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Aditya Puri's 30% Formula

Vinod Mahanta

Sitting in the boardroom in the sixth-floor office of HDFC Bank headquarters, Aditya Puri lets us in on an inside secret. The CEO of HDFC Bank confesses, "By the time everyone walks into the office, I am already upset." Now that sounds a bit strange. The bank he runs doesn't have ICICI Bank's aggressive ambition, Axis Bank's momentum or even State Bank of India's problems in aviation to stir things up. Even during the exciting results season, he follows his self-confessed 'boring' credo to the T, posting similar results every quarter. So what could possibly set Puri off? Well, it could be one of the many things he constantly has on his plate: a delay in project somewhere, cost overruns, fluctuating service levels. "Don't get fooled by my designation. I look into 500 things at a time. Nothing moves here without my consent," he says.

It seems he has taken a leaf out of Ram Charan and Larry Bossidy's book *Execution*, which says excellence is about two things: doing the same thing over and over again every Monday morning and following through incessantly. But as a corollary, Puri has managed to create a world-class Indian bank in 18 years.

How has he managed it? "If GDP grows at 8%, the banking system will grow at 20%, which is a multiplier of two and a half," says Puri. "When the growth rate is higher, we gain higher market share. So if you have 8% growth rate, our growth rate normally is five or six per cent more than the system," he explains, with a Cheshire Cat smile. The answer is not as simplistic as Puri makes it sound. So then how has HDFC managed to outperform its peers through difficult times?

Before we go to the how, a look at the numbers will give a sense of bank's growth. HDFC Bank's customer base currently stands at 25 million, having grown at 35 % CAGR since 2001. The branch network stands at 2544, having added 819 branches in the last two years. The real story, however, is not just growth but the "quality of growth". The superior quality of its funding franchisee - currents and savings account (CASA) at 48% - provides the bank a sticky and low-cost source of funding. And just how good that is can be gauged from the fact that compared to its peer group average of 36%, the bank has maintained an average CASA ratio of 56% over last seven years. And what a high CASA does is give the bank, a Net Interest Margin (NIM) of 4.2%, a good profitability number for any bank. Take a look at another key metric, a quality asset mix: the gross NPAs are just over 1% and have been actually declining in the last 10 quarters.

GO TO MARKET

Given that demand was abundant in underbanked India, the way HDFC positioned itself to take advantage of that demand is a case study. Though it did not have the products of the multinational banks and the reach of the public sector banks, the Bank's growth story is a story of continuous evolution and keeping a conservative approach. The bank did not expand too aggressively in a product without building appropriate capabilities. However, it did not lag on growth or market share gains either. "A conservative approach, in the context of HDFC Bank, means the bank did not compromise on margins and asset quality risks and has waited for the right opportunities.." says Sameer Lumba, Managing Director & CEO, JM Financial Institutional Securities.

During the first decade, the focus was on urban centres, but today semi-urban and rural areas generate a large chunk. "Some 4-5 years back, 80% of their income came from the top 15 cities, today 40% comes from semi urban and rural areas. That's an amazing strategic shift," says Nandan Savnal, an ex-banker and a keen industry watcher. Granular planning has allowed the bank to stagger investment in a way that present performance doesn't suffer while the future growth drivers are also being put in place. "We plan our growth across three horizons: one that I can see in front of me; second, what I can see in front of me but will become a big business five years from now; third, at the bottom of the pyramid, which will become a big business, maybe five years from now," says Puri. Today, nearly 35% of the branches will be making a loss because it takes 20-24 months before a branch breaks even. But that's growth in 2014.

The bank has also snatched market share from its competitors. For example, HDFC Bank's retail loans as a percentage of system retail loans, have increased 7.2 (Dec'07) to 13.2 (March'12). "We have been consistently gaining market share. The overall banking system grew every year at roughly 2.5 times real GDP growth, while we grew 3-5% faster than the system," says Paresh Sukthankar, Executive Director, HDFC Bank.

