

# COMPETITIVENESS of Indian Commercial Banks



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- **How has the Indian Banking Sector performed?**

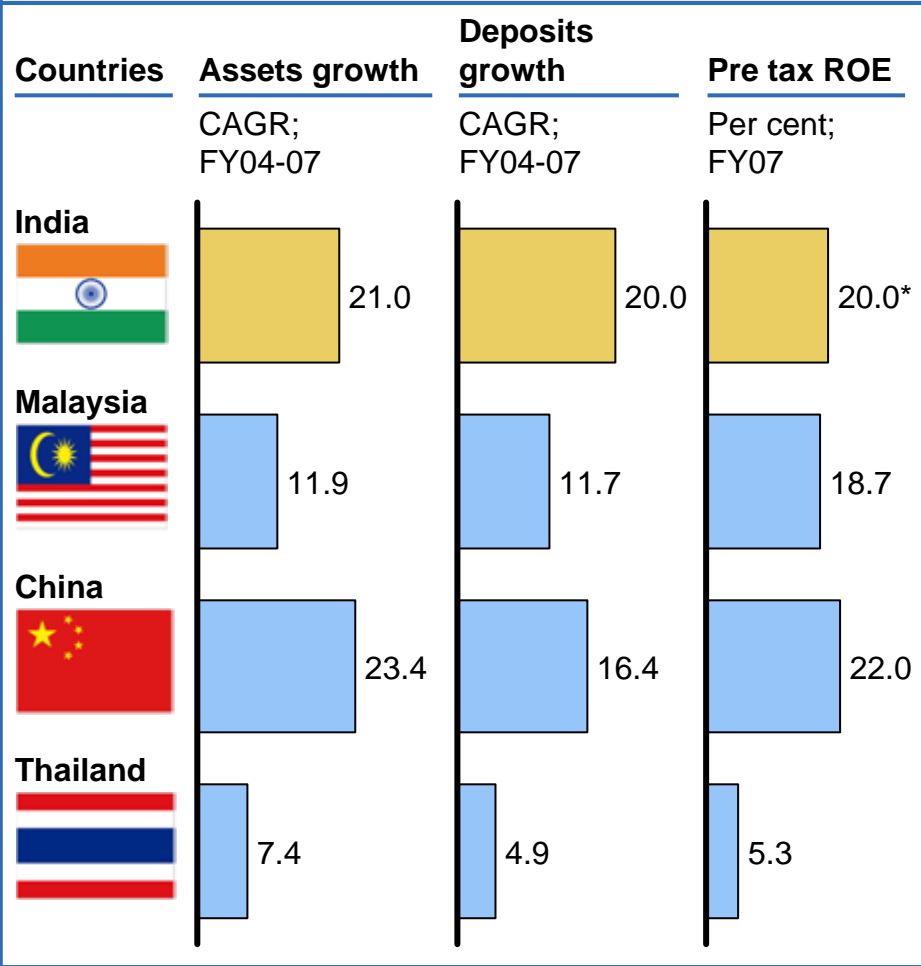
- How competitive are Indian commercial banks and what are the core capability gaps?

- What is the role of Regulators and Policy-makers in enhancing sector competitiveness?

