict manpower requirement not just in terms of simple headcount but in a more versatile manner — by level, by skill type and by branch. Banks typically predict staff on the basis of business. Actually, staff strength is driven by transactions. Productivity improvements have to be estimated taking into account business process re–engineering, business model & strategy, and technology deployment of the bank to come to a precise hiring target at entry level and at lateral levels.

Round the Year Recruitment Engine Backed by Employer Brand

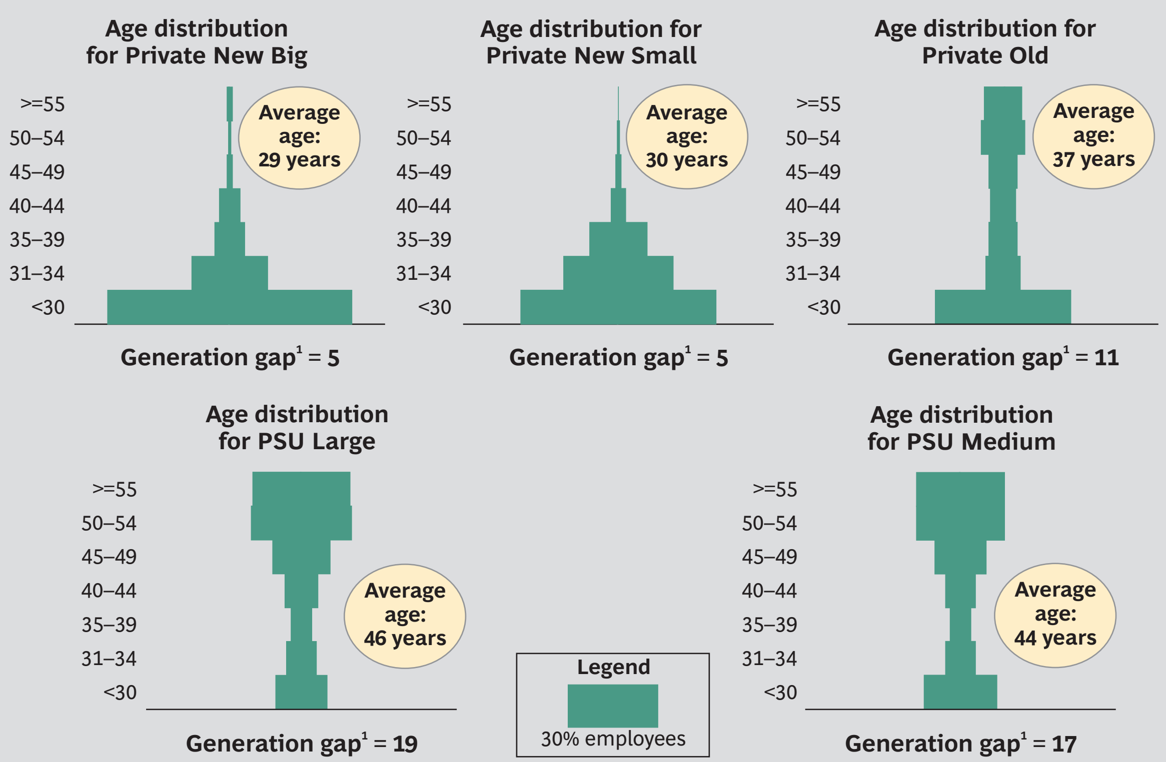
Industry has to hire in large numbers. It currently employs about 10 lac people. It may have to hire as many if attrition stays as it is and productivity does not improve faster. Exhibit 28 demonstrates the extent of hiring going on. In last 2 years,

SOLUTIONS FOR PUBLIC SECTOR ARE DIFFERENT

Exhibit 27 depicts the age distribution across different type of banks. This picture captures the stark contrast in starting positions of different bank types in terms of their manpower stock. New Private Sector banks are on one extreme. Their average age is only 29–30 years. Generation gap — defined as the average age difference between a fresh hire and her immediate boss — is about 5 years. Public Sector is on another extreme with average age of 45–46 years and generation gaps of 17–19 years. 17 year age difference between a fresh recruit and her immediate boss means one or two generations gap between the two individuals. This makes integration of fresh recruits a major challenge. Fresh recruits into an organization seek mentors among their senior batch. With gap of 17 years, the seniors may not fully appreciate the mindset and aspirations of the fresh hire. Due to absence of a proper age pyramid and rapid retirements of senior executives, the middle management at Public Sector has to be groomed at a very accelerated pace to take on senior positions. The fresh recruits have to be taken through a very careful cultural onboarding process. The senior executives and middle managers have to be sensitized to the mindset of the new generation and their career ambitions. New Private Sector is facing attrition today. Public Sector can anticipate attrition a few years down the line. Due to massive loss of experienced talent, Public Sector has to get the seniors to play a very active role in training and passing on their knowledge to next generation.

Apart from the above, solutions for Public Sector HR transformation are very different due to different cultural context and legacy issues. Feedback discussion from immediate boss are very difficult to arrange. Incentive compensation — even though progressively allowed by the government — is difficult to implement due to gaps in planning systems. Negative consequences of non performance are few and inconsequential for some. HR transformation at Public Sector needs to be designed keeping this context. Solutions that work in Private Sector do not work in Public Sector.

EXHIBIT 27 | Different banks, different problems



Source: FIBAC Survey 2012; BCG analysis.
[1]Generation gap: Difference in age between new joinee (25 years) and his immediate senior.

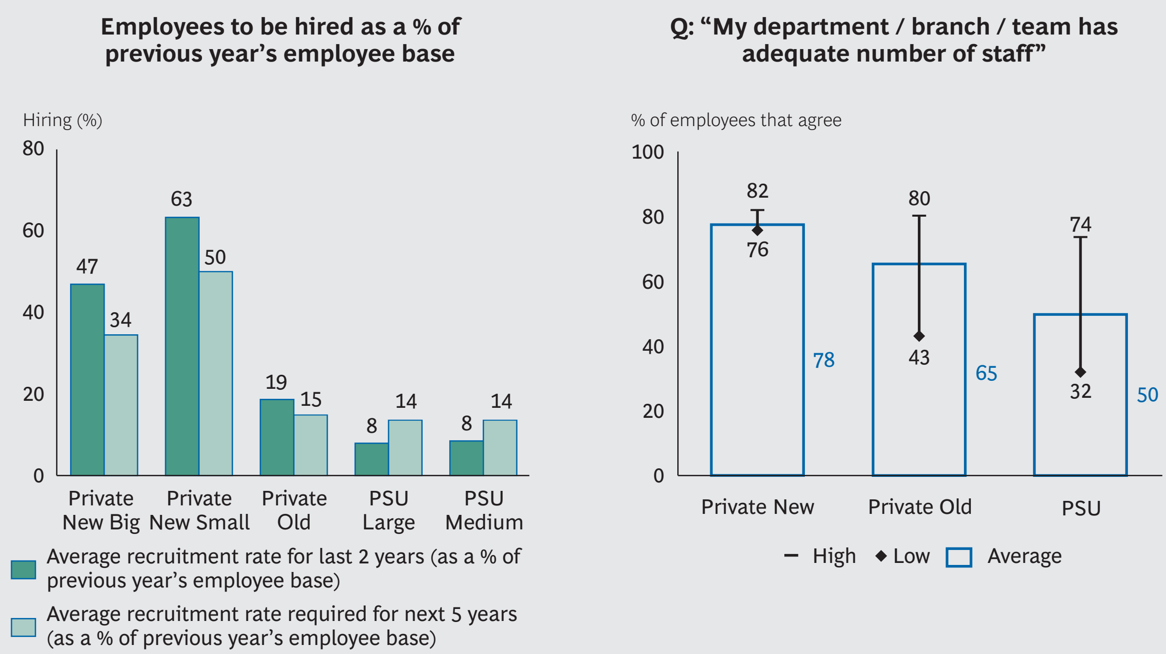
New Private Sector banks hired about 50 percent of their employee base every year on an average. This is unprecedented. At any time, one third of people are less than a year old in tenure. With attrition, perhaps half of the staff is less than a year old in some cases. Public Sector banks intake has to almost double compared to what it has been over last few years. Only 50 percent of staff in Public Sector feels that their department or branch is sufficiently staffed. Some Public Sector banks will face a stiff growth challenge if they are not able to get sufficient manpower soon enough.

Banks need to beef up their recruiting apparatus to meet this challenge. Firstly, recruitment should not be a sporadic activity but a continuous round the year exercise. This will ensure smooth accretion in staff strength right through the year as business grows. The recruitment process has to be re–engineered to minimize the time lag between interview, offer, and joining date. When the recruitment process is slow, the best candidates are lost on the way.

Secondly, recruitment pools have to be broad based. Banks cannot depend overly on a few channels. IBPS driven channel is large for Public Sector. Direct recruitment from campuses, lateral induction at senior levels from the market, captive training colleges, and head hunters—all need to be deployed in appropriate numbers and for appropriate roles.

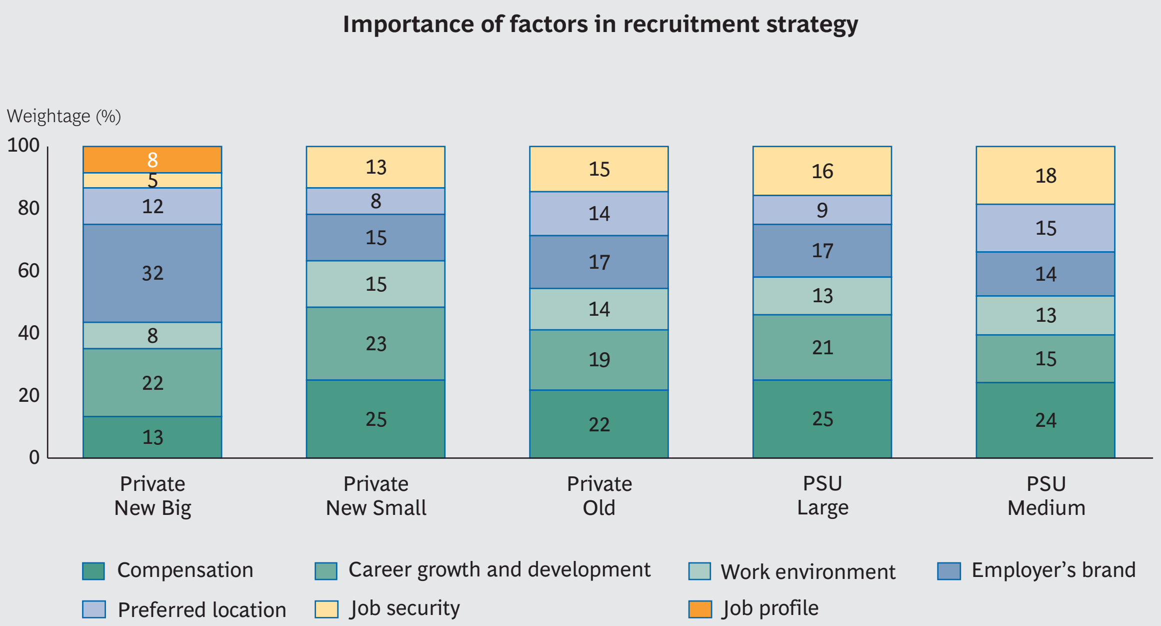
Thirdly, recruiting effectiveness needs to be measured through metrics like conversion rates in different channels of recruitment. The survey shows that some banks are only able to convert 40 percent of the lateral offers while others are able to convert as high as 85 percent. Banks that leverage the prestige of their brand and pitch career growth to new hires do better in conversion than banks relying only on the compensation pitch and job security. Larger Private Sector banks are adopting this strategy as depicted in Exhibit 29. Their top two pitches to new recruits are employer brand and career growth & development. Compare that to Medium Public Sector banks whose top two pitches to new recruits are compensation and job security. Experience of Large Public Sector banks in conversion rates is much worse than others in the industry.

