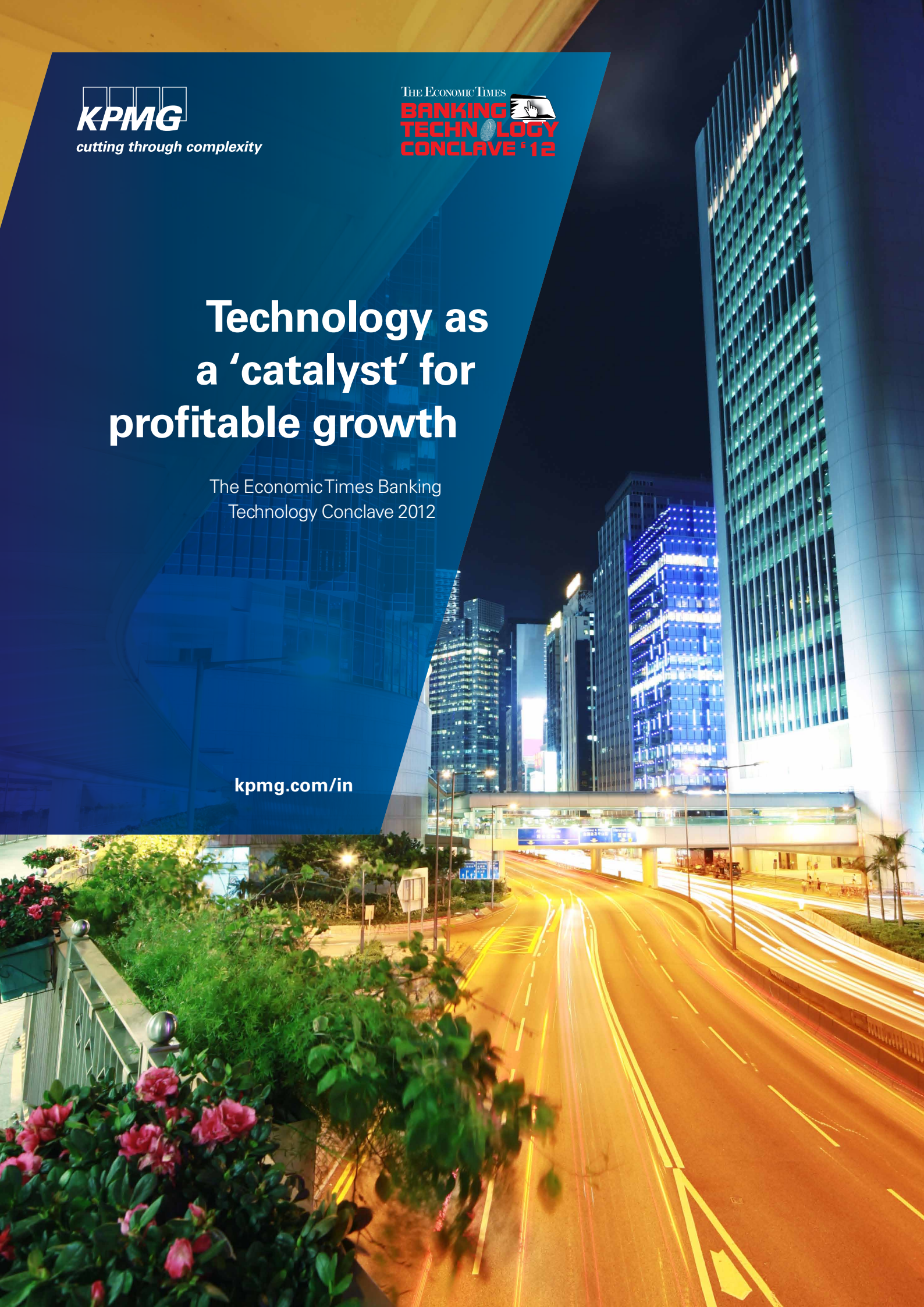


Technology as a 'catalyst' for profitable growth

The EconomicTimes Banking
Technology Conclave 2012

kpmg.com/in



chairperson.speak

Technological advancement has transformed the Banking industry into an anytime, anywhere, fast, and customised service offering. Indeed, technology has now become a key stone of financial services and it is difficult to imagine the world of banking without IT support. Rapid adoption of technology by banks has facilitated introduction of superior and innovative services stimulating faster growth of the sector. Another major benefit of IT has been the lowering of service costs encouraging introduction of more advanced offerings by Banks.

Currently in India, only around 59 percent of the adult population has access to banking services indicating a large untapped opportunity. Financial inclusion, by improving efficiency and productivity, enhances standards of living of the populace. Provision of banking and financial services to the under-banked segments is therefore critical for achievement of inclusive growth. Banks are expanding to under banked markets. However, development and adoption of innovative and appropriate IT aided solutions will determine their long term success.