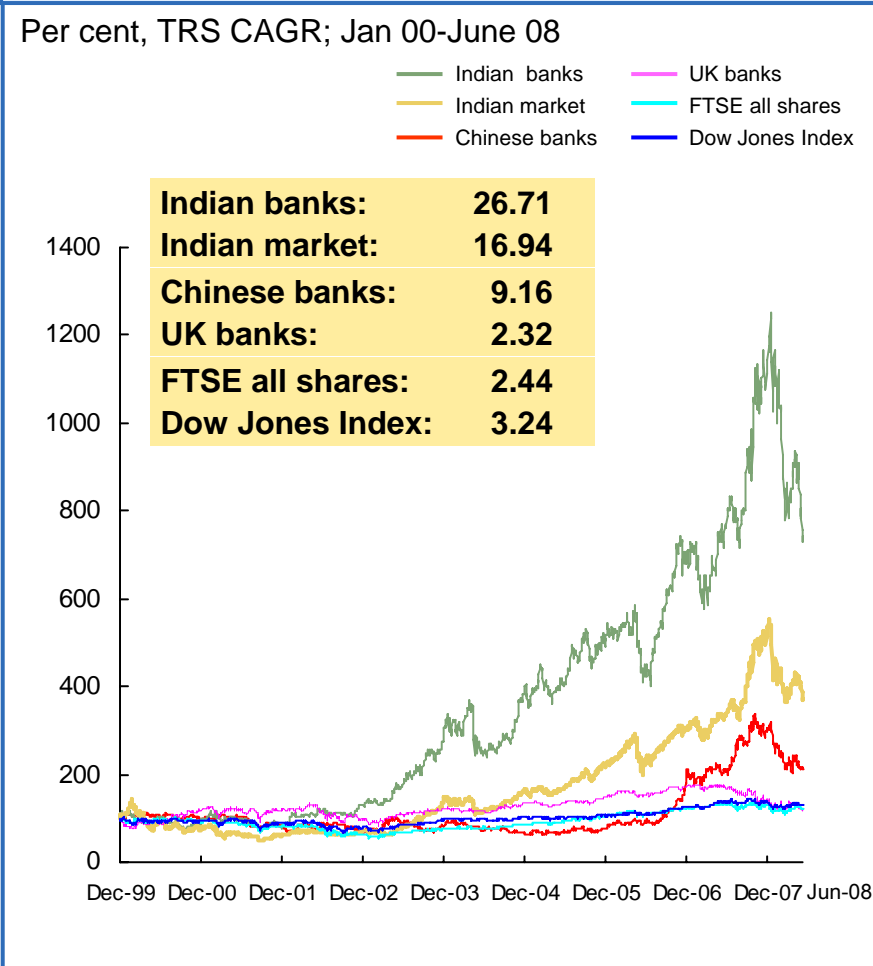


# INDIAN BANKS HAVE PROVIDED HIGH RETURNS TO SHAREHOLDERS OVER THE LAST FEW YEARS

India has achieved high growth and maintained high profitability



Indian banking sector has outperformed most banking indices

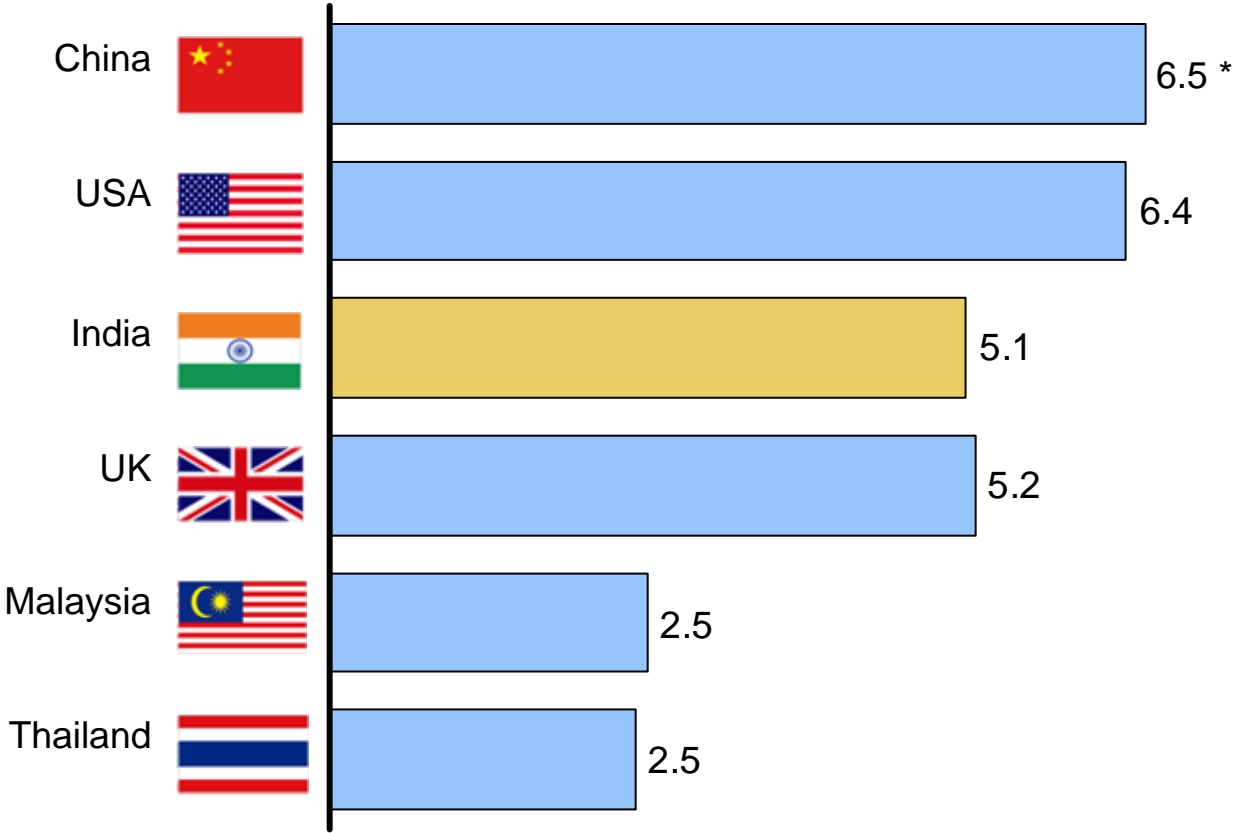


\* Pre-tax profitability calculated by adjusting post-tax ROE

# THE SECTOR HAS MADE A HEALTHY CONTRIBUTION TO GDP GROWTH AND EMPLOYMENT CREATION

Indian banking sector's contribution to GDP is healthy, almost at par with developed countries. . .

Banking sectors value-added to nominal GDP (per cent; 2007)



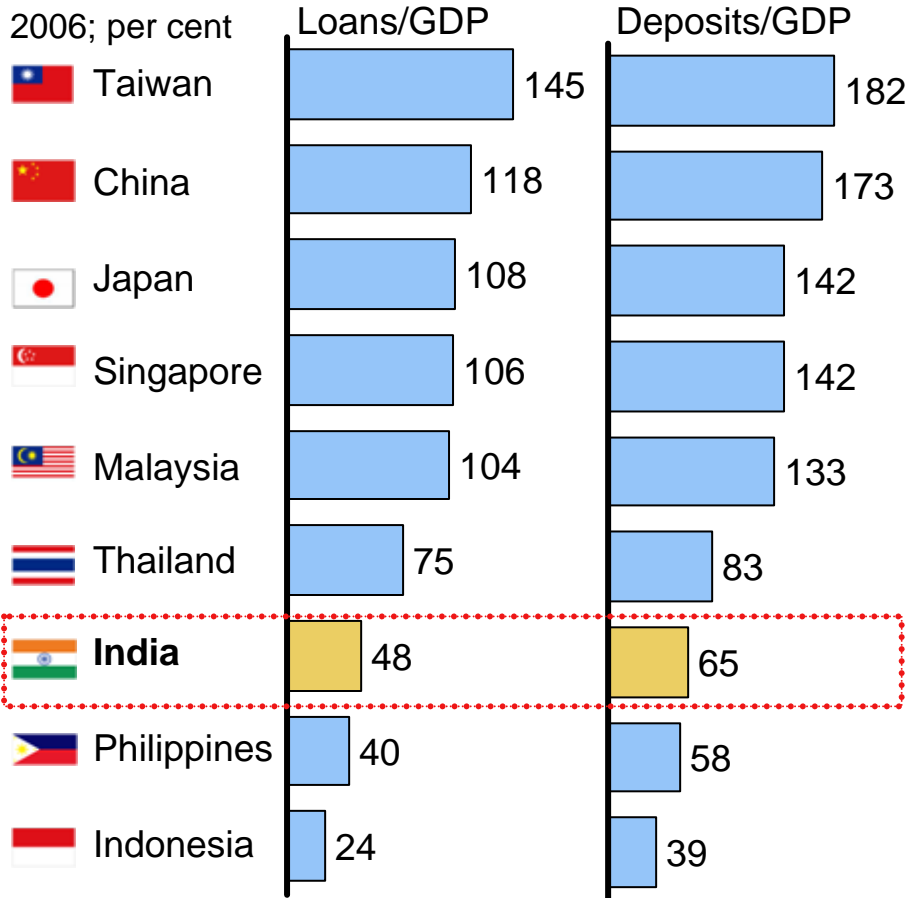
\*China data for 2006

. . . and has the potential to employ people in large numbers

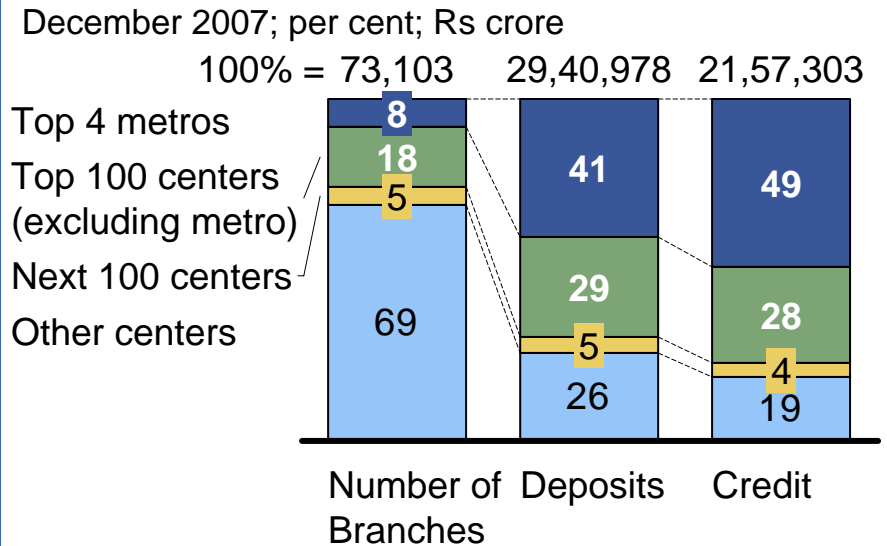
- Financial services can employ as many as 3.6 million people by 2010 and can double the number of people employed in financial services to 7.4 million by 2020

# HOWEVER, THE SECTOR STILL FARES POORLY ON FINANCIAL ACCESS AND DEEPENING

## Level of banking intermediation low compared to other economies



## Access to banking services concentrated in few centers



- Poor benchmarks on non-branch access modes (25 ATMs per million people in India\* as compared to 51 in China\*\*, 193 in Brazil\*\* and 246 in Mexico\*\*)
- Top 100 corporates account for ~50% of total credit – SMEs starved for credit