Exhibit 28 | PSU Banks need to roughly double the intake



Source: FIBAC Survey 2012; BCG analysis.

Exhibit 29 | How to attract talent?



Source: FIBAC Survey 2012; BCG analysis.

Intrusive Learning as New Training and Onboarding Paradigm

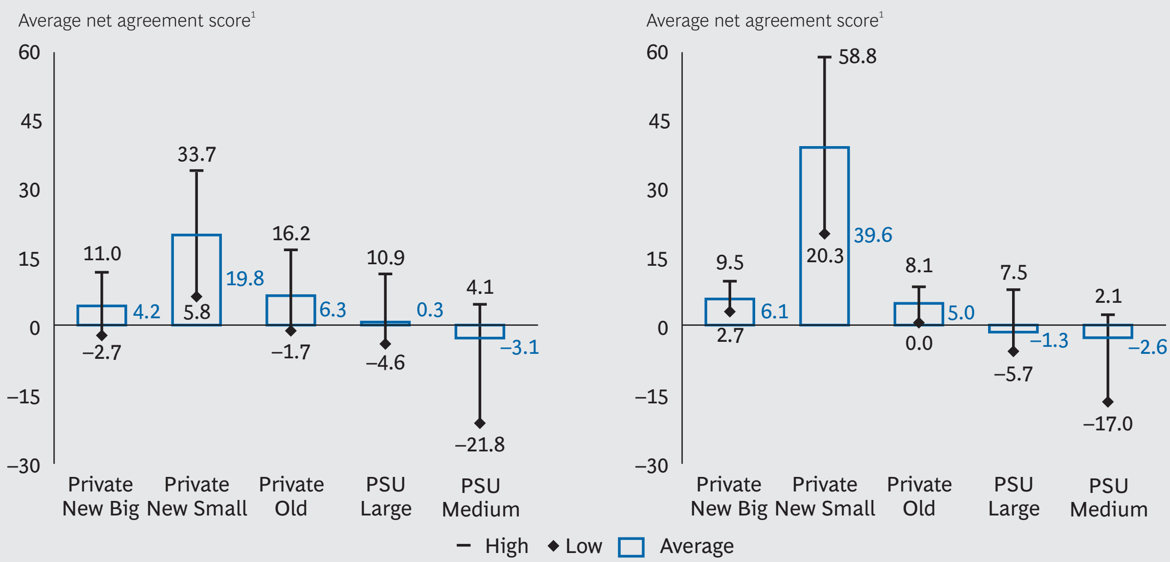
The large number of fresh recruits have to be made productive as soon as possible. With fresh recruits comprising as much as 50 percent of current employee population every year, the cost of not getting the new employees to be productive very fast is very high. Onboarding and training are the most strategic HR processes for productivity and performance management in current context. Exhibit 30 captures the net satisfaction of employees with training and onboarding programs of banks in various categories. As is evident, there is a general dissatisfaction with the effectiveness of training and onboarding in the industry. Only smaller Private Sector banks stand out as a category with clear positive feedback from employees on their training program. Employee assessment on effectiveness of onboarding also shows the same pattern of general discontent with effectiveness of banks' onboarding programme.

Training needs a paradigm shift to intrusive learning. Intrusive learning is based on BCG's research in the field of accelerated human learning and retention. Exhibit 31 illustrates the basic tenets of intrusive learning paradigm. It is essential for people to understand and appreciate the relevance of trainings within their career paths. Employees need to be empowered to choose some of their own trainings. This allows them to take responsibility for their own development. A training calendar has to be published in advance and employees have to have access to online registering themselves. Training calendar has to be very meticulously aligned to strategic agenda and priorities of the bank. This helps employees find trainings that are immediately relevant to their goals. Training has to be done in a safe environment where employees can experiment and learn from their mistakes. Test at the end of trainings increases retention. Successful trainings need to be a minimum threshold requirement for promotions. Teaching others makes one learn better. Trainings have to extensively utilize role plays, simulations, and peer feedback.

A very crucial tenet of intrusive learning is that employees teach each other. This is a

EXHIBIT 30 | Training and onboarding need a new paradigm in industry — poor assessment by employees

Employee assessment of training maturity | **Employee score assessment of onboarding efficiency**



Questions asked to assess training maturity:
- My performance improved due to the trainings I have attended
- I feel my company provides adequate opportunity for employees to get trained
- I feel that the training programs I have attended are linked to my current/ future posting

Questions asked to assess onboarding efficiency:
- Bank's onboarding practices ensure that new hires get right cultural acclimatization
- The bank does a good job of hiring and integrating experienced people as lateral hires
- Bank's onboarding program ensures that new hires get right technical training

Source: FIBAC Survey 2012; BCG analysis.
[1]Average of net agreement score for each of the questions where net agreement score is defined as % of employees that strongly agree (Score4) *minus* % of employees that strongly disagree.
(Score 1) on a 4 point scale.

EXHIBIT 31 | Intrusive Learning – Paradigm shift in training and onboarding

Principles of intrusive learning

More

People learn more...
1. when relevant to their everyday life
2. when given responsibility through choice
3. when expecting a reward

Better

People learn better...
4. when they understand the big picture
5. when concepts, visions are branded

Faster

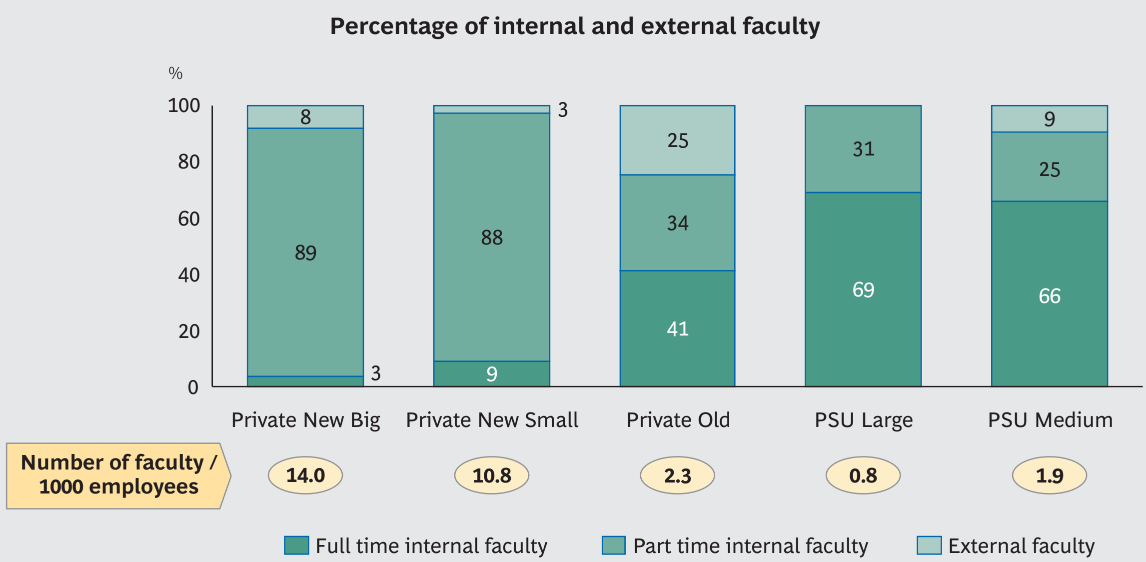
People learn faster...
6. when challenged but safe
7. when aware that they will be tested
8. when they have to teach each other

very powerful idea in current high growth context of Indian banks. Exhibit 32 highlights where the trainers come from in different banks and how many trainers are there per employee. The Private Sector has majority of bank staff acting as part time trainers. Public Sector has majority of full time training staff. Consequently, Private Sector has as high as 14 trainers per thousand employees while Public Sector has only 1–2 trainers per thousand employees. Asking line managers to become part time trainers has many benefits apart from expanding the capacity of training set up. The line managers acting as part time trainers become better at their concepts by training. Bank is able to institutionalize and pass on the knowledge its staff gains on the job to next generation. Not everything can be documented in a book. A lot of intangible experience can be shared when practicing managers talk through live examples.

Discussions on training often are mistakenly too focused on technical skills. Cultural integration is supposed to happen informally. This is a costly oversight in current high growth context of Indian banks. As discussed earlier in this report, it is especially crucial for banks to culturally onboard the new hires. New hires in a bank need to imbibe the softer elements of managing the trade–off between customer's interest, bank's interest, and their own interest. Such balance is not possible to hard code into the performance metrics. The only way to imbibe such ideas is through formal and informal interactions with seniors in the organization. Such activities also lead to development of trust and understanding between the generations in the bank. The emotional connect prevents attrition.

Exhibit 33 depicts the percentage of banks that undertake various types of cultural integration activities to on–board new hires. Two–thirds of the New Private Sector banks undertake all the activities (not the same two–thirds for everything). Old Private Sector and Public Sector have a more patchy program with less than half of the banks having most of the activities for cultural onboarding. The impact is also evident in Exhibit 33. Private Sector banks have 70–80 percent of employee approval on effectiveness of onboarding.

EXHIBIT 32 | Training resource strategy — Public Sector and Private Sector on 2 extreme ends



Source: FIBAC Survey 2012; BCG analysis.