Large investments in IT made by Banks have, no doubt, led to substantial improvements in quality and, in fact, the very nature of the services offered, but in the transition period, serious efforts to measure the actual return on these investments may have taken a back seat. As knowledge partners for 'The Economic Times Banking Technology Conclave 2012', KPMG in India has prepared a thorough paper, which provides this critical insight. The paper, among other things, examines if banks are getting a 'true' return for their technology investments. It evaluates ideas from various sectors, adoption of which can benefit the banks in many ways and assesses the direction in which AML and related compliance initiatives are headed. It also highlights the importance of HR tools in capturing and leveraging the knowledge created over the decades. I take this opportunity to thank them for their efforts.



SHIKHA SHARMA

**Chairperson — ET Banking Technology Conclave 2012,
Managing Director and CEO — Axis Bank**

foreword

Banking in India continues to grow backed by the expansion in the Indian economy, demand for efficient financing and drive of the people of this country. The 'Tech' Revolution in Banking has been exciting but an exhilarating turn is on the anvil.

The possibilities brought about by presence of technology across every banking touch point, internal and external, present a host of opportunities to the early adopters with an equally tough set of challenges. The increasing amount of complexity around the adoption of each new technology solution sometimes needs to be dealt with in a very different manner as compared to approaches followed in the past.

Technology in banking while underscored by its importance as an enabler is fast evolving to a catalyst in redefining the banking landscape. We see this evolution coming about in manner where costs can be controlled and technology led innovation is driving newer business models. While a number of areas are vying for the attention of banking CXOs, in this whitepaper we have discussed four key areas that we believe are significant challenge – opportunity for banks.



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01

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The term investment is used in conjunction with the term return to bring out the true meaning of return. Can this concept be extended to the principal value invested for acquiring information technology solutions in the Banking industry?. As any investments made must have a yield, so too must investments in information technology (IT).

The typical IT investments, such as Core Banking Solution, mobile banking solutions, risk management solutions or client relationship management solutions, involve investments in software, hardware, communication infrastructure, consulting/ implementation and training. As IT along with other constituents like people, product offering, etc is an enabler, (many times an invisible constituent), it is difficult to link and quantify specific benefit attributable to IT investment.

Key steps involved in calculation of Return on Investment (ROI)

One should consider many factors when making an investment decision. The key considerations of an IT investment approval process include:

- Clearly defined business case for the IT investment (i.e. articulating the benefits expected and measurement mechanism for the same)
- Alignment of the IT project with enterprise business strategy
- Time period over which the benefits are expected from the IT investment
- Fixed and incremental costs over the project life cycle
- Measurement mechanism, For example, in the case of a CRM solution, an estimate of an improvement in the call strike rate can be measured
- Costs benefit analysis through computation of financial metrics like payback period, Net present value (NPV), Internal rate of return (IRR), etc.

| | |
|----------------|---|
| ROI (IT) | $\frac{\text{Net realizable benefits (cost savings + new revenue that results from a project - total project costs)}}{\text{Total costs (capital plus recurring)}}$ |
| Payback Period | $\frac{\text{Total costs}}{\text{Total quantified benefits}}$ |
| EVA (IT) | $\text{IT ROI less weighted average cost of capital} \times \text{total IT investment}$ |

The assumptions underlying this model used for computation benefits and risks associated with the project are key reasons for uncertainty in ROI analysis. Awareness of these uncertainties and the impact of risks on ROI can significantly improve the likelihood of successful investment decisions.

The methodology for computing return on IT investments is evolving. No single scientific method is available to deduce the return on investment. However, quantification of the identified improvement areas can be done through measurement ratios. Quantifiable benefits include:

- Cost savings, through reductions in staff numbers, improvement in cash flow through quicker billing and cash collection
- Improvement in call efficiency ratio or customer strike rate
- Process efficiency due to reduced paper work, coordination and communication
- Savings in logistics through improvement in dispatch planning and freight movement
- Reduction in inventory holding period and better inventory management
- Improvement in quality of services through set rejection parameters, thereby improvement in customer retention and reduction in the costs (often very high) associated with obtaining new customers.

Technology ROI prototype¹

Below is a prototype for technology ROI for a Bank implementing a Core Banking Solution (CBS). The prototype is built on several assumptions for the each of the components included for arriving at Capital Cost, Variable Cost and Benefit factors. The assumptions are as under.

Capital costs

All components of Capital Cost are considered as a onetime bulk expense incurred during beginning of a CBS setup and implementation.