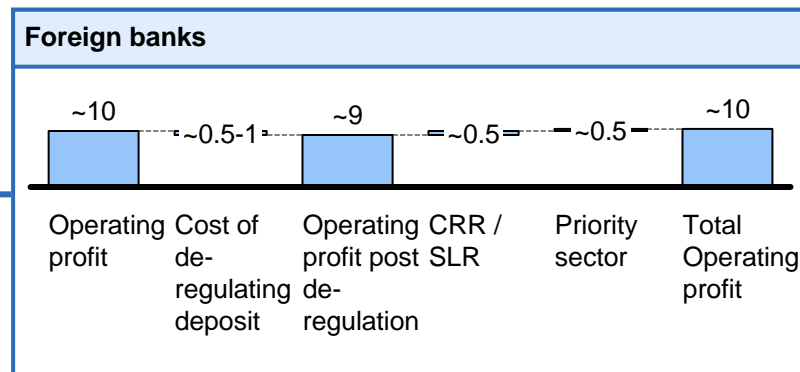
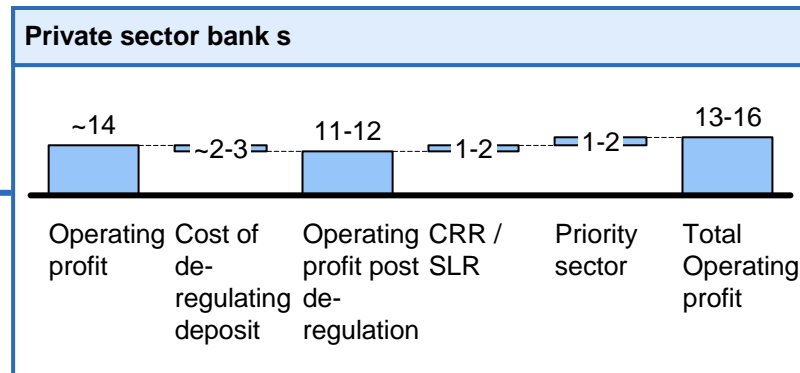
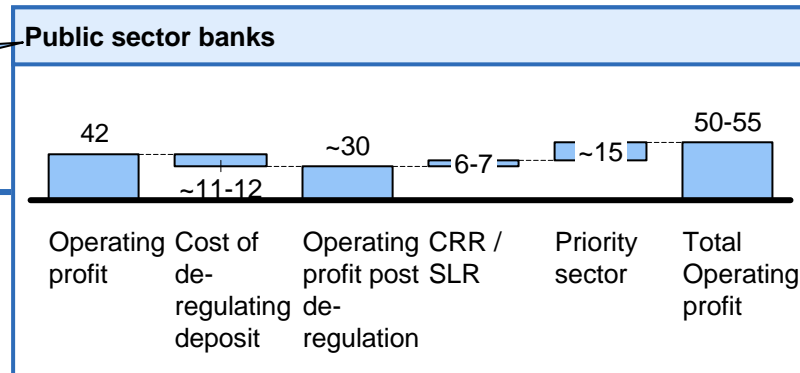
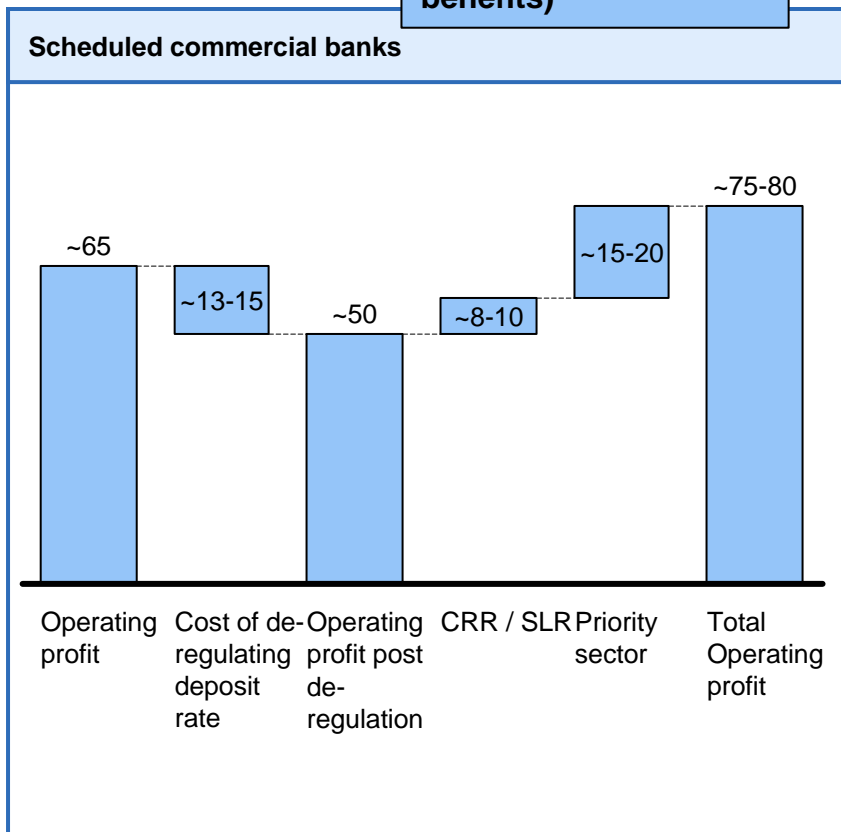
\* ATM numbers for India for 2007

\*\* ATM numbers for China, Brazil, Mexico for 2006

# THE “GRAND BARGAIN” IS HURTING THE SECTOR TO THE TUNE OF ~INR 10,000-15,000 CRS

Rs. '000 crores

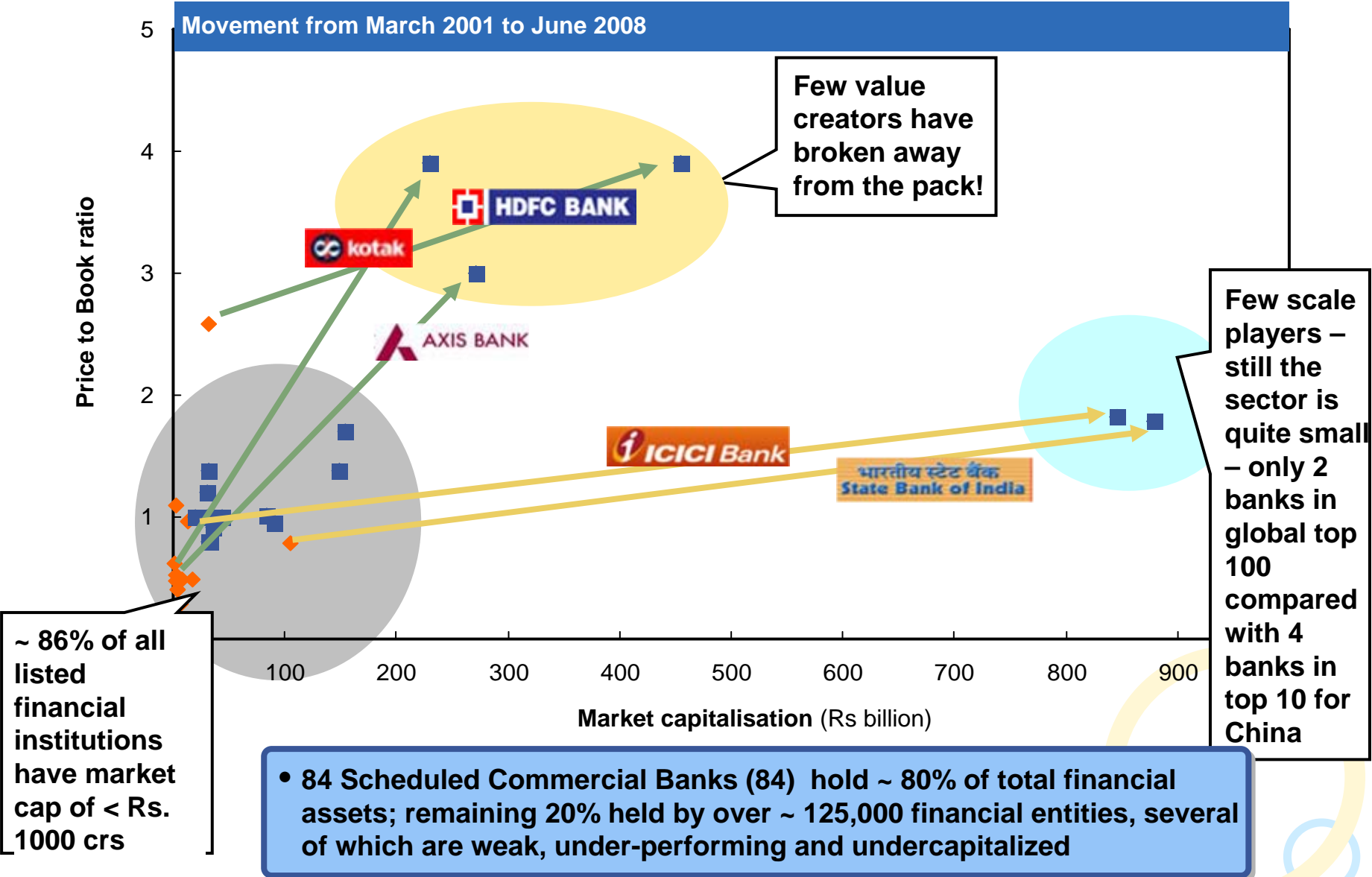
Maximum negative impact of regulatory obligations (net of benefits)