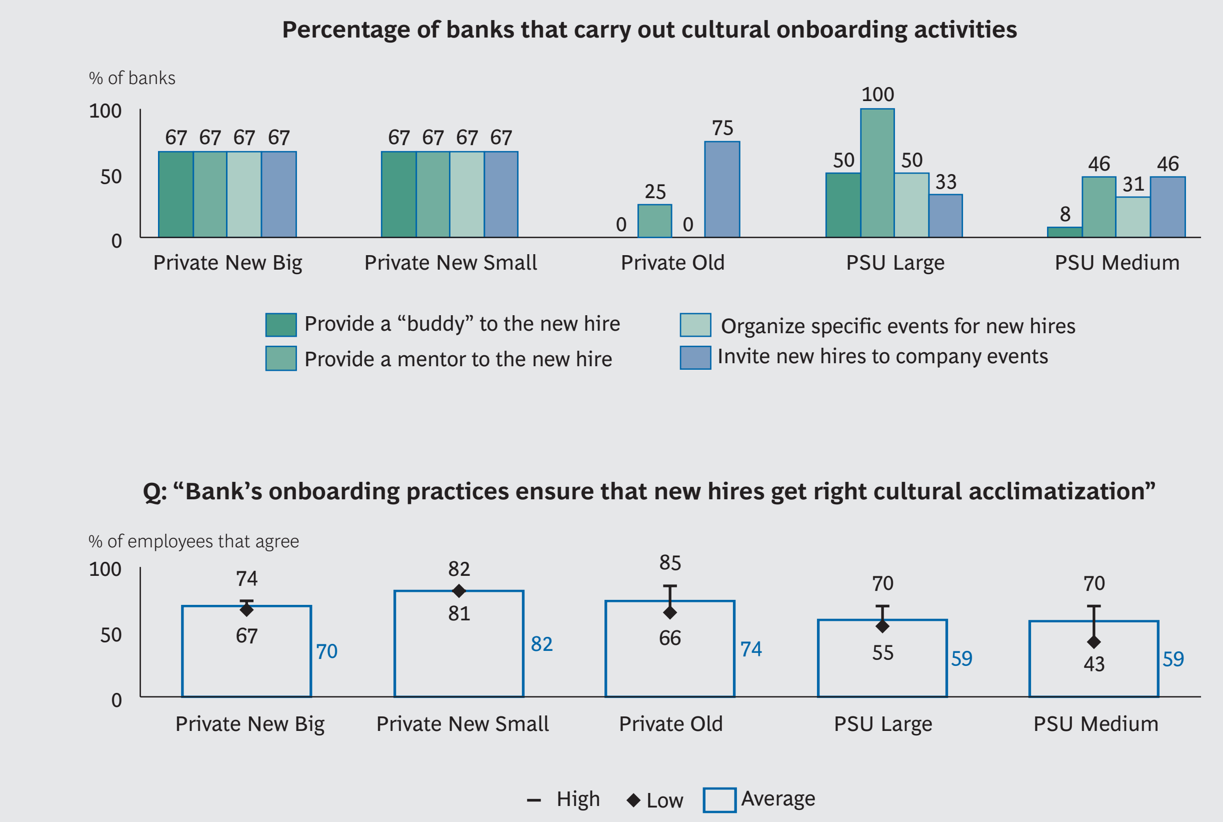
Talent Management: Getting Line to do HR

Accelerated development of leadership pipeline is of critical importance to all categories of banks in India. Private Sector is growing very fast and needs to groom leaders fast to manage the growth in business and head count. Public Sector is losing its senior experienced staff in huge numbers by way of retirements and needs to create their replacements in short time frame.

Development of next line of leaders goes beyond training agenda. It is beyond the HR department. People can be imparted certain skills through intrusive training but wholesome development as a leader can be accomplished only on the job and with special attention from the seniors in the bank in form of coaching and role modeling. Exhibit 34 captures the feedback from employees from different types of banks on the current level of mentorship offered by seniors. Quite consistently approximately 70 percent of the employees are aware that the seniors are expected to take out time to groom juniors. But only 50 percent of the employees are able to claim that they indeed have a mentor personally in the organization who takes personal interest in their development and career growth.

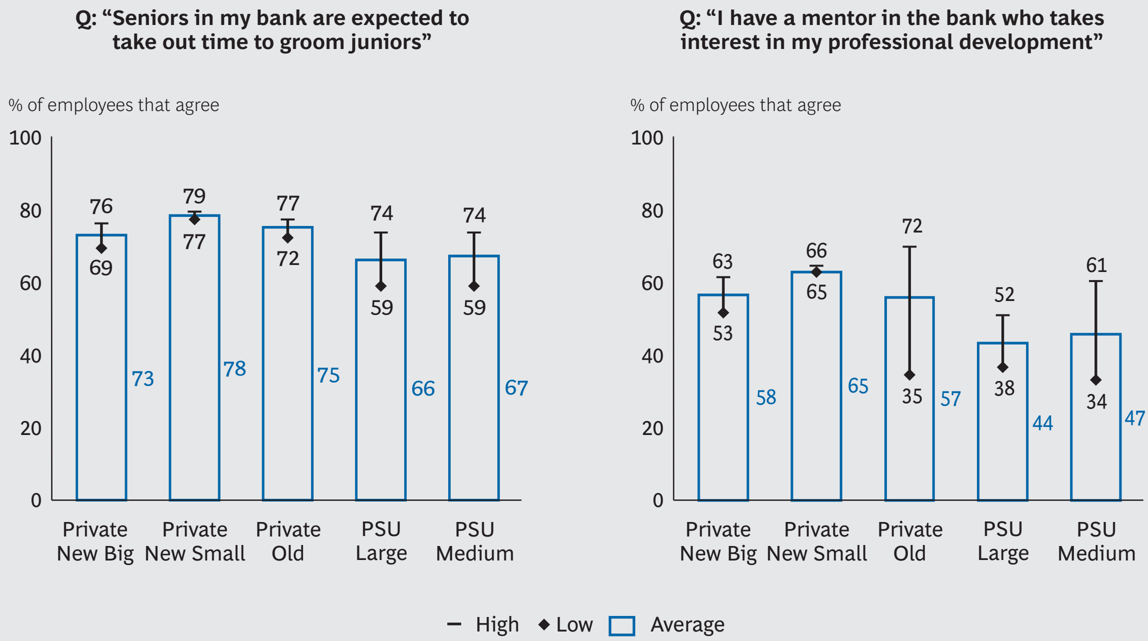
Putting the right people, in right jobs, at right time significantly enhance their productivity (up to 30 percent in some cases). Survey suggests that banks across the categories today transfer as high as 30 percent of their workforce every year. This provides a great opportunity to groom talent through rotation and enhance productivity by placing them in the right jobs at the right time. Many HR departments who have to actually transfer a large number of employees find themselves entirely inadequate to be able to optimize on multiple constraints of employee choice, bank needs, employee grooming, and bank rules. The actual postings end up being a bit adhoc. They are often based on chaotic trial

EXHIBIT 33 | Extent of cultural onboarding



Source: FIBAC Survey 2012; BCG analysis.

Exhibit 34 | Talent management — getting line to do HR



Source: FIBAC Survey 2012; BCG analysis.

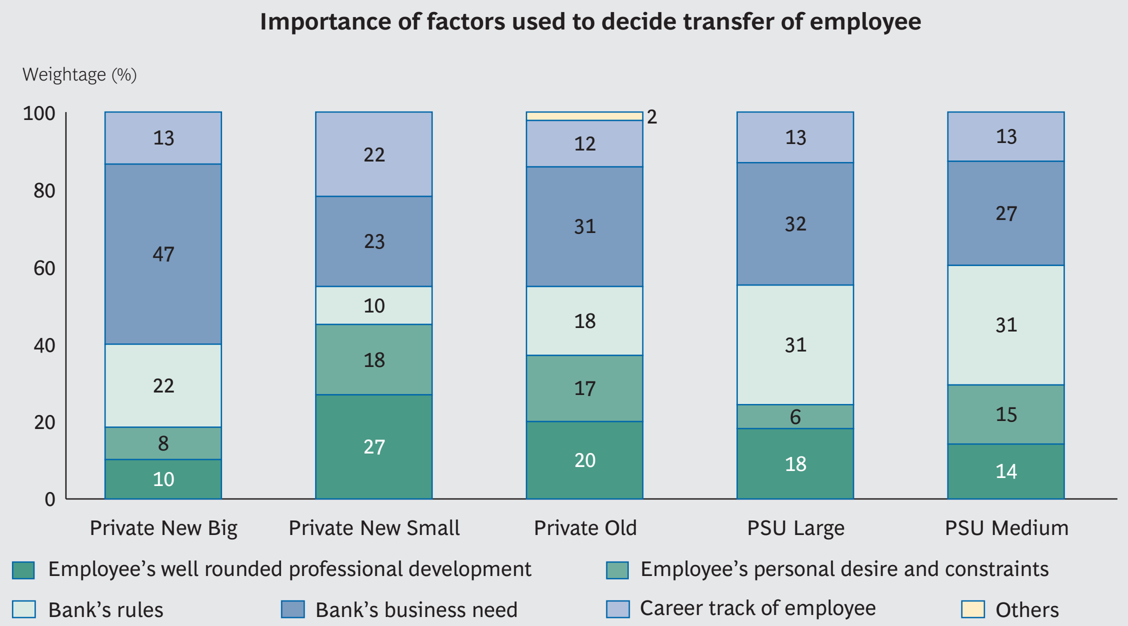
and error method to find the first acceptable solution that meets the hard constraints of bank rules and business requirements. It is now possible to use technology to find the optimal solution that optimizes candidate grooming while meeting constraints of bank rules, bank business needs, and employee constraints. The posting pattern in this paradigm is much different. Exhibit 35 shows the basis on which transfers are done in various categories of banks. As is evident, employee grooming is not the most important criteria today in 4 out of 5 categories. For large Private Sector banks, business priorities take precedence over other things. In Public Sector, bank rules take precedence over other things. There is a lot of productivity waiting to be unlocked through a scientific approach to postings.

Talent management process requires the bank to objectively identify about 25 percent employees at each level as talent pool in the bank and create individualized development and grooming plans for each one of them. Each talent pool candidate must have the equivalent of a career advisor / mentor who is responsible for providing comprehensive and objective developmental feedback to talent pool candidate and ensuring that the plans are executed. Every critical position in the organization must have at least 2–3 successors identified. Good talent management system requires a dedicated team to run this process, significant & sincere senior leadership time, effort & participation in the process and most importantly, it requires organizational integrity to ensure that long term development goals for top talent are placed ahead of short term business objectives.

PMS: Balance the Scorecard and do not Forget the Feedback

Performance Management System (PMS) is at the heart of employee engagement. All other processes — talent management, postings, training etc. — feed from the output of PMS. Integrity of PMS is critical to sustain employees' belief in organization and hence their engagement. Industry is not at its best on this dimension. Cynicism is creeping in. "Managing bosses and perceptions" was considered among top 3 drivers of professional growth by employees in large PSB and Private Sector

EXHIBIT 35 | Transfers can be an instrument of grooming



Source: FIBAC Survey 2012; BCG analysis.