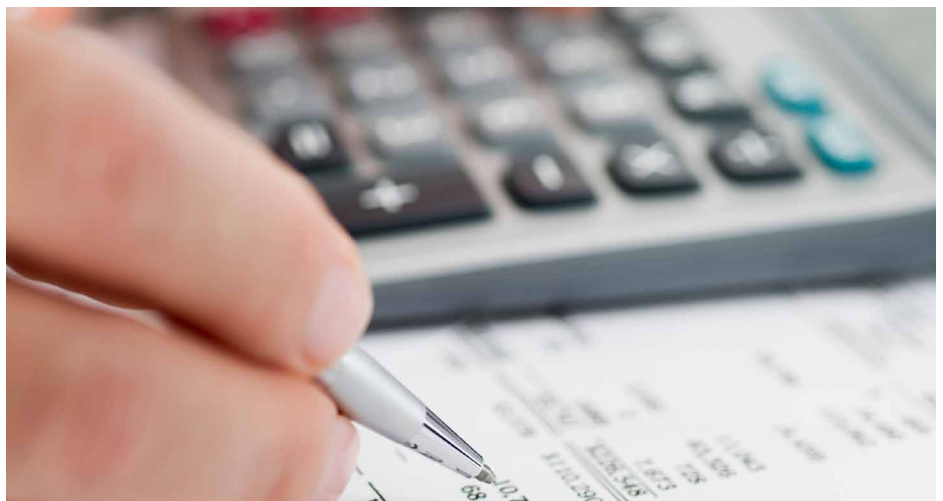
Variable costs

- IT staff cost is rising @ 5 percent, Year on Year (Y-O-Y)
- Non-IT staff cost is declining @ 10 percent, Y-O-Y

- The Application Software Customization cost is expected to rise @ 10 percent for Years 1 and 2 and then @ 5 percent for Years 3 and 4
- License fees are constant for the entire period
- Training costs are expected to decline @ 10 percent, Y-O-Y
- DC - DR Hosting costs remain constant for the entire period
- Internet Bandwidth costs remain unchanged for the entire period
- Facility Management / Managed Services / Integration / Maintenance Costs remain constant for the entire period.

Benefit factors

- Benefits from Centralization of Banking Functions and reduction of re-work due to STP are expected to rise @ 15 percent and @ 5 percent Y-O-Y respectively.
- Benefits from all the other factors such as Reduction in Banking Personnel, Handling increasing transaction volumes over the project period without increase in manpower, savings with respect to new recruitment, Automated Reconciliation and Other Benefits² are expected to rise @ 10 percent Y-O-Y.



¹ Technology as a 'catalyst' for Profitable Growth – KPMG in India Analysis

² Other benefits include improved cash flow through quicker billing and cash collection, improvement in call efficiency ratio or customer strike rate, logistical savings through improvement in dispatch planning and freight movement.

| (All Amounts in INR Crs.) | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|
| Capital Costs | | | | | |
| | Year | | | | |
| | 0 | 1 | 2 | 3 | 4 |
| Application Software (For 350 Branches) | 3.00 | - | - | - | - |
| Implementation | 8.50 | - | - | - | - |
| Hardware for All Branches | 3.25 | - | - | - | - |
| Hardware (DC/DR) | 2.70 | - | - | - | - |
| RDBMS at DC & DR | 1.10 | - | - | - | - |
| Operating Systems & SW | 0.95 | - | - | - | - |
| Network Equipment | 3.50 | - | - | - | - |
| Communication Link | 0.90 | - | - | - | - |
| Enterprise Management System / Network Management System | 1.10 | - | - | - | - |
| Security Systems (Firewall, Anti-melware, etc) | 0.80 | - | - | - | - |
| Total Capital Costs | 25.80 | - | - | - | - |
| Variable Costs | | | | | |
| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 |
| IT Staff | 2.00 | 2.10 | 2.21 | 2.32 | 2.43 |
| Non-IT Staff | 1.50 | 1.35 | 1.22 | 1.09 | 0.98 |
| Application Software Customization | 1.20 | 1.32 | 1.45 | 1.52 | 1.60 |
| Software License | 3.00 | 3.00 | 3.00 | 3.00 | 3.00 |
| Training | 0.75 | 0.68 | 0.61 | 0.55 | 0.49 |
| DC - DR Hosting | 0.40 | 0.40 | 0.40 | 0.40 | 0.40 |
| Internet Bandwidth | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Facility Management / Managed Services /Integration / Implementation Support | 1.70 | 1.70 | 1.70 | 1.70 | 1.70 |
| Total Variable Costs | 11.55 | 11.55 | 11.58 | 11.58 | 11.61 |
| Total Costs (Total Capital Costs + Total Variable Costs) | 37.35 | 11.55 | 11.58 | 11.58 | 11.61 |
| Benefit Factors | | | | | |
| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 |
| Banking Functions Centralization | - | 12.00 | 13.80 | 15.87 | 18.25 |
| Reduction in Banking Personnel | - | 5.00 | 5.50 | 6.05 | 6.66 |
| Handling increasing transaction volumes without increase in manpower | - | 1.00 | 1.10 | 1.21 | 1.33 |
| Avoiding of re-work due to STP | - | 1.50 | 1.58 | 1.65 | 1.74 |
| Savings on new recruitment | - | 0.70 | 0.77 | 0.85 | 0.93 |
| Automated Reconciliation | - | 5.50 | 6.05 | 6.66 | 7.32 |
| Other Benefits | - | 5.00 | 5.50 | 6.05 | 6.66 |
| Total Benefits Realized | - | 30.70 | 34.30 | 38.34 | 42.88 |
| Benefits | | | | | |
| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 |
| Annual Benefit Flow (Total Benefits Realized -Total Costs) | (37.35) | 19.16 | 22.72 | 26.76 | 31.27 |
| Cumulative Benefit Flow | (37.35) | (18.20) | 4.52 | 31.28 | 62.55 |
| Discounted benefit flow | | | | | |
| | Year 0 | Year 1 | Year 2 | Year 3 | Year 4 |
| Discounted Costs | 37.35 | 10.50 | 9.57 | 8.70 | 7.93 |
| Discounted Benefits | - | 27.91 | 28.34 | 28.80 | 29.29 |
| Total Discounted Benefit Flow | (37.35) | 17.41 | 18.77 | 20.10 | 21.36 |
| Total Cumulative Discounted Benefit Flow | (37.35) | (19.94) | (1.16) | 18.94 | 40.30 |
| ROI measures | | | | | |
| | Year 1 | Year 2 | Year 3 | Year 4 | |
| Cost of capital (Estimated) | 10% | | | | |
| Net present value (NPV) | 40.30 | | | | |
| Return on investment (ROI) | 58.33% | 97.97% | 128.64% | 154.42% | |
| Payback (in years) | 1.95 | | | | |

