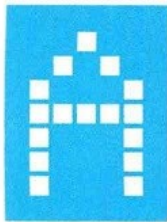


# BEST IN CLASS

**TECHNOLOGY AND A CAUTIOUS APPROACH ARE HELPING INDIA'S SECOND-LARGEST PRIVATE SECTOR BANK BRAVE THE ECONOMIC HEADWINDS.** By ANAND ADHIKARI



ditya Puri, 65, often borrows the concept of “C+I+G” from economics to explain the state of affairs at HDFC Bank. The longest-serving CEO of any bank in India says ‘C’, that is, consumption (I is investment and G is government spending) is something his bank depends heavily on, as more

than 50 per cent of its book is accounted for by retail and consumer businesses.

As part of this, the bank has, of late, been single-mindedly focused on breaking into rural and semi-urban areas, which account for 60 per cent of India’s population. “Our more than 55 per cent branches are in rural and semi-urban geographies,” says Puri, using this to make a point that HDFC Bank’s balance sheet is reflective of the country’s economy. And, this is precisely why Puri is hoping that India’s gross domestic product, or GDP, growth does not slow and remains at least 7.5 per cent this year. “This is on the back of two failed monsoons. Let’s hope we never get three failed monsoons,” says Puri, though he is confident about HDFC Bank as it has for years been growing at three-four times the GDP rate.

“Many of our past decisions are helping us,” says Puri, sitting in the boardroom at the 5th floor of HDFC

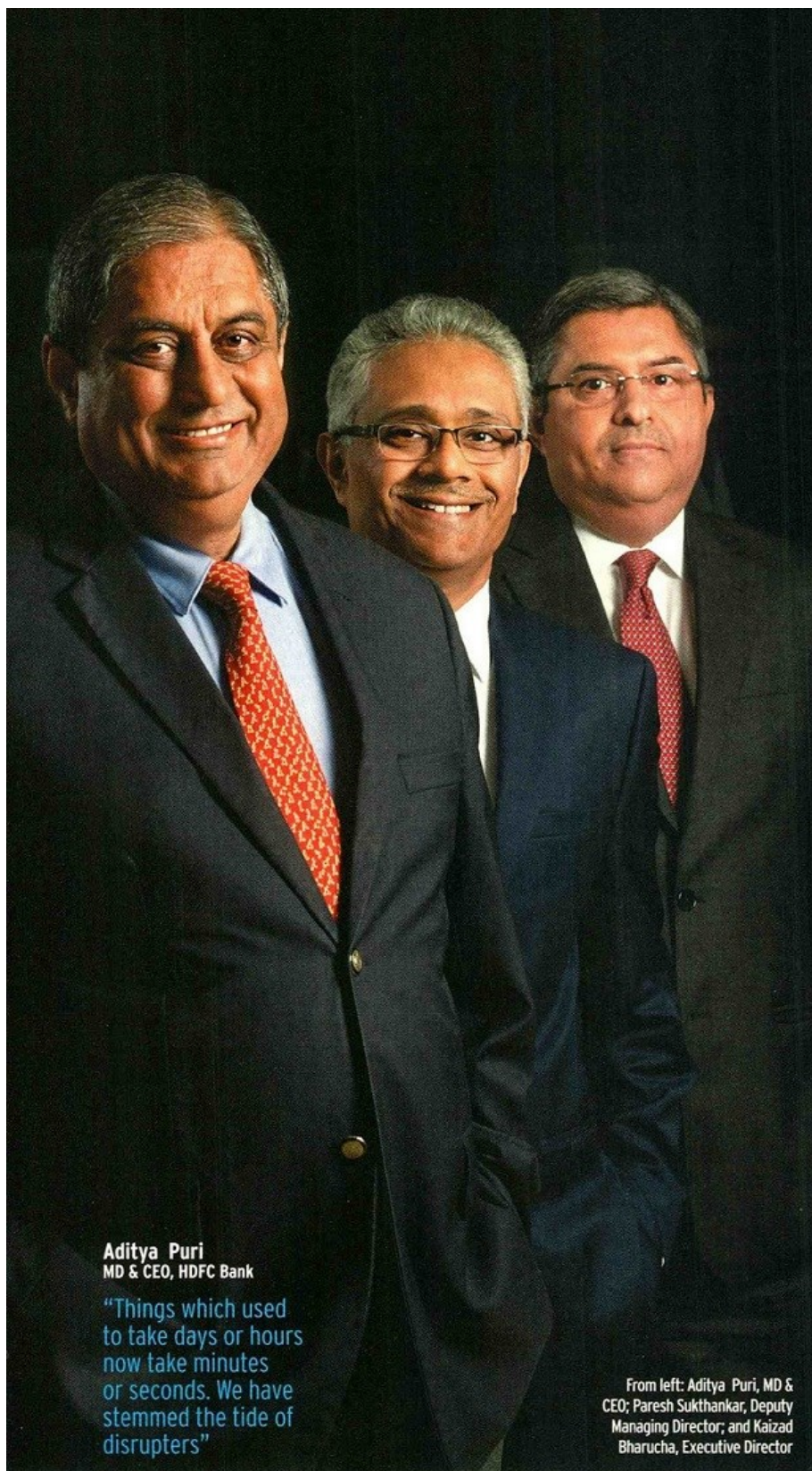
House in central Mumbai. For the past six years, difficult for the economy as a whole, the bank, which Puri has built from scratch over the past 21 years, has been expanding its loan book at 20-25 per cent and revenues at 20 per cent, though profit growth has of late come down from 30 per cent to 20 per cent. Its numbers, especially the asset quality, have no parallels in the country’s banking industry.