\* Operating profit as defined by the RBI

# SIGNIFICANT FRAGMENTATION AND POLARIZATION OF THE SECTOR – RAISING CONCERNS ON SECTORAL STABILITY

ILLUSTRATIVE



Source: Prowess; Team analysis

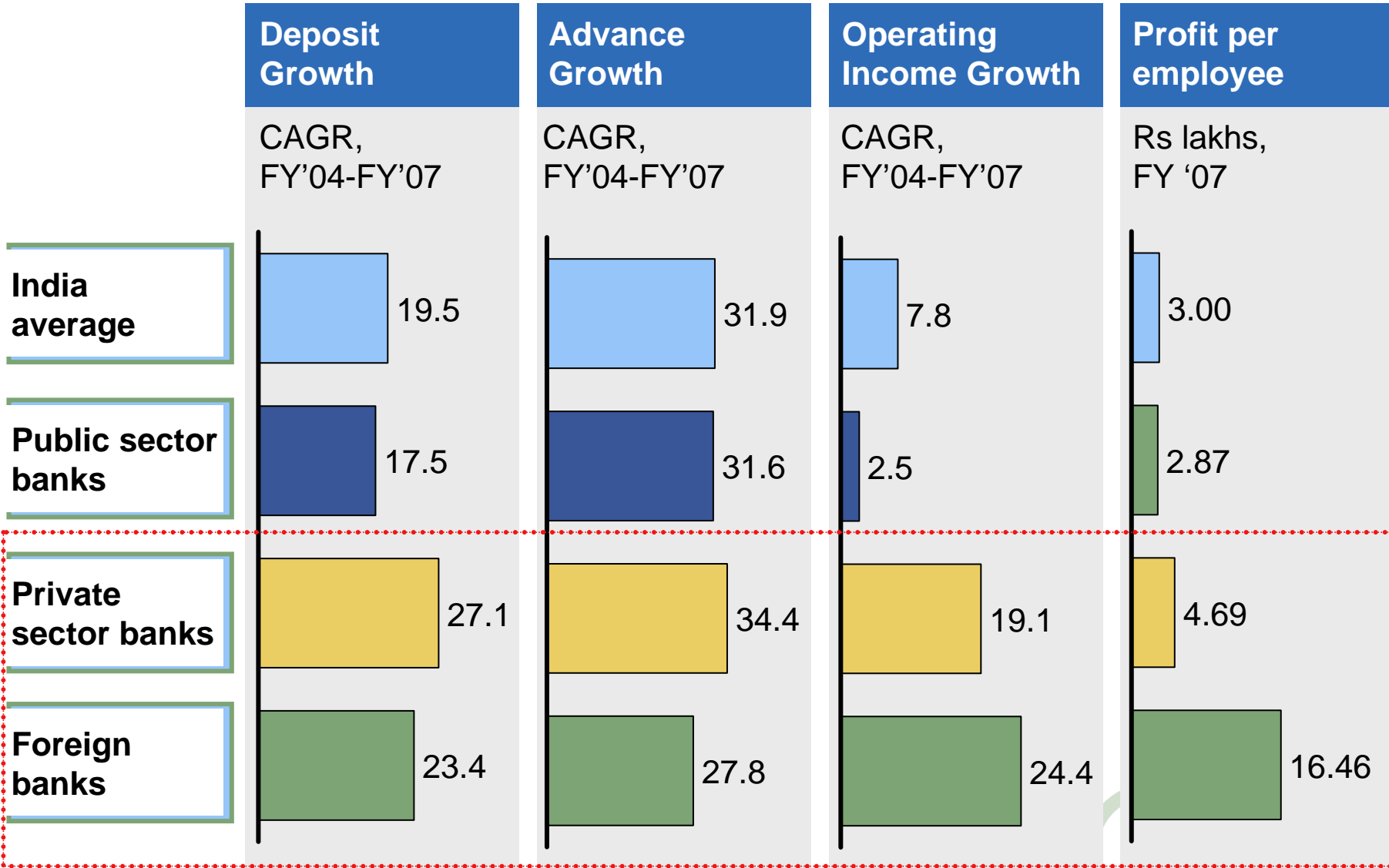
- How has the Indian Banking sector performed?

- **How competitive are Indian commercial banks and what are the core capability gaps?**

- What is the role of Regulators and Policy-makers in enhancing sector competitiveness?