Figures above only indicative

Investment in Information Technology

Investing in information technology provides a competitive advantage as this enables a bank to introduce change, build competitive structure and impact the industry. Following are the major information technology developments:

- Performance leap in data processing, storage capacity and connectivity –these are transforming banking in India
- Automation and quality enhancement in processes using structured data are enabling banks to offer new products, customer engagement models and compete with new incumbents and market models
- Managed IT services by IT service providers has led to the development of more efficient global banking practices.

Technology landscape – Investment implementation status³



The development of Mobile penetration and Social Media are making banks relook at their implemented systems to have version capabilities.

Forces of change in investment – The trends

- Increased focus on core competency through operational excellence and information monetization
- Service focus extend to processing speed and information transparency
- Increased alliances to enhance core capabilities and gain access to non core capabilities.
- The new products being launched, Risk Management, Surveillance and Investigation processes being followed at banks in India would result in becoming dynamic with the policies being updated on a regular basis.

³ Technology as a 'catalyst' for Profitable Growth – KPMG in India Analysis

⁴ We are seeing significant advancement being planned by some banks which are changing the benchmarks and moving these to the 'Investment in Progress' category.

Buck in business intelligence

The ability to make visual sense of complex numbers has been a big hit with companies who have been grappling with data overkill. Now companies across industries are evaluating extended functionality such as search, in – memory analytics, etc. Analytics and Business Intelligence is the topmost priority for CIO's in 2012. IT continues to spend and earmark money on BI, despite constrained budgetary environments⁵. BI projects remain relatively shielded, while a healthy portion of any discretionary money will be available for upcoming analytic initiatives. We are witnessing that beyond traditional IT, business and corporate functions are buying BI tools for line-of-business initiatives, and allocating an increasingly large stake of the spending pie.

Buck in IT infrastructure

Resiliency is among the most common justifications for data center investments for Indian banks. Out-of-date, low-quality data centers are often an unacceptable business risk. At the margin, investments in improved system designs and operations may yield better returns than investments in physical facilities.

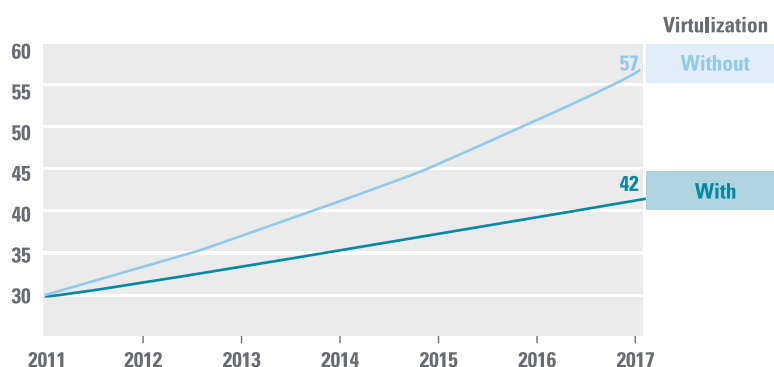
Downtime overwhelmingly stems from application and system failures, not facility outages. An online service provider, for example, found that facility outages accounted for about 1 percent of total downtime. Even the most aggressive improvements in facility uptimes would have a marginal impact on application downtimes. This results in focusing on how to derive more capacity from existing facilities and improve capacity allocation to appropriate tiers depending on criticality.