## Rural/ Semi-Urban Plans

The bank is following a distinct strategy to expand in rural and semi-urban areas. “Most banks in these geographies are present only on the liabilities (deposits) side. We are one of the few players in organised finance who, besides priority sector advances, are also there on the assets (loan) side,” says Puri. The bank’s product suite for these areas ranges from loans for buying two-wheelers, light commercial vehicles, tractors and jewellery to loan against property and personal loans. It also offers *kisan* gold cards.

The bank has, over the years, perfected its rural strategy by setting up branches manned by one or two people, customising retail products and spending a lot on brand building. The challenge, however, is to increase the contribution of semi-urban and rural areas, which account for 55 per cent branches but just 15 per





**Aditya Puri**  
MD & CEO, HDFC Bank

"Things which used to take days or hours now take minutes or seconds. We have stemmed the tide of disrupters"

From left: Aditya Puri, MD & CEO; Paresh Sukthankar, Deputy Managing Director; and Kaizad Bharucha, Executive Director

RACHIT GOSWAMI

## DIGITAL INITIATIVES

■ Single view of all relationships with the HDFC group on the net banking platform (bank, mutual fund, demat account, etc)

■ personal loan to customers based on analysis of their credit history in 10 seconds

■ Customer relationship management extended to mobile and internet platforms. CASA acquisition channel extended to partners, who can now source customers for the bank

■ Digital application platform introduced for instant e-approval to retail loan applications. It allows customers to fill application forms online with help from a representative



cent revenue (the bank aims to take this to 35 per cent over the next three-four years). Puri is confident about meeting the target and says these markets have been seeing good growth in spite of the slowdown in consumption.

The bank is also facing the threat of small finance banks (mostly microfinance institutions-turned-banks) storming the rural market with innovative and low-cost products. On this, Paresh Sukthankar, Deputy Managing Director, says most HDFC Bank branches in these areas are young (three-four years old). "We are going through the process of customer acquisition and understanding. We will increase our share of these customers' wallets in due course," he says (See *How HDFC Bank Stacks Up*).

## Digital Strategy

The bank has been using the developments in the digital world to streamline operations. "The changes in the operating model have brought in efficiencies in terms of faster turnaround and lower cost as transactions are processed concurrently rather than sequentially," says Puri. The bank has been investing a lot in data warehousing, social media linkages, data analytics and mobile-based innovations. In retail banking, it now promises personal loans to existing customers in 10 seconds and car loans in 30 minutes. There is also an instant top-up car loan. It has also been tying up with ecommerce merchants for direct transactions. The ATM strategy involves doing multiple things. For instance, it is increasingly using its ATM machines for communication, especially for getting across messages on new offerings.

"There is nothing like competition to keep you on your toes," says Sukthankar, who also heads the retail banking division. Puri pitches in by saying they are changing the banking experience for retail customers. "Things that used to take days or hours now take minutes or seconds. We have stemmed the tide of disrupters," he says. (See *Best Digital Banking Initiative*).

## Corporate Banking

HDFC Bank, at the time of starting out a little more than two decades ago, had decided to serve the top end of the market. The space was crowded then with government banks dominating project finance and foreign banks catering to multinationals with their superior products and service. HDFC Bank never built a large project finance book.