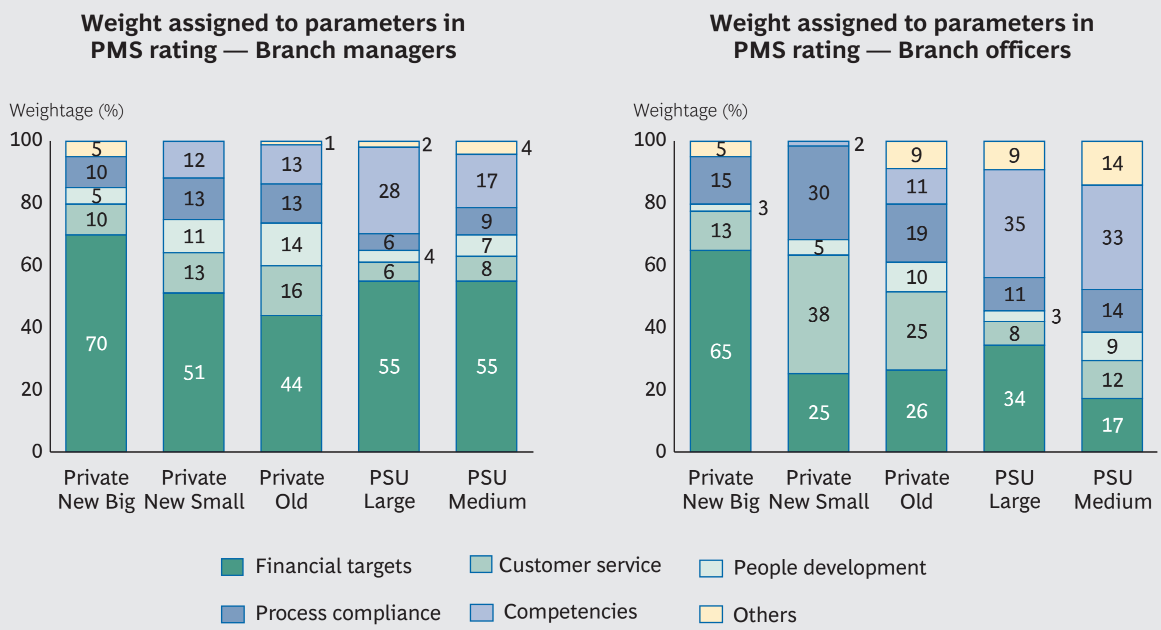
banks. It is crucial that PMS measures performance as objectively as possible, rating is fair and calibrated for relative performance of peers, there is direct linkage of PMS with promotions & recognitions, and employee is communicated in detail about her rating and rationale for decisions regarding her career.

The design of performance scorecard is the first step. Exhibit 36 shows the relative weights of various criteria by banks in various categories for performance score card of branch managers and branch officers. It is evident that financial targets is the dominant metric for branch managers across the board. At 70 percent weight to financial targets, large Private Sector banks are the extreme. 50–60 percent weight to financial targets seems appropriate in order to balance the score card with more holistic range of measures — like people development, customer service, compliance, and competencies. It is important that everything on the score card has enough weight (10 percent) that it matters in influencing behaviors. Long list of metrics with small weights have little impact. Not every priority should be put in the score card. Many behavioral changes in employees can be achieved through informal recognitions and reprimands like a phone call from the boss. Strategic priorities like people development should find place in score cards of seniors and these should be measured though upward feedback. Similarly non financial elements like customer service can also be measured through customer surveys or mystery shopping.

Branch officers in many banks do not have measurable targets. The weight of financial metrics in their score cards is distinctly lower as shown in Exhibit 36. If non financial metrics are non measurable and subjective then a vast majority of staff complains of lack of objectivity, lack of calibration and inconsistency. With new branch structures and roles therein, it is possible to envisage roles of branch officers such that financial targets and measurable non financial targets comprise majority of the score card.

Grade inflation is an endemic problem. Majority of employees get high ratings. Subjective score cards encourage this trend and reduce the credibility of ratings in the

Exhibit 36 | Performance measurement criteria in banks



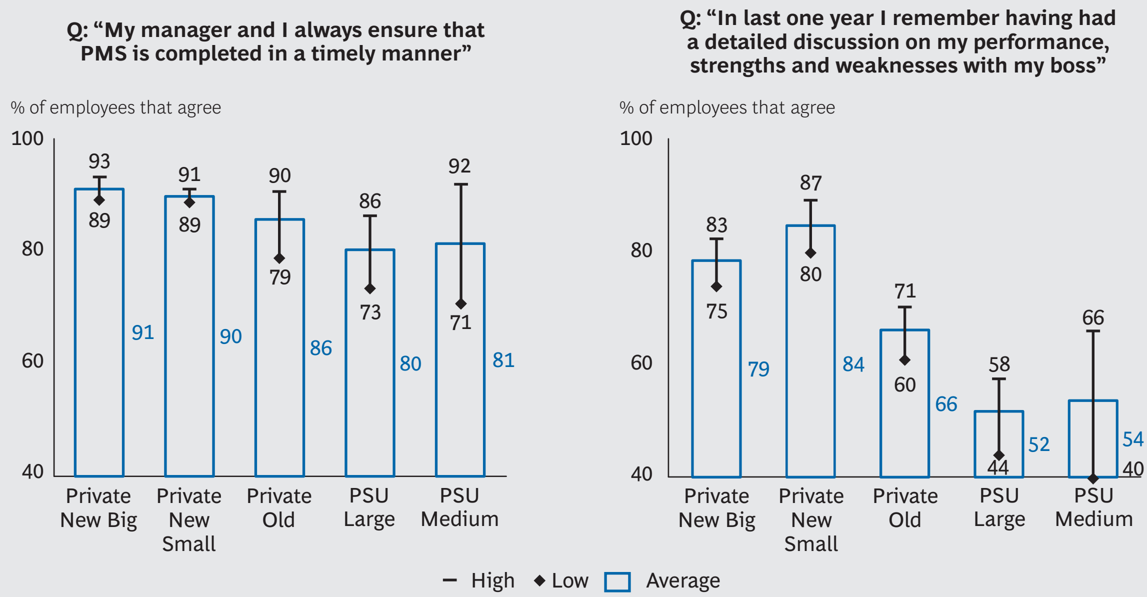
Source: FIBAC Survey 2012; BCG analysis.

eyes of staff and management alike. Many Public Sector banks are not able to distribute incentives on basis of employee individual performance rating due to this suspicion. Banks need to find a method to calibrate ratings that suits their culture and legacy. In Private Sector, normal curve can be forced. In Public Sector, that may not be possible due to poor empowerment of middle managers. Public Sector can create committee approach where seniors review the files of candidates and slot employee in various grades based on formal ratings and verbal feedback from the employee's bosses.

Getting ratings right is a very small first step. It amounts to getting the PMS right in letter. The PMS in spirit starts after that. Exhibit 37 captures the challenge. Across the board, the number of employees who had a discussion about their feedback and development is lower than the ones who finished the PMS on time. The moment of truth in PMS is the feedback discussion. Many bosses avoid it. It is not always a pleasant discussion. It takes skill and maturity to do it. Banks will need to train supervisors on soft skills around feedback discussions. Private Sector banks need to emphasize this due to massive staff turnover and the need to get the fresh recruits to understand expectations quickly. Public Sector may need to find more innovative ways to deliver feedback. Employee mentors who are not their direct bosses may find it easier to give feedback to Public Sector employees.

The ultimate acid test of performance management system is shown in Exhibit 38. Do employees believe that the good performers are rewarded, poor performers are punished, and the deserving by and large get promoted? In other words do employees feel they get a fair deal? Exhibit 38 shows the feedback from different bank types. As a general trend across bank types, maximum number of employees feel that good performance is rewarded, lesser number of employees feel that promotions are fair, and even lesser feel that poor performers are sidelined. Across all bank types some banks are able to do it very well and some are not. There is a lot of scope for learning from each other. Employee faith in the system depends largely on the leadership commitment to take decisions on time and on

Exhibit 37 | PMS mostly done in letter and not spirit



Source: FIBAC Survey 2012; BCG analysis.

copious communication. Even more important is to be unflinching at the time of taking critical decisions so as to not dilute standards.

Technology Enablement of all Aspects of HR

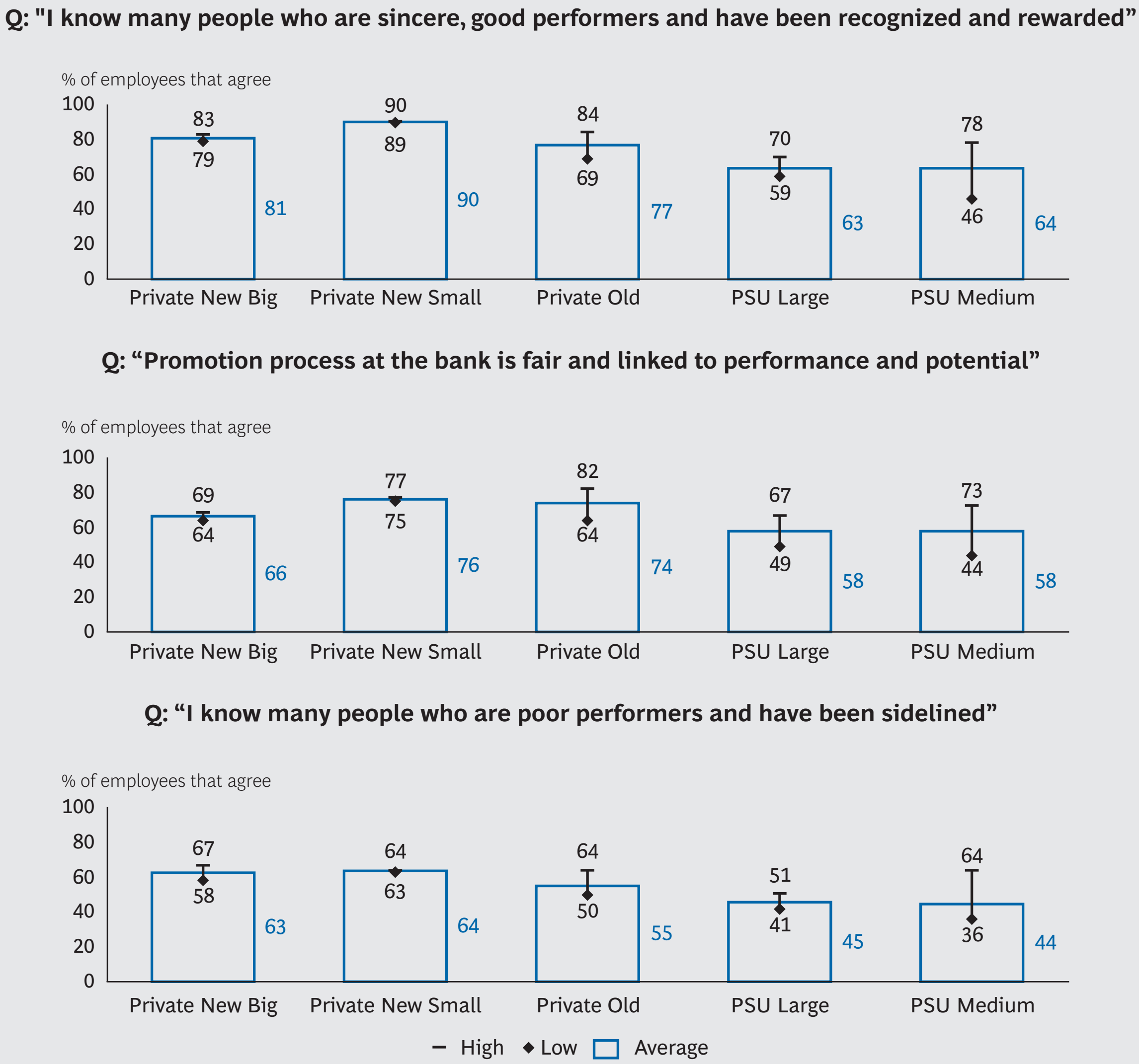
Banks have made great strides in technology for business processes and customer transactions. Introduction of technology tools for enabling and automating HR processes can hasten adoption of new HR practices significantly. Many tools are available off the shelf and a few others are simple adjustments to bank's existing HRMS. Many a times features are available in existing HR systems but they are not used. Exhibit 39 demonstrates the technology tools at various steps of the end to end HR process.