Following are investment directions applied:

- Migrating applications to virtualized platforms to limit data center capacity requirements
- Moving non – critical application environments into lower-tier facilities

A global bank, for example, cut their six year power demand to nearly 40 megawatts, from 57 megawatts a more than 25 percent reduction—by leveraging its data center build program to accelerate the use of virtual machines (Exhibit 1). This translated to a 25 percent reduction in new capacity build.

Global bank's data center demand and strategic capacity, megawatts



Source: McKinsey Quarterly; December 2011

Buck in e-commerce

The number of Internet users in India stood at 112 million in September 2011, with 88 million of them coming from the urban cities and 24 million from the country's numerous villages and small towns. The current e-commerce market in India is around USD 10 billion, while US e-commerce market is set to touch USD 200 billion in 2013, growing at 17 per cent. (According to Internet Mobile Association Of India (IAMAI))

The above numbers are making Indian banks enhance their online presence to build real-time, personalized relationships with customers. It includes meeting the ever-growing expectations in mobile, including downloadable apps for Apple's iOS and Google's Android and other operating systems, to broaden capabilities while ensuring a consistent experience throughout all digital channels.

Buck in core banking solution

The ROI in CBS can be well exemplified by the business benefits achieved which largely out-weighed the costs involved in the implementation of the CBS by a leading Public Sector Bank in India during the period 2002 to 2009. In 2002, banks planned to replace its legacy system that ran on a stand-alone basis in a collection-disbursement model with a CBS. Banks tied up with a leading system integrator having global presence to implement one of the best core banking solutions provided by the biggest player in the CBS arena. Benefits have largely been a reduction in personnel and additional recruitment and an increased automation across specific functions of the bank depending on the process changes brought about across a bank. Centralising functions bringing in greater efficiency. As a side effect of implementing CBS banks also could get into the Depository Participant (DP) arena.

Conclusion

The successful deployment of IT creates value for the organization. However, value is realized only if it is planned and implemented in a controlled manner. ROI is a good measure, if used at the time of IT acquisition; it can provide:

- Cost justification and awareness of cost of ownership, and
- Benefit estimation and accountability for benefit fulfillment.

The measurement of IT is not a one-time process but an ongoing one. The control criteria may be designed to measure all the related IT processes, including acquisition, implementation, stabilization and upgrade/improvement of systems.

credit.bureaus, kyc, anti. money.laundering, uidai have.they.helped.banking?

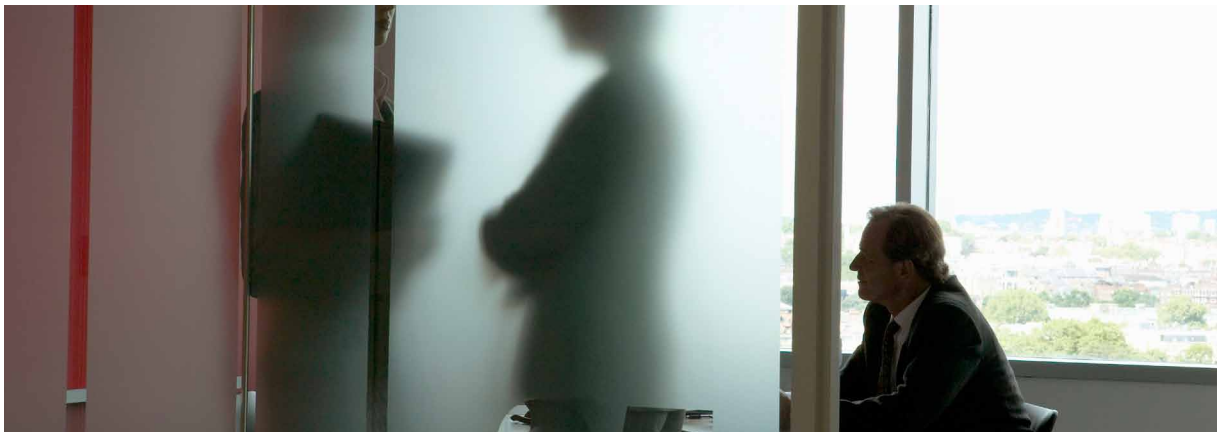


Headlines have been made since the advent of findings by US Senate on money laundering. Two large multinational banks have been at the receiving end with the probability of some other Banks joining the queue. To address money laundering issue, guidelines on Anti Money Laundering (AML) by regulators world over have been defined and refined. However, ambiguity and lack of clarity on enforcement still exists and financial sector is continuously falling prey to it.

Money Laundering has been haunting financial institutions in the past and will continue to do so. As legislation around AML evolves; organizations move from looking at implementing AML as a mere compliance requirement to a holistic business/operational risk management tool.