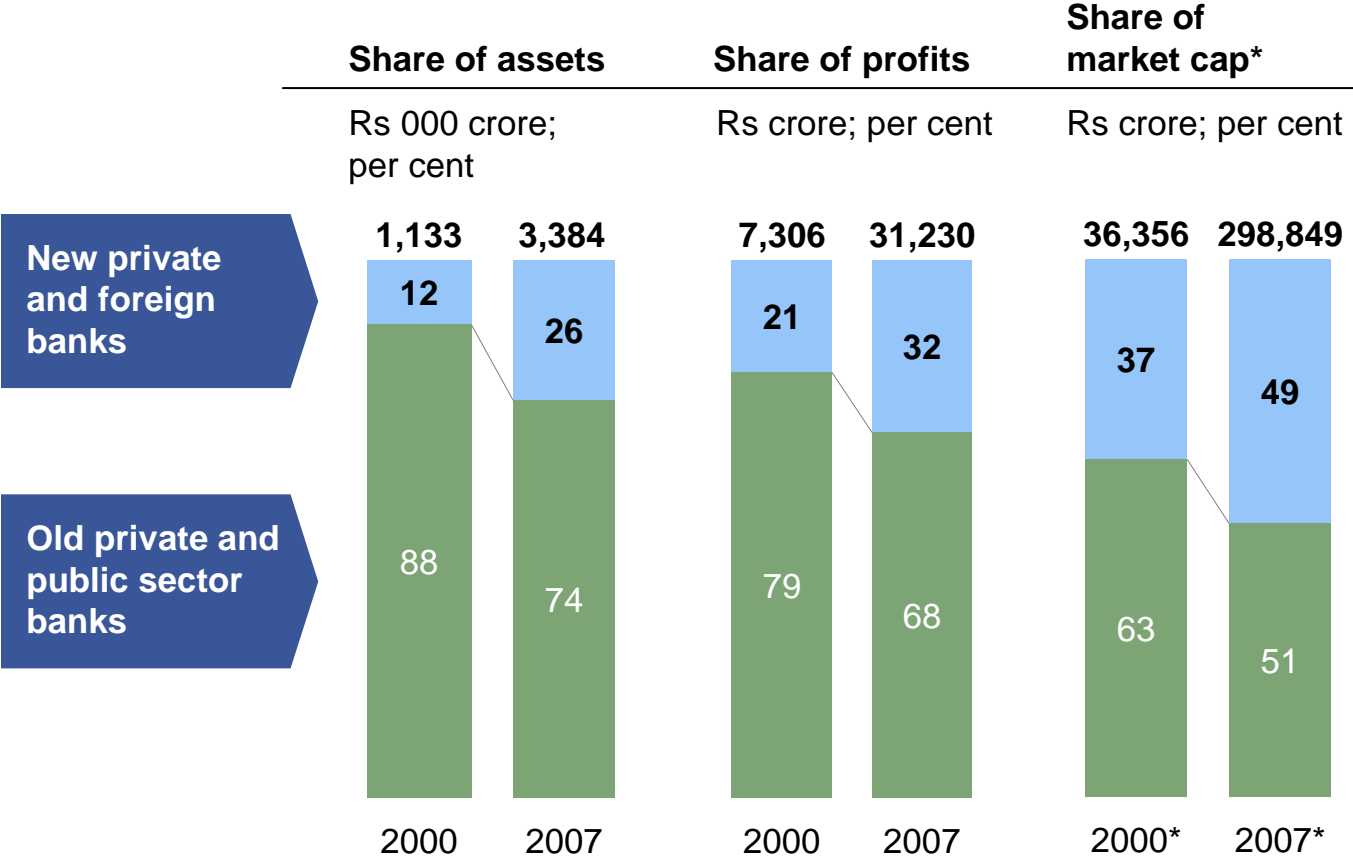


# PRIVATE AND FOREIGN BANKS HAVE SHOWN HIGHER GROWTH AND PROFITABILITY COMPARED TO PUBLIC SECTOR BANKS



Source: RBI

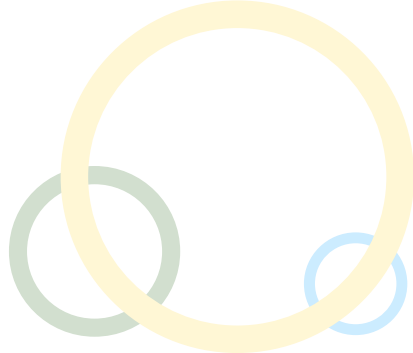
# AS A RESULT, VALUE HAS MIGRATED TOWARDS NEW PRIVATE SECTOR AND FOREIGN BANKS



\* As of March 2007; market cap for banks not listed in FY00 imputed using a price to book value of peers

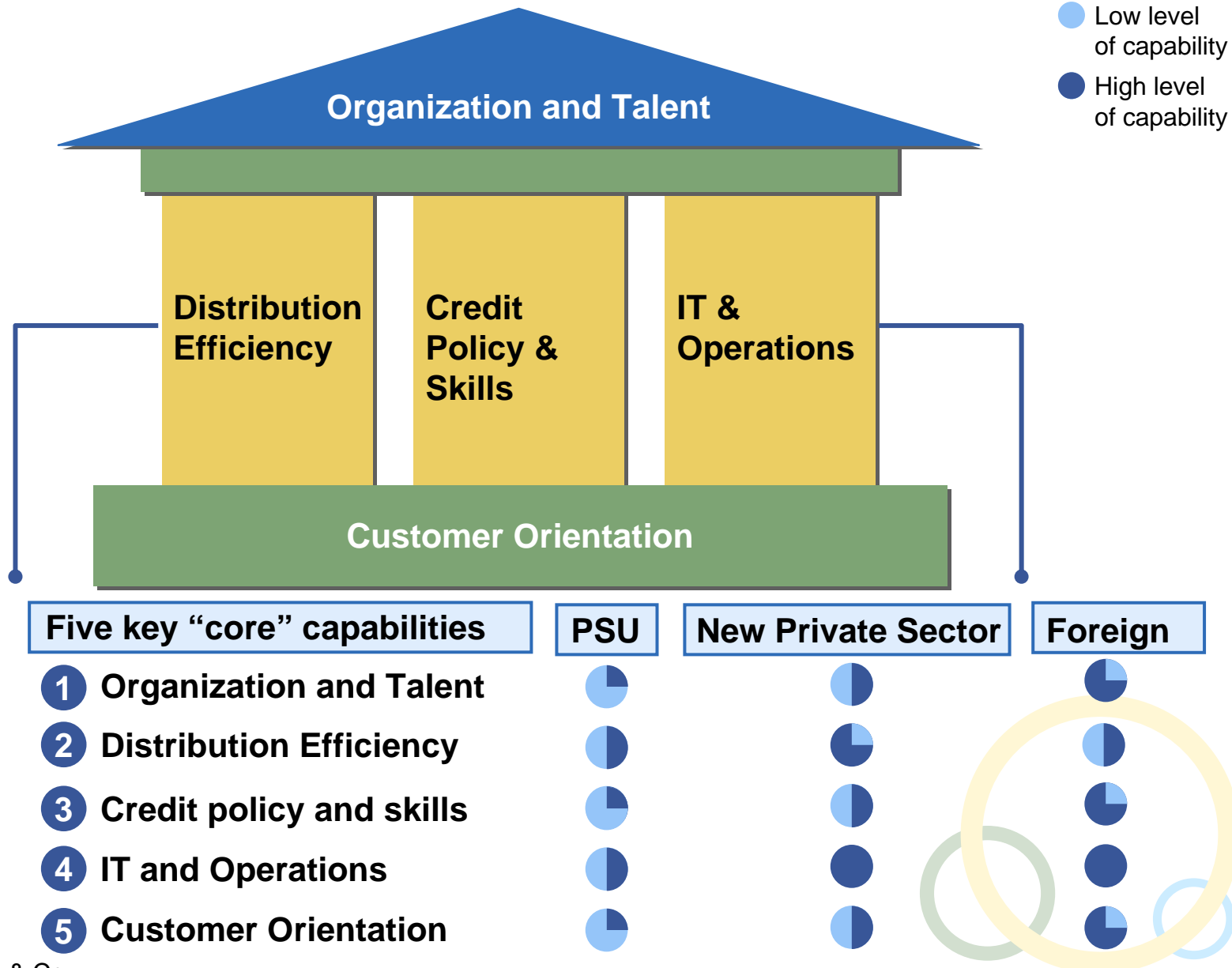
\*\* Foreign banks not included in market cap analysis as they are not listed