Technology based tracking can ensure that first year postings of a new recruit is tracked meticulously and the quality of her experience is monitored. As discussed before, technology can enable intrusive learning in a significant manner. Training calendars can be made available online and employees can be allowed to register themselves. Online e–learning modules enable employees to educate themselves at leisure and outside of office if required. Technology tools can help track trainings attended by an employee.

Effectiveness of Performance Management Systems (PMS) is as good as their adoption. Technology can make filing of evaluation forms very convenient for reviewers. For example, they can have web based access to the system such that they can fill the evaluation from outside office, if required. Such online evaluation systems can also help track whether evaluations are indeed being filled on time by reviewers and discussed with candidates on time.

Talent management can be enabled through technology by making an employee's job history and track record available at the click of a button for discussion. Technology tools can also help find optimized solutions for postings and transfers of people such that their grooming options are optimized within constraints of bank rules and bank business requirements.

EXHIBIT 38 | Promotion and recognition — the acid test of PMS



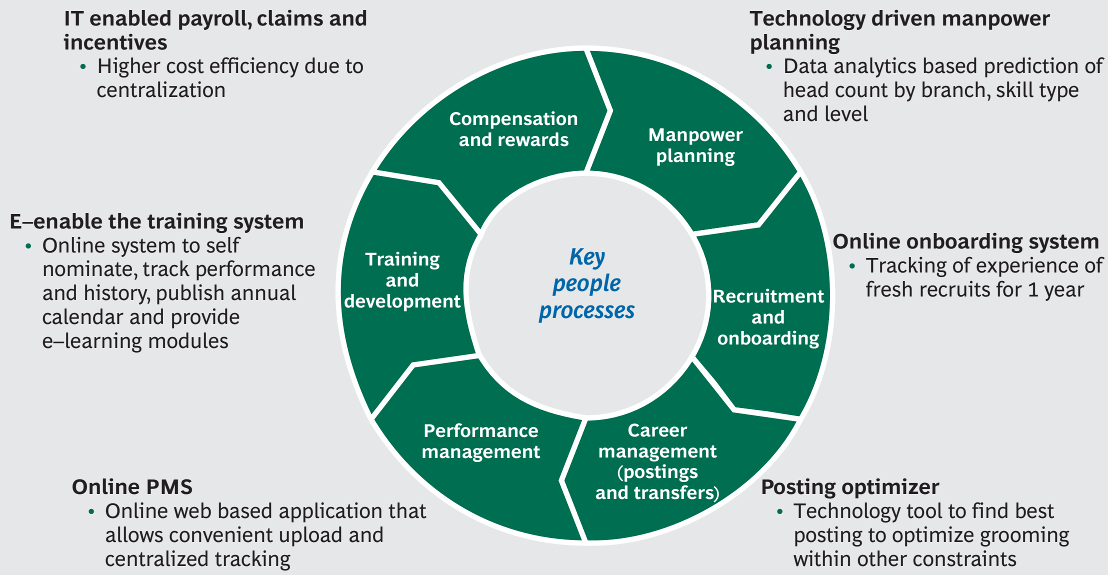
Source: FIBAC Survey 2012; BCG analysis.

Manpower planning can be driven by an analytics engine that can compute and forecast, using Core Banking Solution (CBS) data, the manpower requirement by job family at an individual branch level. This will greatly improve the accuracy and frequency with which a rolling manpower plan can be created.

Banks can invest in platforms / portals for interactions with employees that can serve as mechanisms for disseminating information specific to an employee as well as collect inputs, feedback and requests from employees. Such a system makes the administration of many HR functions relatively easy. For instance, some banks use intranet to display internal jobs and transfer opportunities information. This allows all employees to be aware of opportunities available and also increases the perception of fairness around transfer. Such portals, if implemented well, can enhance employee perception of HR responsiveness.

Real–time dashboards can greatly enhance productivity in an organization by providing accurate and consistent information across the organization. A dashboard can help a branch manager prioritize his efforts and

Exhibit 39 | Leverage technology in HR



ensure that the branch reaches the required targets to achieve incentives. Further integrating performance management systems can improve the discipline behind the completion timelines by allowing for automated flagging. It also provides information in electronic format directly precluding error prone data entry.

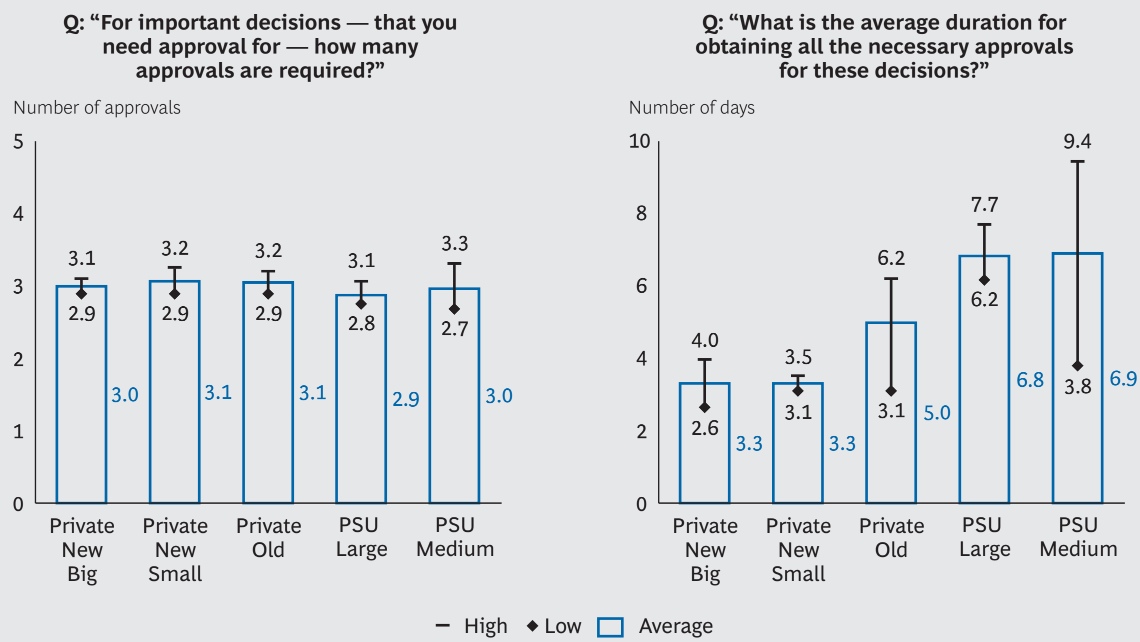
Smarter Work Environment: Reduce Employee Time Wastage

BCG research has shown that complex organizations are less productive. Employee engagement, their willingness to collaborate with each other, and their willingness to take decisions fall as processes become messy with multiple stakeholders, many meetings, huge e-mail traffic to respond to, and multiple step decision processes. As banks respond to growing complexity in demands from sophisticated customers, they need to prevent the organizations from becoming complicated and hence less productive.

Exhibits 40 and 41 are based on employee feedback and demonstrate a dipstick investigation into organization processes that lead to disengagement. Exhibit 40 is about the number of steps required in a typical decision. Most bank employees have said that a typical decision takes 3 steps or 3 permissions. But one bank takes 2.6 days on an average to finish the 3 steps. Another takes 9.4 days to finish the 3 steps in decision making. Employees waiting for 9.4 days for the decision to be taken are frustrated, demoralized, unproductive and eventually cynical. A lot of activity has been undertaken to make banks' operating processes more efficient by reducing process steps and reducing turn around time for customers. Banks' normal internal decision making processes need to be reviewed to eliminate waste and make employees more productive and engaged.

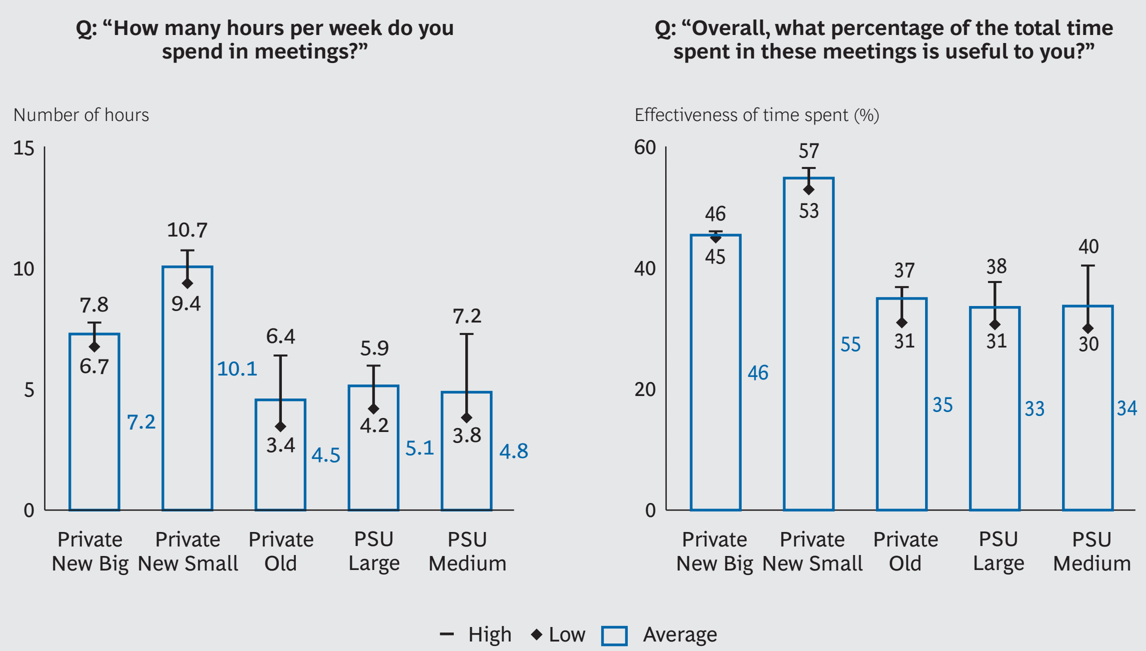
Exhibit 41 demonstrates the same point for another major drag of employee time in organizations — meetings. The average number of hours spent in meetings varied between 4 hours to 11 hours per week across different banks. The percentage of time in meetings that was useful was estimated as high at 57 percent for one bank and as low as 30 percent for another bank. Wasteful use of time is unproductive and demoralizing. Banks can learn a lot from each other in making the work environment more productive for their people. Senior management might need to change some of their habits.

Exhibit 40 | Steps to decision and time taken to decide



Source: FIBAC Survey 2012; BCG analysis.

Exhibit 41 | Time spent in meetings



Source: FIBAC Survey 2012; BCG analysis.

TECHNOLOGY MATURITY

A Mature Technology Model is Crucial

Indian banks have been fortunate with technology. They do not have any legacy issues and they have access to technology expertise at lower costs compared to western peers. Consequently technology cost to revenue ratio for Indian banking industry is much lower compared to western benchmarks. This is not a solace. On the strategic lever of technology, it is not the cost but the maturity of technology model and its ability to enhance customer and employee experience that matters.