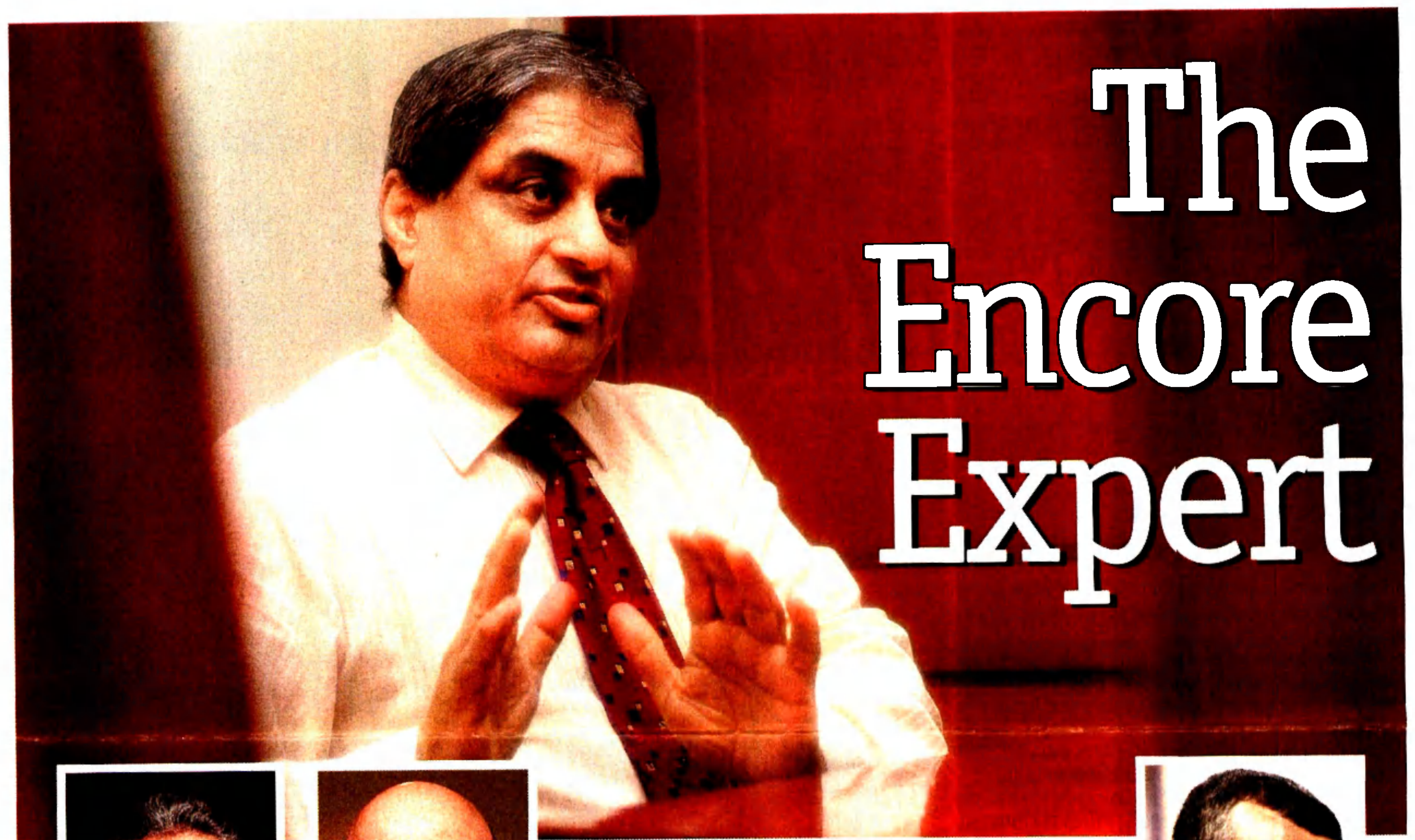
Of course, the bank has an enviable interest side income profile, but on the non-interest income side too, the bank does not rely on investment banking (a chink in the bank's armour) and project financing like other banks. Its strength is in the services it started with during its salad days of corporate banking - transaction banking, loan processing, private banking, forex services - and third party distribution that give it a strong fee income distribution.

THE BALANCING ACT

Puri has also not only managed the customer acquisition on both retail and corporate side very well for stability in profitability. During the last seven years, when retail was the main driver of growth, many banks were not growing wholesale or corporate banking and therefore suffered when retail slowed in 2008. HDFC Bank continued its focus on both, retail and corporate, and with its diversified product portfolio managed topline and bottomline stability.

The Encore... Continued on page 2...

The Encore Expert



Aditya Puri's... FROM PG 1

In an under-banked country, growing fast isn't a big issue, but growing while maintaining the margins is a whole different game. The bank's net interest margins are amongst the highest in the industry. Over last seven years, the Bank NIM stands at 4.4% versus peer group average of 2.8%. "If 50% of my portfolio is retail, my margin by definition has to be higher and if I take it lower I am putting the sustainability of my bank at a risk," says Puri. But given that retail is such a large component of the portfolio, the cost to revenue for the bank is higher than competition because of the cost of putting up new branches, especially in semi-urban and rural areas.

So now that the bank is stable with a solid base of branches and a robust product portfolio why not gun more aggressively for market share? "I could grow maybe 10% faster but am not sure whether I can manage the downside," says Puri. Even in its early days, HDFC Bank focused less on growth and more on quality assets, so NPAs were few. Thus, while other banks were spending a lot of time on legacy issues and salvaging bad loans, HDFC Bank focused on growth when the markets grew. It also helped that in that era, bank shares (other than SBI's) were not sought after. Consequently, Puri and his team were not obsessed with valuation. They had no compulsion to grow the balance-sheet at a fast pace.