Source: CMIE-Prowess; DataStream; Bloomberg; annual reports; McKinsey analysis

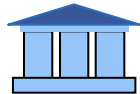


# THIS 'BREAKAWAY' PERFORMANCE IS DRIVEN BY GAPS ACROSS FIVE CORE CAPABILITY DIMENSIONS

ILLUSTRATIVE

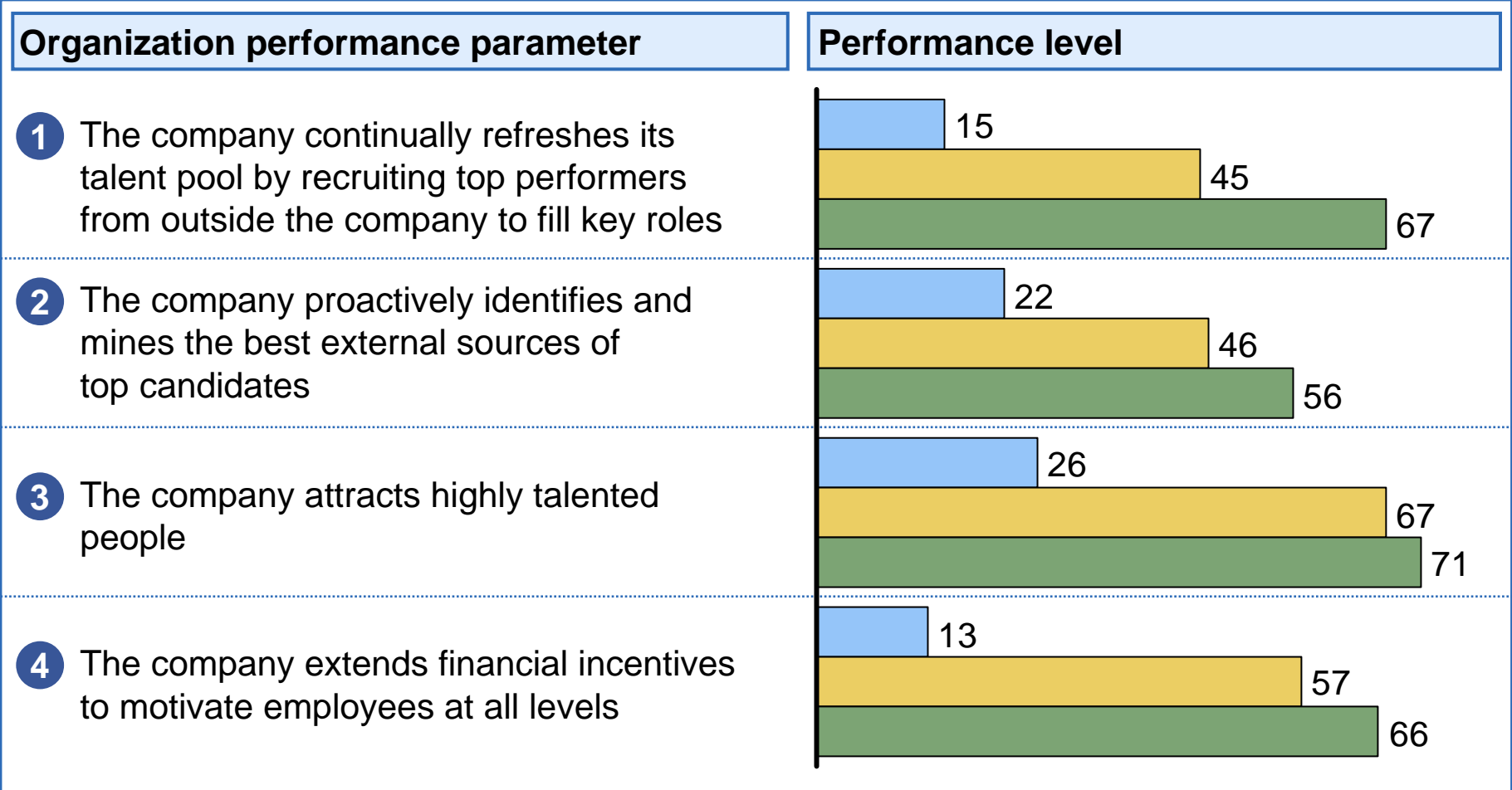


# TALENT AND PEOPLE DEVELOPMENT WILL BE THE BIGGEST CHALLENGE FOR INDIAN BANKS, PARTICULARLY FOR PSUs



■ PSU  
■ Private  
■ Foreign

Per cent responding strongly agree or agree; 2007

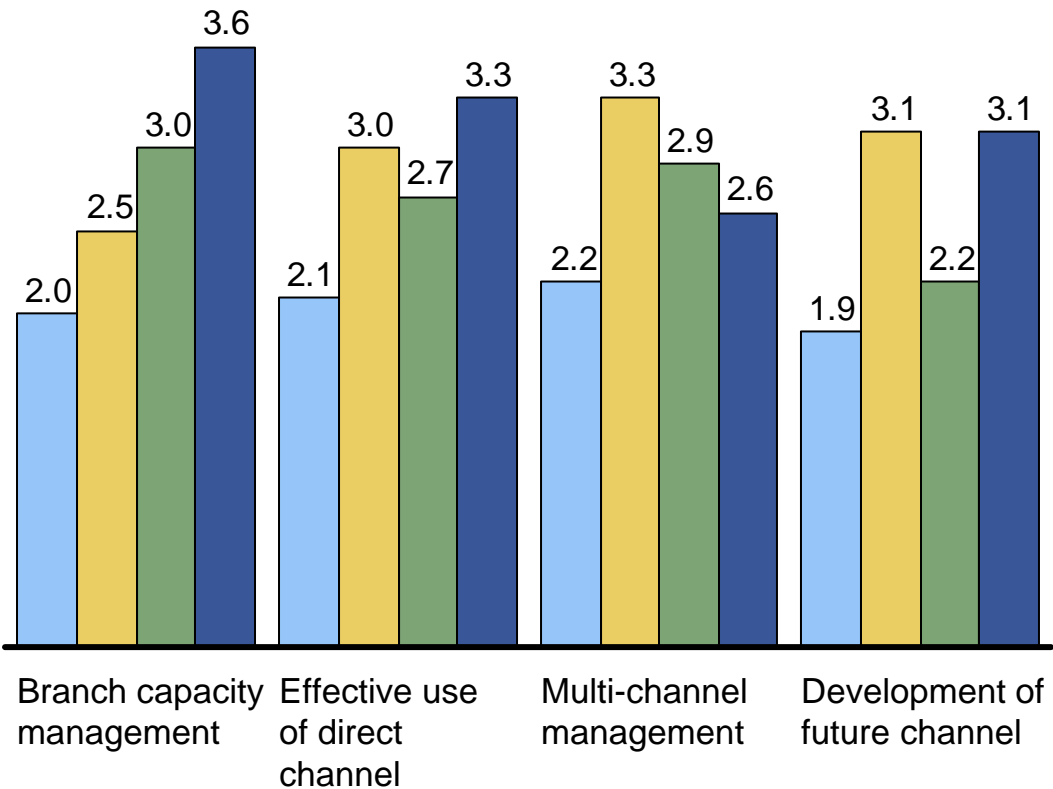


Source: McKinsey & Company Proprietary Organisation Performance Profile survey of leading banks in India (n = 1,024); Financial Services 360, Indian Banking – Towards Global Best Practices