Is there any disconnect between Government, regulators and financial institutions in understanding money laundering and developing effective AML guidelines, programs and implementing a Risk-based approach in managing the two?

Regulators have become more active and are developing demanding robust processes such as sharing of information, common Know Your Customer (KYC) and consolidation of money laundering activities under Financial Action Task Force (FATF) umbrella. The pressing priority of bank's senior executives is now to come up with an effective and practical approach to minimize the money laundering impact.



Before getting to the approach, let us put the problem in perspective. During late nineties and early 2000, banks established increasing number of corresponding relationships which included "high risk" foreign banks. For example, the US banks, through these correspondent accounts, became estuary for 'tainted' money flowing into the American economy and as a result, facilitated illegitimate enterprises, including drug trafficking and financial frauds. Some other notable cases which attracted the attention of global community towards money laundering were at Bank of New York, Bank of Credit and Commerce International, Barclays, Natwest, Royal Bank of Scotland, ING and UBS.⁶

Post 9/11 attack, a stronger AML law was enacted as part of the Patriot Act of 2002. Over the next ten years, banks over the world having presence in US, directly or indirectly, substantially strengthened their correspondent AML controls. This included close monitoring of the cross border transactions, strict KYC checks, reporting of the suspicious transactions to name a few.

With the advent of findings on the money laundering activities for multinational banks such as HSBC and Standard Chartered Bank, the question has come up of whether the banking community has done enough on AML in implementing controls or has this been more a case of one-off lapses. It may be argued that one of the Banks has a history of weak anti-money laundering controls, but how can one ignore the same for other banks, substantial in size, sailing in the same direction. With the release of findings and report by the US Senate Permanent Subcommittee on Investigations, a seismic shift is on the way AML shall be regulated as well as implemented.

⁶ Technology as a 'catalyst' for Profitable Growth – KPMG in India Analysis

Unpredictability about the risk in the overall banking scenario across the world, has forced banks to realign their focus on their banking functions. The International Monetary Fund (IMF), estimated amount of money laundered globally in one year is 2-5 percent of the global GDP with a whopping USD 419 billion out of India.⁷ Following the glooming economic condition, banks have been engrossed into an ever-compounding regulatory environment and hence, facing a host of new compliance requirements pertaining to risk management. The seemingly endless string of new regulatory guidelines and need for operational efficiencies, banks have to baseline their functions to a moving and divergent set of targets.

In the recent past, banks have been following rule based approach and that helped them partially in meeting the compliance objectives. However, the new risks that economy is increasingly facing has made risk-based approach and customer due diligence a paramount necessity. For the implementation of risk-based approach, it is imperative that institutions evolve and implement a consolidated assessment & scoring

solution. To achieve the desired goal, principles, controls measures (preventive and detective) used to combat money laundering are required to be disseminated in organizational structures specifically within the anti money laundering and anti fraud units.

But the question remains whether and how it is achievable. Experts are finding ways to move from conventional rule based MIS and business intelligence to more risk based, contextual, flexible and reactive operational data stores.

"We should collect more data and keep the records of the customers longer so that we can monitor the history of transactions to establish the trend and detect any irregularities."

To ensure consistency in the operations for a particular guideline issued by the Regulator, one of the key is an integrated industry wide data reporting Banks can benefit from taking a single-platform approach of maintaining customer data such as KYC in the same way CIBIL is maintaining data on customer worthiness.

Feedback from respondent of the KPMG Global AML Survey clearly stresses on the need for a central KYC repository

maintaining data of all the customers in the Indian Banking sector.⁸

Some of the issues that we have been observed in the Indian Banking Sector while complying with the KYC regulations are mentioned below. These issues were rampant while maintaining KYC data of the customers investing in mutual funds.

SEBI came up with an idea of maintaining single KYC for the customer while ensuring sharing of data with all the constituents. SEBI then appointed centralized KYC Registration Agency (KRA) responsible for maintaining and managing KYC of customers, where a one-time KYC check performed by one institution can be reused by others.

Securities and Exchange Board of India (SEBI) came up with an idea of maintaining single KYC for the customer while ensuring sharing of data with all the constituents. Centralized KYC Registration Agency (KRA) have been setup, which is responsible for maintaining and managing KYC of customers, where a one-time KYC check performed by one institution can be reused by others.⁹

| | |
|--|-------------------------|
| Significant Process Redundancy | KYC Registration Agency |
| Long customer/ client acceptance time | |
| AML/KYC spending cost | |
| Frequent regulatory oversight | |
| Inconsistent KYC standards | |
| Work duplication at every intermediary | |
| Marginal KYC effectiveness | |
| Wastage of record-keeping space | |

Source: Technology as a 'catalyst' for Profitable Growth – KPMG in India Analysis