**ITS STRONG  
CREDIT AP-  
PRaisal  
PROCESS IS  
REFLECTED  
IN NET NPAs  
WHICH, AT  
0.25%, ARE  
THE LOWEST  
AMONG ALL  
BANKS**

## BEST DIGITAL BANKING INITIATIVE



It was a coincidence. As this writer settled down to re-search HDFC

Bank's digital innovations, a message alert popped up on the screen. It was a promotional mail from the bank: "Every offer you could wish for, will now be yours in one click. PayZapp it!" The ad promised 'dhamaka discounts', 'crazy cashbacks' and 'peppy promos' – more an e-tailing start-up's vocabulary than that of a two-decade-old bank. The digital disruption, it seems, is leaving nobody untouched.

PayZapp, HDFC's mobile app introduced in June 2015, can be used to pay for everything from beauty products to grocery to flight tickets. Payments and semi-closed digital wallet platforms, where a consumer can deposit money for shopping, started surfacing around 2013. Now, more and more Indians are carrying out small transactions through mobile apps operated by Paytm,

Mobikwik and Oxigen, among others, which are thriving on erasing the pain of bank transactions. Some estimate that the payments market is a mammoth \$500-billion opportunity if domestic and international remittances, government payments, utility bills and merchant payments are included. Not all of this is being addressed by wallet companies today. If these start-ups, armed with private equity money, corner a big share of this pie, it will be more than an opportunity lost for the traditional banks.

HDFC, on its part, is responding systematically, though slowly. Apart from PayZapp, it has integrated the Chillr app, developed by a start-up, which allows a customer to send money from a bank account to anyone in his phonebook. Chillr, unlike PayZapp, is not a virtual wallet. Both have crossed a million downloads. The leader of the wallet world, Paytm, claims around 100 million downloads.

Even today, despite having a large balance sheet, it is predominantly into working capital loans. In contrast, most banks' corporate portfolio is skewed towards project finance or term loans, which are more risky.

The bank moved towards emerging as well as small and medium enterprises only in early 2000 after learning to serve big companies, the most demanding customers in the market.

"We now have a broad spectrum of products in wholesale banking such as cash management, custodial services, investment banking, LCs (letters of credit) and guarantees," says Kaizad Bharucha, Executive Director, HDFC Bank.



However, PayZapp scores higher in average transaction size, which is ₹300. The Chiller founders had approached HDFC Bank towards the end of 2014. The bank launched the app by March 2015. "We have to be open to the fact that a lot of good work is happening in start-ups," says Nitin Chugh, Country Head, Digital Banking, HDFC Bank.

The bank today boasts an innovation team that develops its own technology as well as keeps scouting the market for ideas. Innovation is now an integral part of the bank's digital strategy that also seeks to ensure that the customer's digital experience is both comprehensive and simple. So, at HDFC Bank, digital banking goes much beyond payments. For instance, internet banking covers about 200 things such as submission of Form 15 G/H for fixed deposits; change of know-your-customer details; address change; CIBIL credit score; and balance transfer on credit card.

About 68 per cent

financial transactions were done online as on November 2015. "The difference here with other banks is that most of our innovations are based on practicality. They may not be glamorous," says Parag Rao, the Country Head for Card Payment Products, Merchant Acquiring Services and



ASHESH SHAH

## "WE HAVE TO BE OPEN TO THE FACT THAT A LOT OF GOOD WORK IS HAPPENING IN START-UPS"

**Niti Chugh**  
Country Head, Digital Banking/ HDFC Bank

Marketing. Over the past two years, the bank has worked on its front-end (user interface) design. And to deliver some of its products with simplicity and speed, it has had to re-engineer its back-end, too. There is no way the bank could have approved personal loans in 10 seconds, a facility available to select

customers, unless the back-end churned out analytics and credit history efficiently. For this, and other things, the bank appears to have spent enormous resources on big data.

Rao cites 'Missed Call Banking', launched last year, as an example of a highly practical product that doesn't seem glamorous. "It

is important to reach out to far-flung areas and customers," he says. In Missed Call Banking, one can dial a number and get information from a menu of services (balance in account, status of remittances, etc) via SMS. Coming soon is another "simplified" product that will help customers top up their phones with pre-set amounts through missed calls.

KPMG, Business Today's partner in the Best Banks survey, says "the initiatives undertaken by the bank indicate strong digital banking capabilities". It adds that these "are difficult to replicate".

According to the bank's executives, what is tough to replicate is the execution of the "many factors" put together. This includes making digital a part of employees' DNA. If you walk into a branch to open a fixed deposit account, chances are that the employees will not have a physical copy of the form. They will, instead, demonstrate how you can do it online.