# PRIVATE SECTOR BANKS HAVE PIONEERED GLOBAL STANDARDS OF EFFICIENCY IN DISTRIBUTION

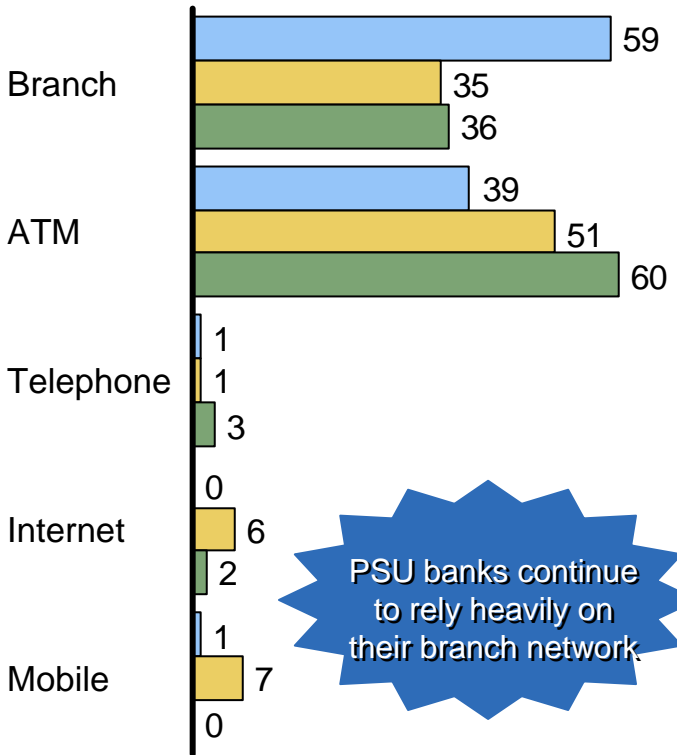


**Private sector and foreign compare favorably against global peers on distribution efficiency\***



**Private sector and foreign banks have a higher usage of alternate channels**

Per cent using a particular channel

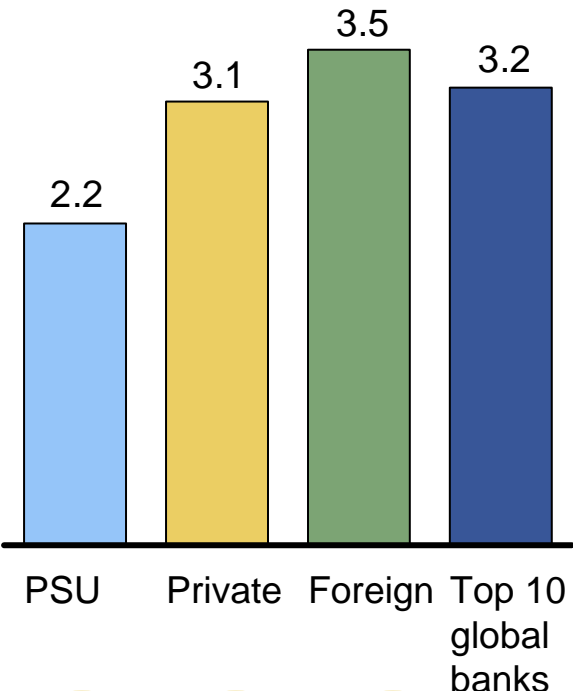


\* Scale of 0-4, 0 being the lowest and 4 being the highest

# INDIAN BANKS COMPARE FAVORABLY AGAINST GLOBAL CREDIT AND RISK BEST PRACTICES

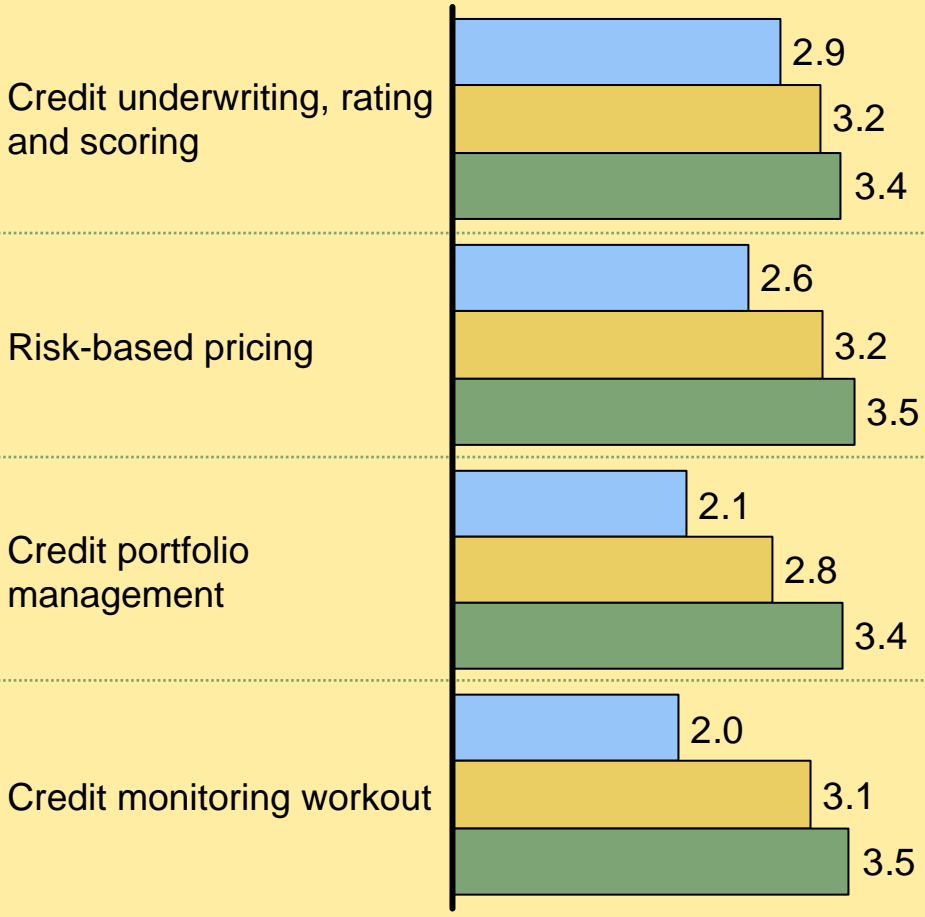
■ PSU  
■ Private  
■ Foreign  
■ Global Top 10 banks

Private sector and foreign banks in India exercise best-in-class credit skills and policy\* ...