Objective of this research was to establish the gaps in maturity levels of technology in Indian banks. Across categories, banks have identified “adding value to customers with better products and superior service” as their top technology priority. Do banks have the IT capability to deliver against this priority? The top three areas that were chosen as biggest gaps were: (1) Ability to configure and offer new products quickly, (2) Online visibility of status of applications and service requests, (3) Single view of customers across all product relationships. All the gap areas relate to customer experience with the bank.

This research has highlighted significant distance to be covered on technology maturity at majority of Indian banks in terms of their application portfolio, their ability to manage vendors, and their ability to get businesses to adopt new technology fully for themselves and for customers. The larger New Private Sector banks come out as leaders by a wide margin in technology maturity.

Three imperatives for this journey have emerged from this research:

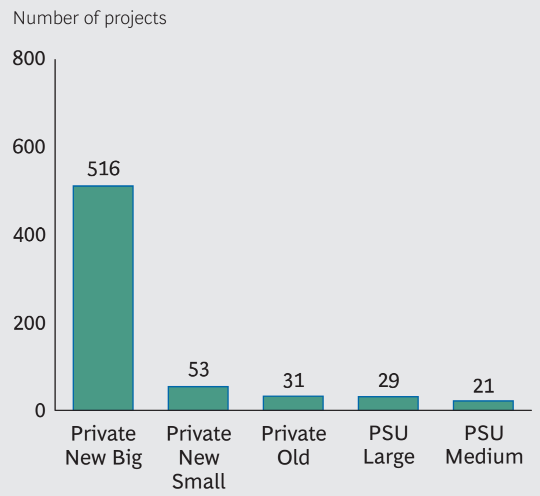
- Technology strategy: Have more functionality but with simple architecture
- Smart sourcing: Develop vendor management capability
- IT Governance: Ensure business ownership and adoption

Technology Strategy: Have More Functionality but with Simple Architecture

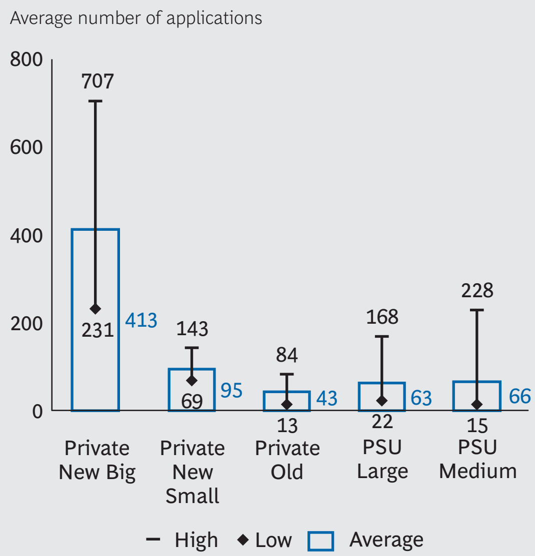
Almost every aspect of banking can be technology enabled. Front end employee applications, customer e–interfaces, middle office information systems, back office processing, work flow tools, etc. are just a few items from a long list of applications that need to be introduced to make life easier for either the customers or the employees beyond the core banking application. Continuous investment in applications and fine–tuning of IT is needed. Exhibit 42 demonstrates some metrics that capture the introduction of applications and the pace of fine–tuning undertaken by the banks.

EXHIBIT 42 | Application and projects portfolio

Average number of projects[1,2] delivered in FY12



Application portfolio



Source: FIBAC Survey 2012; BCG analysis.
¹Includes Run–the–bank & Change–the–bank projects.
²Includes new projects, not necessarily modifications to existing licenses.

Large Private Sector banks are leading the pack by a large margin in terms of number of applications and projects. On an average, they have 413 applications per bank and 516 projects delivered per bank in the financial year 2012. This is a massive lead compared to almost any bank in the system. There is a major gap in applications portfolio. The project pipelines in many banks seem to be not working efficiently with projects being abandoned en route or not finishing forever. This could happen due to many reasons — only the very critical and high decibel / penalty projects get priority; there are inadequate resources to work and follow up on projects; projects are not being delivered in appropriate time frames, leading to clogging of pipelines; business is inappropriately engaged with IT matters related to products / features and execution; leadership is not committed or well versed; quality of vendors / contracts with the banks are not appropriate; among others.

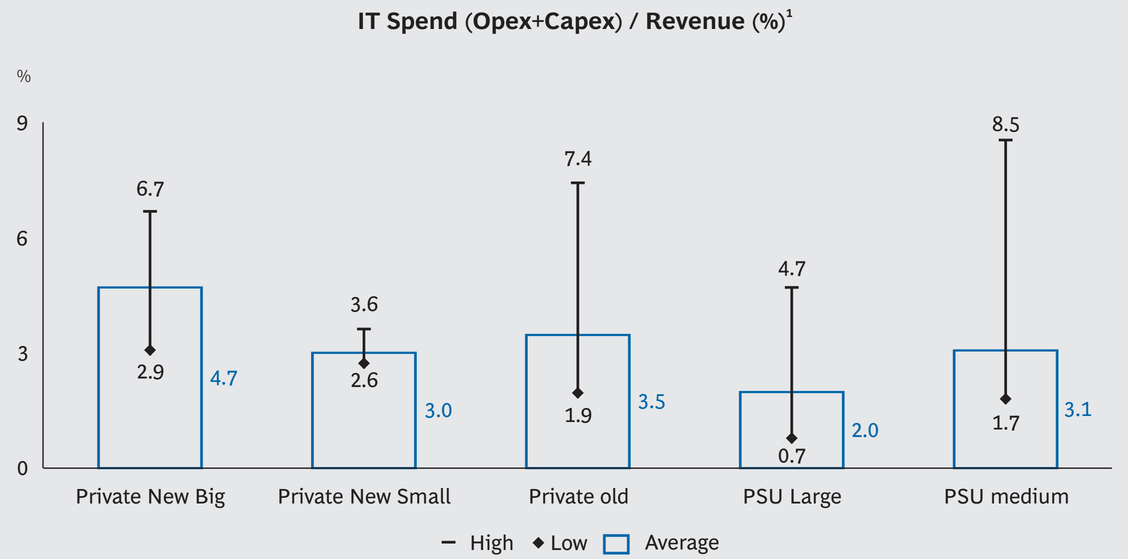
Indian banking industry is significantly behind the global benchmarks on complexity and maturity of IT. On an average a European bank undertakes about 500 projects every year compared to 75 in India. European banks have on an average 1,700 applications compared to average of 98 in India. And European banks deal with 400 vendors compared to 49 in India.

Some of this complexity in western banks is due to legacy challenges. But a major part is attributable to technology maturity which Indian banks will be moving towards.

As the banks move towards an expanded application portfolio, they run the risk of making their IT architecture very complex and rigid. This is the challenge with western banks who have added applications indiscriminately over time. Simplicity of IT architecture has to be a criterion as more applications are added and refined with more projects.

Application portfolio and projects have monetary implications. Exhibit 43 showcases the variation in money spent on IT (as percentage of revenues of the bank for the sake of comparison) by various banks. It is an average of three years capex and opex expenditure to ensure large one time investments do not skew the picture and impact of model choices between opex and capex is normalized. There is substantial variation within different categories. Highest in industry is at 8.5 percent and lowest is at 0.7 percent. Banks with large application portfolio and with large number of projects have on an average largest investment in IT. There is scale benefit observed between PSU (medium) and PSU (large). However, there is no scale benefit

Exhibit 43 | Significant difference in IT investment



Source: FIBAC Survey 2012; BCG analysis.
[1]Average for the years FY10–FY12.

observed between New Private (big) and New Private (small) banks. Actually, on the contrary, the New Private (big) banks are investing further in technology. It is clear that investment in technology by Public Sector has to go up significantly to catch up with the innovation in larger Private Sector banks in India.

Smart Sourcing: Develop Vendor Management Capability

Outsourcing is unavoidable in today's technology delivery paradigm. Vendor development and management is a core skill. Majority of Indian banks have more experience with hardware supply & maintenance vendors and software license vendors. Experience with software services vendors has been limited so far. This capability has to be developed.

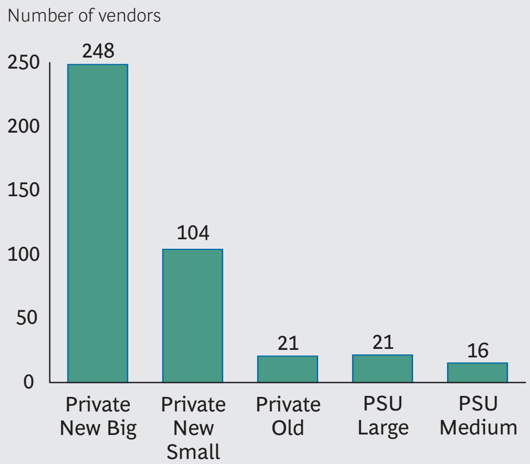
Exhibit 44 shows the total number of outsourced software service providers used by the banks in 2012. These don't include software license providers and hardware vendors. And the right hand chart of Exhibit 44 shows the concentration of spend in the top 5 vendors. Old Private Sector and Public Sector have very limited vendor base (16–21 vendors) and very high concentration of spends (85–88 percent). Private Sector banks have a large distributed vendor base (104–248 vendors) and less concentrated spends. With advanced technology maturity, increase in number of vendors is inevitable. Large number of vendors reduces concentration risk and increases access to innovation. Managing many vendors and extracting value from them takes a lot of internal capability in banks.

It is not a surprise that large number of Public Sector banks have such few vendors, given the complexity of selecting a vendor through the complex hiring process and often an inability to extract the best from the vendor.

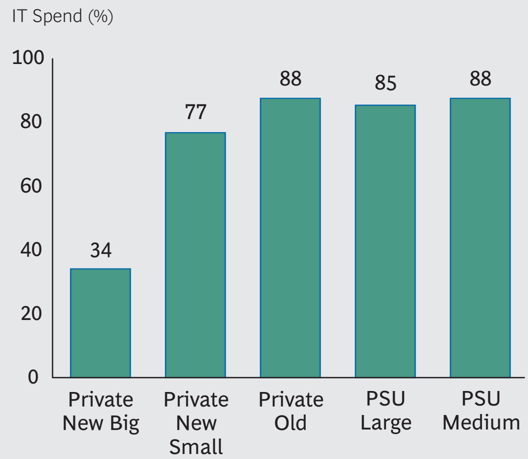
Exhibit 45 summarizes the experience of banks with vendors in two key categories — ATMs and Core Banking. Size and capability have direct impact on the services being derived from service providers. Private New Large on account of size and capability seem to be the most satisfied, while PSU Medium seem to be the least satisfied. With same vendors different banks are able to extract different service levels. In–house IT organizations face difficulties in managing vendors due to lack of key competencies, highly complex contracts, non prioritization of IT demands of business. Contract management is developing as a specialized skill and banks have to invest in this critical capability.

EXHIBIT 44 | Vendor portfolios of banks

Average number of IT vendors / IT service providers[1] per bank



Average share of IT spend accounted by top 5 vendors



Source: FIBAC Survey 2012; BCG analysis.
[1]Includes only software services providers and not hardware vendors or software license vendors.