⁷ United Nations Office on Drugs and Crime

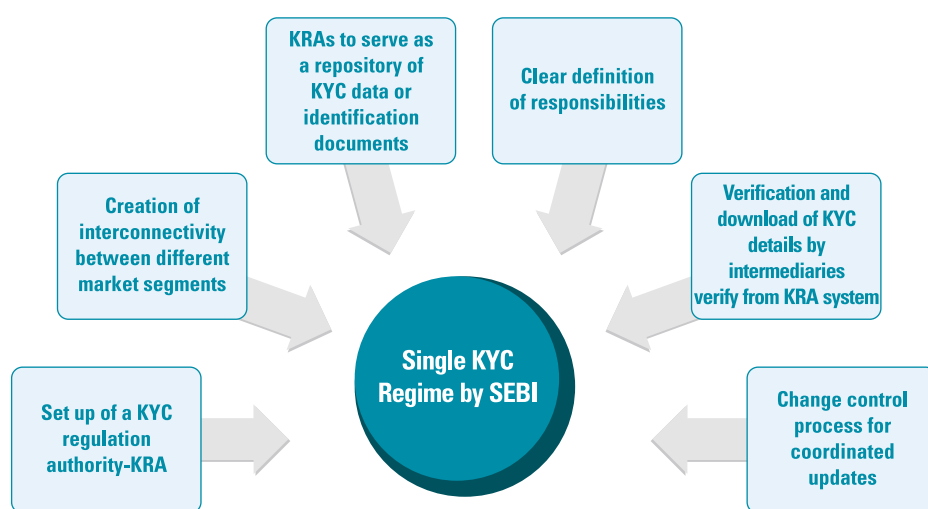
⁸ KPMG Global AML Survey – Global Anti Money Laundering Survey 2011, released by KPMG Global, Risk Consulting

⁹ SEBI (KYC (Know Your Client) Registration Agency (KRA)), Regulations, 2011

Identification of a customer and maintenance of the data is only one building block of the AML –continuous monitoring and compliance with the new guidelines & regulations being issued by country specific and global regulators are also critical. The second building block of 'continuous monitoring' requirement is the necessity to keep relevant KYC data items up-to-date. Without updated data, banks cannot know their customers, nor screen transactions against sanctions lists. Having said that, one of the areas for improvement that bankers are asking for is that regulators should not only enforce continuous monitoring and penalties, but also provide more guidelines.

Some of the challenges/gaps which are required to be thought upon while embarking on the next phase of efficiency in the Indian Banking Sector are:

- Standardization of KYC policies and procedures
- Integration of compliance approach with global guidelines on KYC & AML
- Shared approach from the non-regulatory authorities such as Government, FATF and FIU
- Standardization and consolidation of the data across the industry and per transaction
- Reusability of customer information and reduction in storage space
- Data quality for the success of screening or monitoring and decision-making process.
- Well defined rules of maintaining data (Although these will evolve, operational feasibility should be considered)
- Periodic review and update of customer's KYC data
- Interface with different systems being used by Indian Banks
- Cost effectiveness of the overall program bringing per customer cost down
- Sustaining business model and customer education on one KYC
- Enhance monitoring of Regulatory Adherence to their Guidelines



Source: Technology as a 'catalyst' for Profitable Growth – KPMG in India Analysis