Gross NPA ratio, FY '07	2.7%	1.9%	1.8%
Net NPA ratio, FY '07	1.1%	1.0%	0.7%

... However, PSU banks lag behind significantly\*

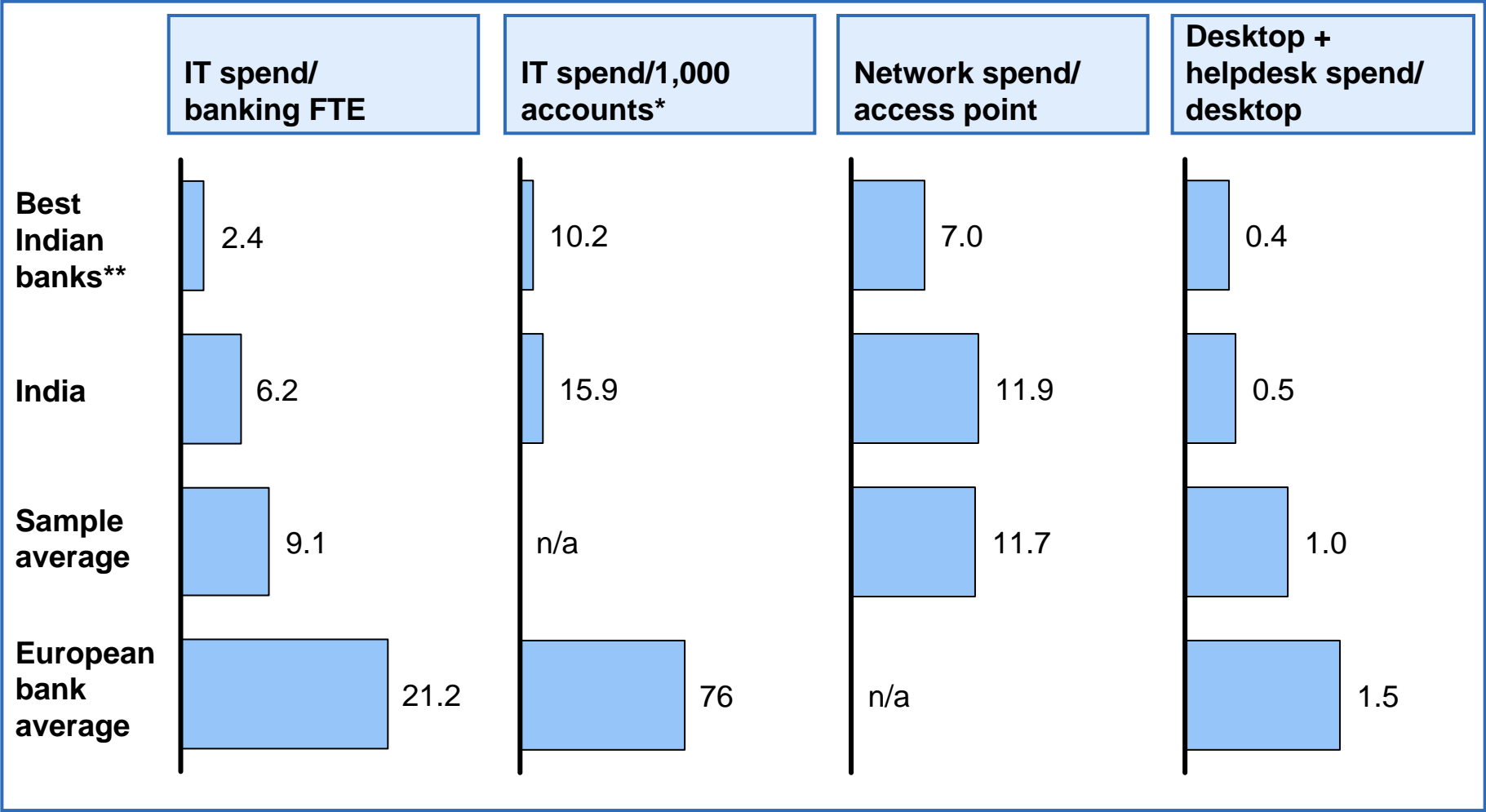


\* On a scale of 0-4, 0 being the lowest and 4 being the highest

# ON TECHNOLOGY THE BEST BANKS IN INDIA ARE AMONG THE MOST EFFICIENT IN THE WORLD



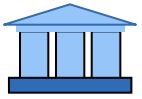
US\$ 000s; 2007



\* Accounts include only deposit accounts

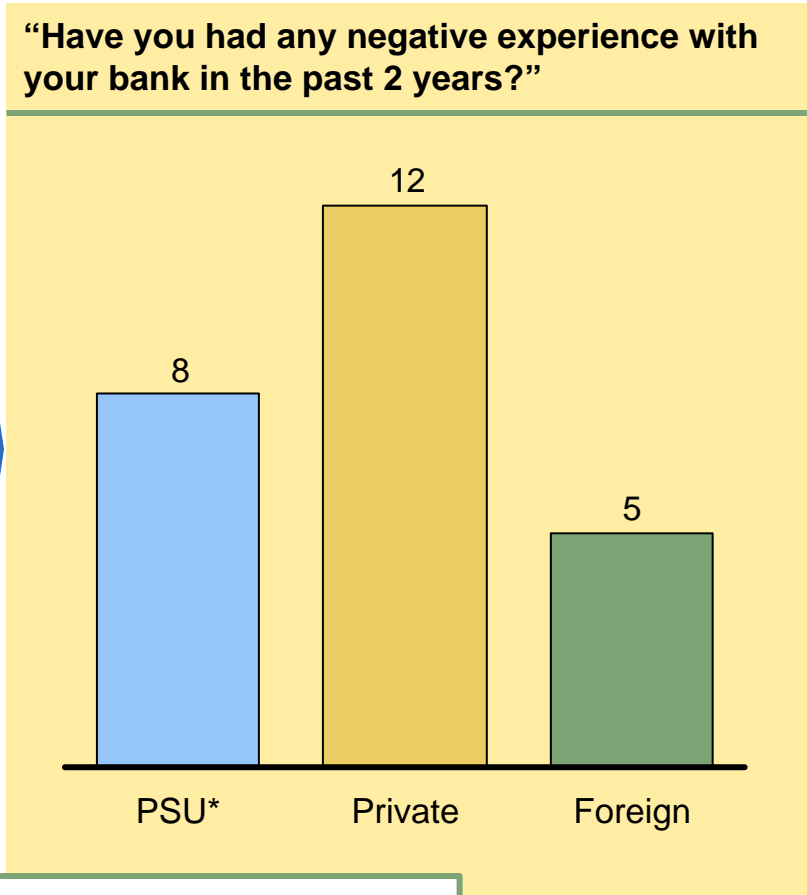
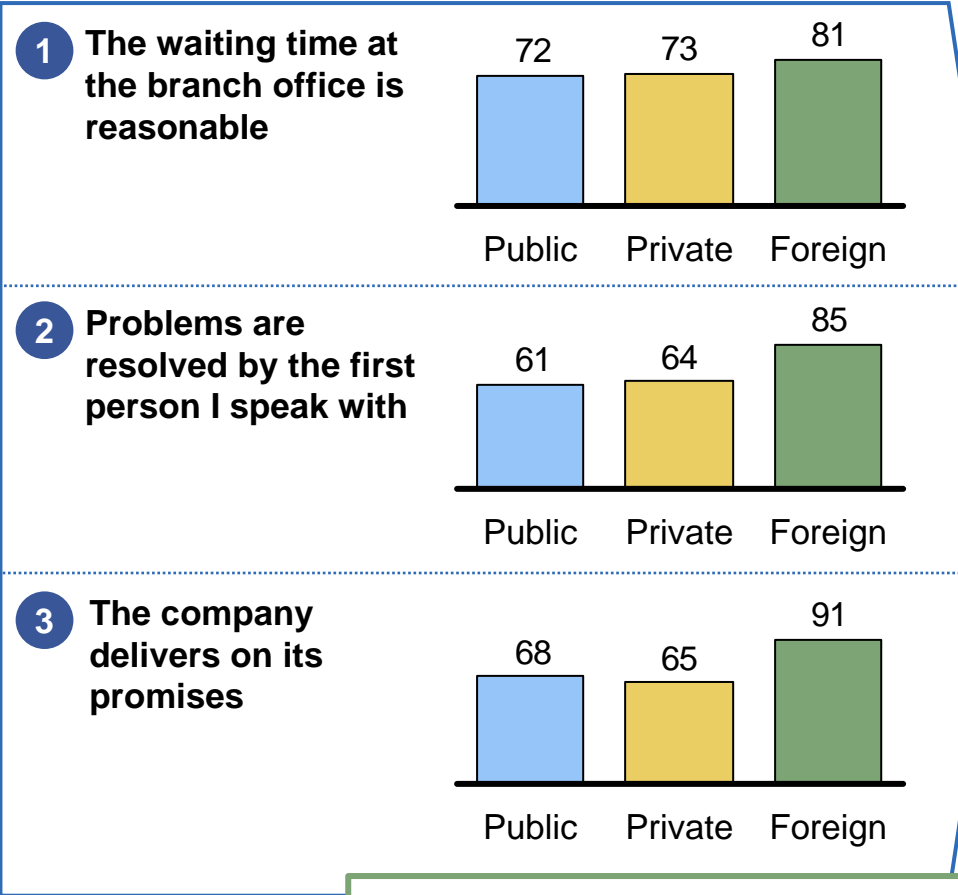
\*\* Sample set of best banks in India includes 5 leading private and foreign banks

# INDIAN BANKS ARE NOT GEARED TO MEET INCREASING CUSTOMER DEMANDS AND SERVICE EXPECTATIONS



■ PSU  
■ Private  
■ Foreign

Per cent responding strongly agree or agree; 2007



**New emerging segments likely to drive need for superior services**

- Affluent customers
- Young professionals

\* Includes old private

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# SEVERAL SYSTEMIC INEFFICIENCIES PLAGUING THE SECTOR



**Fragmented industry structure with too many small players**

**State-owned banks underperforming due to constraints on management and capital**

**Regulations weakening competition among players and inhibiting operational flexibility**

**Constraints on foreign bank expansion**



**Fragmented regulatory structure suboptimal as banking/non-banking activities converge**

**Inadequate legal and information infrastructure**

# NEED FOR BOLD REGULATORY MOVES ACROSS FOUR DIMENSIONS

## Key recommendations

### Create a “level playing field” between players

- Strengthen PSU banks
  - Sell under-performing players; merge smaller ones with larger PSUs
  - Better governance through Board reforms (independent selection of members, non-Govt shareholder nominees)
  - Create state-linked banks as an alternative to privatization
- Define compulsory minimum standards for performance, governance and risk management to ensure that continuously under-performing players cannot survive through regulatory grace
- Ease restrictions on foreign players: New banking license restrictions, branch expansion restrictions, equity ownership caps

### Foster efficiency and competition within the system

- Remove key regulations that restrict bank efficiency
  - Branch approval process & closure norms, priority sector lending, CRR and SLR norms, interest rate caps and minimum loan sizes, labour market restrictions

### Promote scale efficiencies

- Allow banks freedom to adopt a bank-parent model, holding company model or integrated bank model and actively facilitate much broader scope of business
- Facilitate back-office outsourcing – e.g., encourage state-owned banks to unify back offices or facilitate creation of a shared industry-wide utility

### Coordination between regulators

- Sound out attitude of other regulators about coordinating activities
- Move over time to a coordinated regulator model
- Move over time to one regulator in the long term (if feasible and still deemed desirable)

**END OF PRESENTATION**