Contracts run into trouble because the following five questions are not properly answered while negotiating.

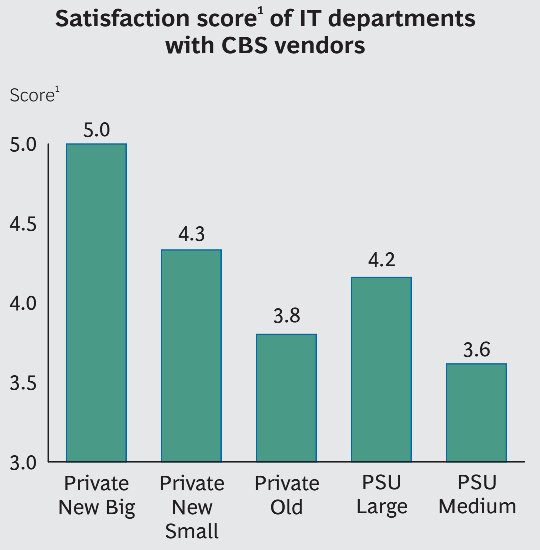
- Contract size: What is the appropriate size of the project to ensure it is able to have a transformative impact desired?
- Performance management: What outcome oriented metrics for success of IT project be designed so that the incentives for vendors are aligned with the bank's interests?
- Asset ownership: Who should own the IT assets? Where is the risk better managed?
- Flexibility: What future changes or new requirements can be anticipated and how to build those possibilities in contract terms now?
- Collaborative models: To what extent can the project be shared across other institutions and what are the cost and strategic implications?

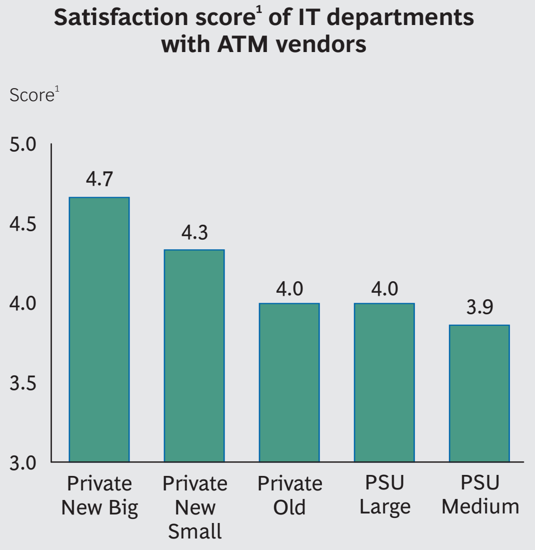
IT Governance: Ensure Business Ownership and Adoption

IT and business have a love–hate relationship in most banks. Getting them to work together is the Holy Grail. Problems happen at various stages. Business is not fully involved in design of system specifications. This leads to many iterations and cost and time over runs. Even more challenging is the lack of ownership in implementation. Businesses do not adopt a new system and junk old system because it takes a lot of effort from staff to get used to a new system which often has teething troubles. Even when the system is adopted, employees do not know all the features and bank does not get the RoI in technology due to less than full harnessing of the system. Exhibit 46 depicts the feedback from IT departments regarding response from businesses. As is evident in the chart, technology departments feel helpless as business units do not take full ownership for design and implementation. Business units have to know technology well enough to use it to create differentiated propositions in the market.

Banks have to set up a IT governance mechanism with business. This mechanism should be able to address key issues around prioritization, demand management, de–duplication, timeliness, and tracking of output metrics. Banks need to put in place a IT budgeting process and a IT steering committee structure to create a very transparent decision making process having every stakeholder's skin in the game. Business units need to have earmarked resources whose role is to translate business needs into IT specifications and vice versa. These resources have to report to business.

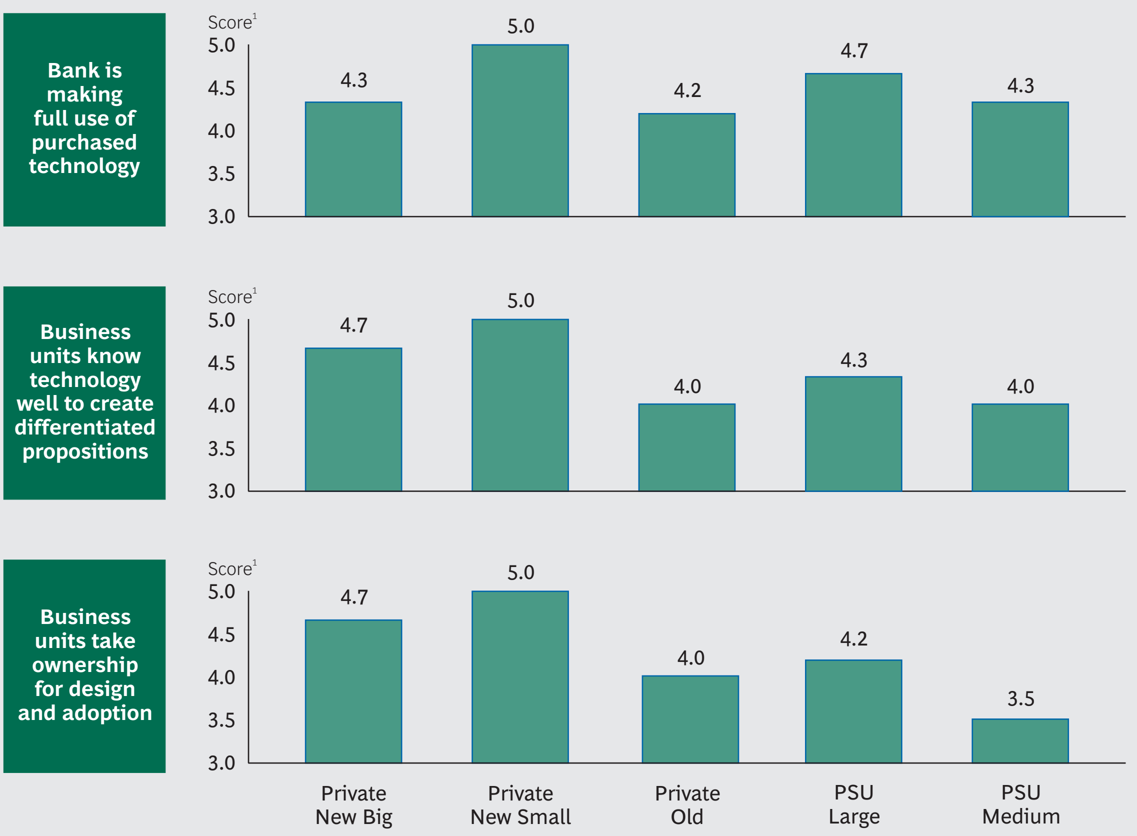
EXHIBIT 45 | Satisfaction with vendors varies significantly





Source: FIBAC Survey 2012; BCG analysis.
¹Average score on a 5 point scale.

EXHIBIT 46 | How aligned are business and IT — perspective from IT departments



Source: FIBAC Survey 2012; BCG analysis.
¹Average score on a 5 point scale.

IMPERATIVES FOR THE GOVERNMENT AND THE REGULATOR

THE STUDY HAS HIGHLIGHTED a number of action points for industry. The following imperatives for the Government of India and for the Reserve Bank of India have surfaced which will enable and facilitate faster movement by the industry.

Imperatives for the Government of India

- Government as the majority shareholder in PSBs should exercise its right in the respective boards to ask for a discussion on assessment of bank's current level of customer and employee engagement. Ideally such discussion should be had in light of benchmarking of bank's engagement levels with respect to peer set in Public Sector and Private Sector. The discussion should cover, among others, the specific metrics that have been identified in this study.

- The feasibility of creating a joint venture company owned by all Public Sector banks for POS acquiring business needs to be explored. Public Sector banks are absent from the acquiring side of card payment business. Additional player would give a fillip to POS acquiring business in India and help develop the market for card payment transactions.

- Establish a debit card and mobile banking usage stimulation fund with a mandate to encourage usage of the new electronic channels through advertisements, enhance user education, and promote safety of transactions. Education on electronic channels of banking should be introduced in school curricula for children.

- There is a perception that Public Sector banks get a raw deal from technology vendors and outsourcing partners. Often the Public Sector bids for technology or outsourcing are quoted at very low prices and there after vendors compensate themselves by compromising on quality. It is observed that the quality of service received by Public Sector is lower than that of Private Sector from the same vendor. This systemic disadvantage needs to be addressed by the government indirectly through:

  – Exploring ways to build capabilities in Public Sector to manage contracts and vendors

  – Exploring ways so that Public Sector RFP process puts sufficient emphasis on quality and not just lowest cost

- Driving employee centricity initiatives in Public Sector banks requires sustained multi–year efforts by top management. Government has to explore possibilities of providing stability in top management teams in PSU Banks for 3–5 year duration to ensure that initiatives are seen through to their logical conclusion.

Imperatives for the Reserve Bank of India

- Evaluate bolder options in debit card schemes to trigger exponential growth in adoption. The debit card scheme prevalent in European countries which have exceptionally high debit card spends have to be studied and evaluated for phased introduction in India.

- NPCI should be encouraged to consider more disruptive and innovative schemes for debit card in India. Being a non–profit entity, NPCI should be supported, as appropriate, financially or through regulatory fiat to be able to sustain the initial investment.

- Bank led partnership model for mobile telephony based financial inclusion solution is not picking up as desired. There is mistrust between banks and telecom companies as regards customer ownership. This mistrust is preventing any significant movement forward on the major national priority and potential disruptive business opportunity. RBI needs to investigate underlying drivers for this lack of progress of mobile payments and mobile telephony based financial inclusion solutions and take firm measures to create right incentives for players to co–operate.

- RBI should institute incentives for banks to promote electronic transactions — especially usage of electronic channels by small ticket customers. These incentives could be linked to metrics like percentage of banks' customers using various digital channels. The incentive could be in the form of benefits in priority sector lending target or financial inclusion targets.

- RBI inspection of banks should include assessment of their IT architecture complexity, vendor management systems and skills, vendor concentration risks, and business ownership of IT. RBI may need to upgrade its own skills in technology to be able to provide such supervision. Given the distinct trend of rising technology intensity of banking, it is also a major source of hitherto unknown risks and hence a significant supervisory imperative.

APPENDIX

Introduction to Research

Research was conducted across three areas — Customer, Human Resources and Information Technology. Surveys were filled by 33 banks (11 Private Sector banks and 22 Public Sector banks), more than 50,000 employees (across levels) and about 14,000 customers. The surveys included topics covering customer perceptions and behavior, employee engagement and effectiveness and bank's approach towards HR and IT. Responses from these surveys were analyzed collectively to understand the relationship between banks, their employees and customers.

In order to maintain confidentiality, results and analysis of the survey are presented bank–category wise throughout the report. Banks have been divided into five categories based on asset size — Private New Big, Private New Small, Private Old, PSU Large, PSU Medium. Bank category averages along with high and low points are presented to show variance amongst peers.