— Goutam Das

## Asset Quality

The asset quality of some of the country's best banks has been worsening for years now. HDFC Bank is an exception to this. Its strong credit appraisal process is reflected in net non-performing assets, or NPAs, which, at 0.25 per cent, are the lowest among all banks. The figures are 2.12 per cent for State Bank of India and 1.61 per cent for ICICI Bank. This makes HDFC Bank the winner on the asset quality front too.

One reason for this is guidance provided by the parent, HDFC Ltd, and the second is the strong systems and processes introduced by Puri who, before joining HDFC Bank,

was heading Citibank in Malaysia.

"We have a clear system. Any portfolio exhibiting signs of delinquency or delayed payments not in line with the programme is slowed or cut down," says Puri. The bank, for instance, made early exit from small-ticket personal loans where the industry suffered huge losses after the 2008 slowdown. Also, it first started offering credit cards to its existing customers, and that too after a detailed analysis of their creditworthiness. More recently, it stayed from infrastructure loans, a cause of stress at many banks. "It was difficult to evaluate all the components that go into infrastructure projects," says Kaizad. Last, but not the



least, it forayed into semi-urban and rural areas after a lot of testing of products and pilot launches to check for credit losses. The bank's seriousness about asset quality can be gauged from the fact that the risk staff don't report to business heads and all the information about risk converges at the CEO level.

But are there risks to asset quality if the economy plunges further due to the slowdown in China? "As of now, there are no such signs," says Puri.

The bank has also beefed up its board by adding former Reserve Bank of India Deputy Governor Shyamala Gopinath as chairman. Sukthankar was made deputy managing director two years ago. Puri's term has been extended till 2020.

## THE BANK FORAYED INTO SEMI-URBAN AND RURAL AREAS AFTER A LOT OF TESTING OF PRODUCTS AND PILOT LAUNCHES TO CHECK FOR CREDIT LOSSES

is also the high proportion of fixed deposits, especially foreign currency deposits, raised after September 2013, when Reserve Bank of India Governor Raghuram Rajan had opened the window to stem the depreciation of the rupee. The banking sector had mobilised over \$30 billion through this window.

The bank, however, has a different take on this. "CASA is going up in absolute terms. In fact, our CASA market share has gone up by 15-20 per cent," says Sukthankar. Analysts say if the country's economy deteriorates and competition from payments and small finance banks intensifies, the decline in CASA as a proportion of total deposits will hit the bank's cost of funds. "There is going to be a fight for CASA when the new banks are operational," says an analyst. Sukthankar, however, says the market is big enough.

The second challenge is the high cost-to-income ratio of 0.45 per cent. The figure for ICICI Bank is 0.37 per cent. The bank says this is due to its bigger retail portfolio. "There is high transaction intensity in retail because of smaller loan sizes," says Sukthankar. The other reason is the huge investments the bank has undertaken in branch expansion and digitisation. "We should gain in terms of cost in the

next three-five years as digital banking picks up. Our proportion of digital transactions is growing in a big way," says Sukthankar. Puri believes the reasons for the high cost-to-income ratio are not bad per se as "consumer or retail businesses also generate higher earnings and margins".

Lastly, banks will always be exposed to people, governance, fraud as well as technology risks. A frank Puri says cyber security risk

will always remain a major concern. "The only way to safeguard oneself is putting up more checks and balances," he says. In fact, the bank was recently under the lens of regulators for violation of KYC norms and anti-money laundering guidelines after a media expose that entangled some other banks too. "You can never eliminate people fraud. Technology is not God. No management system is God. So, it is wrong to presume that frauds will go away just because you have gone hi-tech," he says. ♦

## AHEAD OF THE PACK

PARAMETERS	HDFC BANK	ICICI BANK	AXIS BANK	SBI
Total Assets (₹crore)	5,90,503	6,46,129	4,61,932	20,48,079
Capital Adequacy (%)	16.79	17.02	15.09	12
Cost to Income Ratio	0.45	0.37	0.41	0.50
Net NPAs (%)	0.25	1.61	0.47	2.12
Return on Assets (%)	1.73	1.73	1.59	0.64

Source: BT-KPMG Study

## Challenges

The bank has a strong liabilities franchise. Its deposits have been growing at more than 20 per cent a year. The slowdown in the economy and competition for the low-cost current and savings account (CASA) deposits from new generation private sector banks is impacting the established players. The bank's CASA deposits have also not moved up from the mid-40 per cent range for the past five-six years. CASA is a source of low-cost funds for banks. A high CASA number indicates high margins and profitability. One of the reasons for CASA not improving

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