WAIT AND WATCH

A cautious banker, Puri will not venture into a product headlong — it's a deliberate process of learning, adapting, creating viability, and then expanding gradually. In category after category where the bank is a leader — personal loans, gold loans, microfinance, two-wheelers, crop loans — it's been the same, deliberate process. In gold loans, for instance, the pilot started four-and-a-half years ago but the product was taken national only last year. "HDFC Bank did not blindly follow ICICI Bank in entering the retail loan space. It waited for the market to mature, practices to settle in, and the industry got a sense of the default pattern, particularly in products like credit cards and personal loans," acknowledges a banking expert.

Puri likes the deliberate growth path. "We don't bet the bank on anything. If we don't understand anything, we don't enter that space," says Puri. Even in a tough category like credit cards where major players are either bleeding or exiting, the bank is a market leader with 36% market share (more than 55 lakh cards), even after being a late entrant into the category and it's has been profitable throughout. "Even in 2008-09 and 2009-10 when the credit card industry was facing severe pressures because delinquencies had shot up and credit costs went up by, 2-3 times, we identified segments to focus on and grew in a cautious but sustained way." says Sukthankar. Today, 70% of the credit cards are issued to internal customers.

A carefully managed evolution process from a corporate bank catering to the Tatas, Birlas, Reliances, and Levers of the world helped too, as the leaderships in transaction banking helped it become a leader in current accounts too. Similarly due to Puri's experience at Citi, the bank mastered that which no bank could. It entered the unchartered territory of financing stock brokers, giving guarantees, extending loan against shares to retail investors. Armed with proper risk management techniques, it associated itself in every, way a bank with the stock market. Today more than 50% of the stock exchange settlement happens through the bank.

Since inception, HDFC Bank has a stated mission to be a world-class Indian bank. Puri and his team take that statement seriously. In benchmarking exercises, the bank's metrics are measured against global peers to gauge where it stands. The CEO likes Wells Fargo for its product penetration and cross-selling, State Street for its transactions expertise and Hang Seng for how it manages margins. Three months ago, the bank completed a benchmarking exercise on engagement with the customers and cross-selling, and it is being rolled out across the bank now. "We aim for the global benchmark and then 20% improvement over that," says Puri.

Paresh Sukhtankar

Anil Jaggia

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There has been a big push has been to take customer engagement to next level. Now that product portfolios in corporate and retail banking have scale, the Bank has started moving from a product centric to customer centric mode using its data ware housing and analytics expertise to help cross sell better. "In urban markets, we have scale in each product. In semi-urban and rural markets our customers view the bank as a one-stop shop. So customer centricity has accelerated in the last two years," says Sukthankar.

As man who doesn't carry a mobile phone, Puri is a curious mix of an old-style banker with a cutting-edge tech outlook. From day one, he has heavily relied on technology to reach new customers, better customer service and lower costs. The bank's IT investment is a high single digit percentage to its revenues. Today, only 16% of all transactions are done through branches and the rest through other channels. "Our aim is always be at the fore front and we continue to invest and upgrade our systems: for example, the Electronic Data Warehousing, Business Intelligence suite and the ATM switch are presently being refreshed to take our capability to the next curve. We have a very active customer base and our systems handle heavy transaction volumes. Consequently, our systems have to be highly available, resilient and scalable," says Anil Jaggia, CIO, HDFC Bank. The bank's customers are heavy users of net banking and online banking channels (again, largest number in Indian banking), with robust net-banking and mobile apps (his latest obsession) in addition to mobile banking working on 3G as well as 2G platforms.

While a strong team aided by systems, processes and technology led to a sustainable business model, a large part of the credit for the Bank's growth undoubtedly goes to Puri's leadership. As any insider will tell you, he is the Aditya (sun) in the bank's solar system around which every thing revolves. "Given that Mr Puri has steered affairs of the bank since the inception of the bank and the Bank has followed a consistent strategy since then. He should be credited for providing the right direction and strategy, building the right team and ensuring the execution" says Lumba of JM Financial.

Through a delegative leader with a robust system of reviews and "special reviews" (highly avoidable!), Puri admits he may have a disproportionate say in strategy. But he adds that if projects are going to plan, he doesn't get into it. "But you have to be very careful with my delegation. If you are not performing you will find me there everyday," he smiles.

But for a man who come in to office at 8.45 am and leaves at 5.30 pm, he runs a tight ship with a hands-on approach: meeting lots of employees and customers, visiting branches, and keeping a hawk-eye on things like cost, among others. For example, costs are monitored very closely, because as the bank is expanding into rural areas the cost of business is going up, and with the tight ship that the bank runs, costs have to be controlled to maintain high margins. So for executives who miss targets, go off plan or veer from the budgets, Puri has meetings he likes to call "dental appointments". "I tell people, please treat the CEO visit as a dentist visit. There will be pain. While you will get a lot of encouragement, my job is to tell you what's working and what is not."

After 18 years at helm, Puri, HDFC Bank and its 30% profit growth mantra have become synonymous. The big question now is: after Puri, who? Technically, there is no age limit for the CEO of a private bank. But then that could be Puri's biggest secret.

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