Customer Research

The objective of the Customer survey was to understand primary savings bank relationship, channel adoption and usage, satisfaction levels, retention and advocacy across customers of Indian banks. This survey was conducted in 20 cities across regions, covering 26 banks.

Research Methodology

Face to face interviews were conducted among 13,874 respondents by The Nielsen Company using a structured questionnaire. The target group was customers having a primary account in one of the 26 chosen banks. Primary account was defined as the savings account from which the customer had made maximum payments (through cheque, cash withdrawal from ATM, debit card, online payments etc.) in the last one year. Only 18+ age group customers were interviewed and Male: Female ratio of 80:20 was maintained for each bank.

Sample Profile (as shown in table 1)

Geographical Distribution (Table 1a)
Customers were interviewed across regions covering 20 cities.

Age Distribution (Table 1b)
Customers interviewed are distributed evenly across age groups. Analysis was conducted to highlight differences in behaviour amongst age groups.

Occupation Distribution (Table 1c)
Our sample consists of ~30 percent salaried and ~34 percent businessmen. Analysis was carried out to show dissimilarity between them.

Socio–Economic Class Distribution (Table 1d)
Socio–Economic classification is based on education and occupation of the chief wage earner in the household. ~70 percent of our

TABLE 1: SAMPLE PROFILE

1a: Geographical distribution			
Town class according to survey (population)	**RBI definition**	**Sample share (%)**	**Cities covered**
Metro (>40 lac)	Metro	24%	Mumbai, Delhi, Kolkata, Bangalore
Tier 1 (10–40 lac)		25%	Jaipur, Patna, Surat, Vishakapatnam
Tier 2 (5–10 lac)	Urban	23%	Gwalior, Bhubhaneshwar, Kolhapur, Salem
Tier 3 (1–5 lac)		18%	Hissar (Haryana), Rourkela (Orissa), Patan (Gujarat), Vellore (Tamil Nadu)
Tier 4 (10,000–1 lac)	Semi–Urban	10%	Malihabad (Uttar Pradesh), Baruipur (West Bengal), Umred (Maharashtra), Urappakkam (Tamil Nadu)

1b: Age distribution	
Age group	**Sample share (%)**
18–25 years	28%
26–30 years	22%
31–40 years	29%
41–50 years	13%
>50 years	8%

1c: Occupation distribution	
Occupation	**Sample share (%)**
Salaried	30%
Businessmen	34%
Student	14%
Housewife	9%
Others	13%

1d: Socio–Economic class distribution	
Socio–Economic class	**Sample share (%)**
SEC A	36%
SEC B	33%
SEC C	19%
SEC D	8%
SEC E	4%

sample consists of customer belonging to SEC A and B class.

Definitions

Net Satisfaction Score (NSS)
Percentage of highly satisfied respondents (Score 5) *minus* Percentage of highly dissatisfied respondents (Score 1) on a 5 point scale. Compared to a simpler metric such as percentage of satisfied customers, we have found NSS to be more discriminating between banks as it penalizes dissatisfying a number of customers even as it rewards having satisfied customers.

Net Promoter Score (NPS)
Percentage of Promoters (Score 10, 9) *minus* Percentage of Detractors (Score 0–6) on an 11 point scale. NPS is a standard metric to measure advocacy across industries.

Margin of Error
Considering sample size for individual banks, ~3 percent margin of error applies at 95 percent level of confidence. Thus differences >=3 percent have been considered statistically significant in this report.

Interaction
Number of times any of the six channels (Branch, ATM, Debit card, Mobile banking, Call center, Internet) is used by a customer.

Human Resources Research

The objective of the HR survey was to compare and understand the different approaches taken by banks towards recruiting, training, managing and rewarding their employees. The responses of this survey were linked to employee engagement and effectiveness.

Banks were surveyed across topics including manpower requirement, recruitment, training, performance management system and talent management. HR departments filled in the survey which was then analyzed bank category wise for the report.

Additionally, 57,205 employees across banks filled an online survey aimed at measuring employee engagement and effectiveness. Engagement questions in this survey were on a 4 point scale ranging from "Strongly Disagree" to "Strongly Agree".

Definitions

Frontline sales staff
Contract sales employees and in–house Feet on Street (FOS)

Generation Gap
Average difference in age between a new joinee (25 years) and his immediate senior

Net Agreement Score
Percentage of employees that strongly agree (Score 4) *minus* Percentage of employees that strongly disagree (Score 1) on a 4 point scale. This metric has been defined to bring out difference between banks.

Information Technology Research

Information Technology survey was aimed at arriving at an understanding of banks' approach to IT projects and investments. IT departments of banks were surveyed to understand their IT cost drivers, projects portfolio and pipeline, ability to manage IT vendors and business–technology interaction. Interviews were conducted across different bank categories to develop deeper understanding of banks' responses. Results were analyzed across various bank categories and compared with global benchmarks arising out of various international surveys conducted by BCG.

Participating Banks (as shown in Table 2)

26 bank's customers were surveyed for customer research: 3 Private New Big, 3 Private New Small, 3 Private Old, 6 PSU Large and 11 PSU Medium banks.

30 banks participated in the HR survey: 3 Private New Big, 3 Private New Small, 5 Private Old, 6 PSU Large and 13 PSU Medium banks.

31 banks participated in the employee survey: 2 Private New Big, 2 Private New Small, 5 Private Old, 6 PSU Large and 16 PSU Medium banks.

31 banks participated in IT survey: 3 Private New Big, 3 Private New Small, 5 Private Old, 6 PSU Large and 14 PSU Medium banks.

TABLE 2: PARTICIPATING BANKS BY CATEGORY		
Sr. No.	Bank	Category
1	Axis Bank	**Private New Big**
2	HDFC Bank	
3	ICICI Bank	
4	IndusInd Bank	**Private New Small**
5	Kotak Mahindra Bank	
6	Yes Bank	
7	Federal Bank	**Private Old**
8	ING Vysya Bank	
9	Karnataka Bank	
10	Karur Vysya Bank	
11	The South Indian Bank	
12	Bank of Baroda	**PSU Large**
13	Bank of India	
14	Canara Bank	
15	Punjab National Bank	
16	State Bank of India	
17	Union Bank of India	
18	Allahabad Bank	**PSU Medium**
19	Andhra Bank	
20	Bank of Maharashtra	
21	Catholic Syrian Bank	
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	State Bank of Mysore	
30	State Bank of Patiala	
31	UCO Bank	
32	United Bank of India	
33	Vijaya Bank	

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A report by The Boston Consulting Group, September 2010

NOTE TO THE READER

About the Authors
Saurabh Tripathi is a Partner & Director in the Mumbai office of The Boston Consulting Group. Bharat Poddar is a Partner & Director in BCG's Mumbai office. Ashish Garg is a Partner & Director in BCG's New Delhi office. Avartan Bokil is a Principal in the firm's Mumbai office. Gaurav Malhotra is a Principal in the firm's New Delhi office.

For Further Contact
If you would like to discuss the themes and content of this report, please contact:

Alpesh Shah
BCG Mumbai
+91 22 6749 7163
shah.alpesh@bcg.com

Ashish Garg
BCG New Delhi
+91 124 459 7123
garg.ashish@bcg.com

Ashish Iyer
BCG Mumbai
+91 22 6749 7249
iyer.ashish@bcg.com

Bharat Poddar
BCG Mumbai
+91 22 6749 7145
poddar.bharat@bcg.com

Neeraj Aggarwal
BCG New Delhi
+91 124 459 7078
aggarwal.neeraj@bcg.com

Pranay Mehrotra
BCG Mumbai
+91 22 6749 7143
mehrotra.pranay@bcg.com

Ruchin Goyal
BCG Mumbai
+91 22 6749 7147
goyal.ruchin@bcg.com

Saurabh Tripathi
BCG Mumbai
+91 22 6749 7013
tripathi.saurabh@bcg.com

Acknowledgments
This report has been prepared by The Boston Consulting Group. The authors would like to thank IBA for help with conducting surveys within member banks. The analysis of the survey has been included in this report. The authors also gratefully acknowledge the contributions of Hardik Shah, Jitesh Shah, Kanika Sanghi, Prateek Roongta and Priyanka Baxi in conducting various analyses for this report and David Nazareth and Nikit Shah for supporting analysis. A special thanks to Jasmin Pithawala for managing the marketing process and Jamshed Daruwalla, Kim Friedman, Pradeep Hire, Rahul Surve, Nevin Varghese and Sajit Vijayan for their contributions towards the design and production of this report.

The authors gratefully acknowledge the data collection efforts on various HR and technology related metrics from 33 participating banks made by the respective nodal teams as listed below. This report would not have been possible without their invaluable support.

Mr. Mithilesh Kumar
Allahabad Bank
PSU (Medium)

Mr. V. S. N. Sarma
Andhra Bank
PSU (Medium)

Mr. Julius Samson
Axis Bank
Private (New)

Mr. Sanjay Mudaliar
Bank of Baroda
PSU (Large)

Mr. Milind Vaidya
Bank of India
PSU (Large)

Mr. M. K. Biswas
Bank of Maharashtra
PSU (Medium)

Dr. U. V. Rao
Canara Bank
PSU (Large)

Mr. Shibu P. Varghese
Catholic Syrian Bank
Private (Old)

Mr. Ajay Rath
Central Bank of India
PSU (Medium)

Mr. H. S. Srinath
Corporation Bank
PSU (Medium)

Mr. A. C. Katial
Dena Bank
PSU (Medium)

Mr. Babu Thomas / Mr. Jose Francis
Federal Bank
Private (Old)

Mr. Ripal Sheth
HDFC Bank
Private (New)

Mr. T. K. Srirang / Mr. Subhendu Tripathy
ICICI Bank
Private (New)

Ms. Sapna Karkera
IDBI Bank
PSU (Medium)

Mr. T. Jayashankar
Indian Bank
PSU (Medium)

Mr. M. S. Hariharan / Ms. R. Usha
Indian Overseas Bank
PSU (Medium)

Mr. Nikhil Anand
IndusInd Bank
Private (New)

Ms. Sonalee Panda
ING Vysya Bank
Private (Old)

Mr. Anantha Padmanabha
Karnataka Bank
Private (Old)

Mr. G. Sampath
Karur Vysya Bank
Private (Old)

Ms. Shilpa Joshi
Kotak Mahindra Bank
Private (New)

Mr. Kuldeep Bhalla
Oriental Bank of Commerce
PSU (Medium)

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

Mr. Rajinder Mirakhur
State Bank of India
PSU (Large)

Mr. Shyamgopal
State Bank of Mysore
PSU (Medium)

Mr. S. Ramesh / Mr. Sanjeev Mahajan
State Bank of Patiala
PSU (Medium)

Mr. A. Narendran
The South Indian Bank
Private (Old)

Mr. Padmalochan Acharya
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. Deodutta Kurane
Yes Bank
Private (New)

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India

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Mail: Federation of Indian Chambers of Commerce & Industry
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New Delhi – 110 001
India

Please contact IBA at:
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Fax: +91 22 22184222, attention IBA/Permissions
Tel: +91 22 22174012
Mail: Indian Banks' Association
Corporate Communications, Centre 1
6th Floor, World Trade Centre,
Cuffe Parade
Mumbai – 400 005
India

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