To summarize

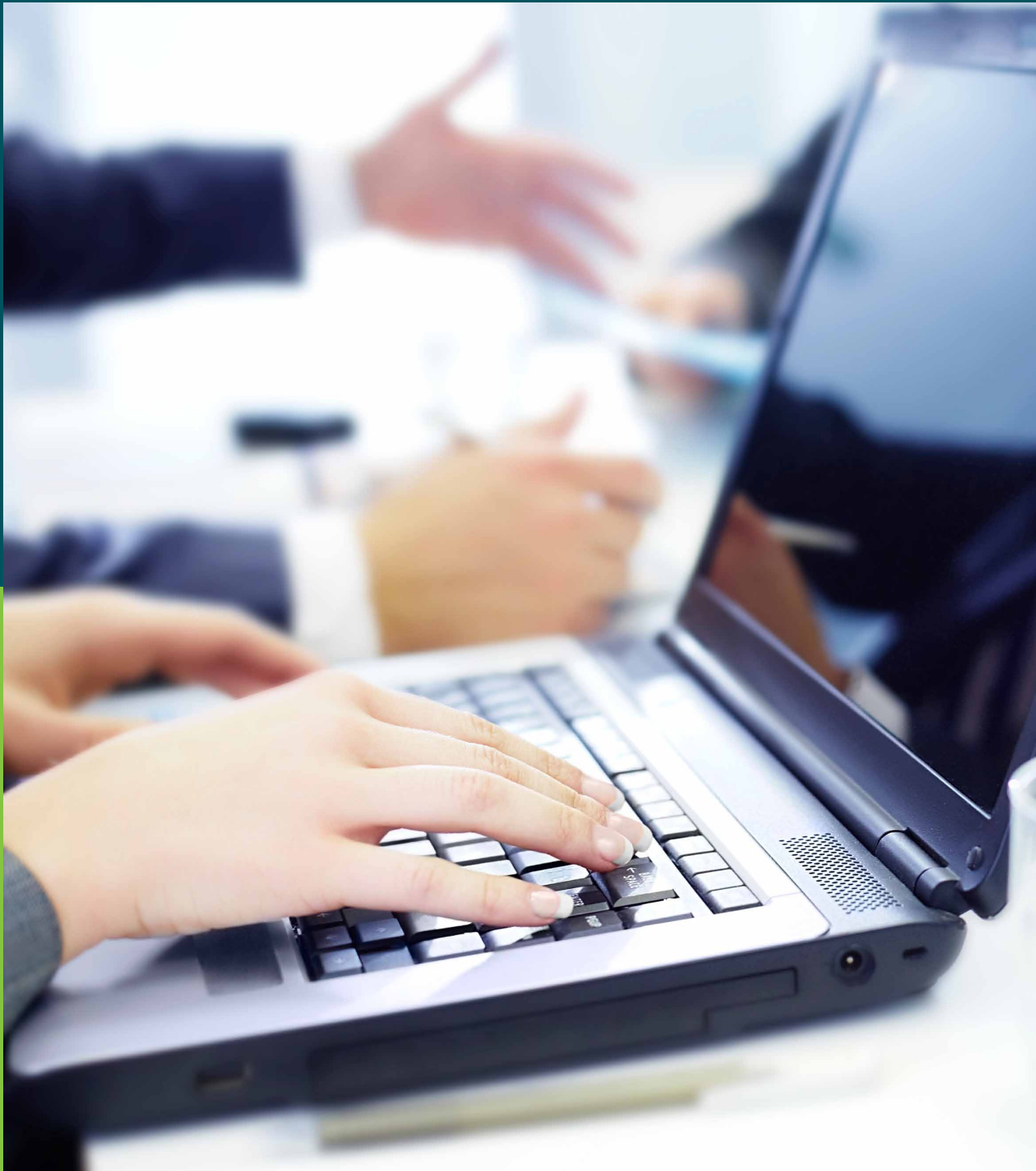
Banks should give serious thought on addressing the above mentioned challenges, both in terms of the gaps in the information currently maintained, as well as systems used to consolidate relevant KYC information with relevant controls.

Unfortunately, few banks and their systems are able to use the data collected at on-boarding for monitoring purposes, at least at the moment. As a result, KYC and transaction monitoring arrangements are likely to continue as separate and distinct activities, undermining the effectiveness of this key requirement until a unified approach being put in place.

Perhaps, the greatest challenge for the regulator and banks is to zero down on maintaining single version of truth for the customer. While stakeholders are analyzing ways to implement common KYC for all the financial services including banking, a more collaborative approach between Government, regulator and financial institutions will help in achieving the desired objective.

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from.other.sectors.to.banking



India has been a growth story on the world map, being one of the fastest growing economies over the last two decades. One of the key factors that has been fueling this growth is a sound and steady increase in the banking services.

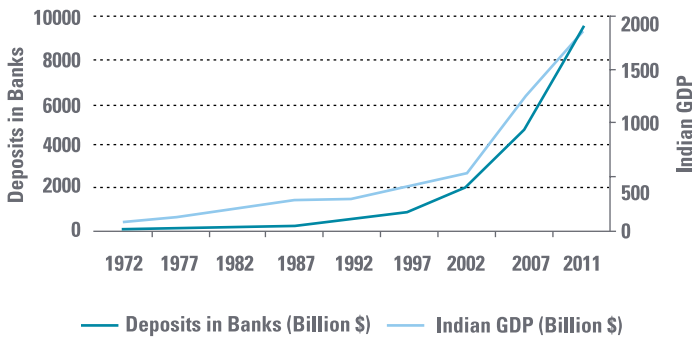
The deposits in Indian Banks have increased by almost 500 trillion rupees since the liberalization of Indian economy about 20 years ago. Graph shows how Indian GDP and Bank Deposits have been growing over the last four decades.

This exponential growth in deposits is due to multiple factors, with growth in the banking touch points being one of the biggest contributors. Since liberalization of Indian economy in 1991, the banking touch points in India have grown multiple folds, the number of branches increasing close to 1.7 times in last 20 years, and alternate channels including ATMs, POS, Branch Correspondents etc. making banking available to greater sections of society

Post liberalization of Indian economy, India saw a growth in the private sector banks operating in India with entry of current banking giants like ICICI Bank and HDFC Bank. The entry of private sector banks changed the landscape of Indian Banking making it more customers centric, sales oriented Government and RBI's development initiatives have Information technologies like development around Core Banking Solution, Payment Systems, electronic channels Implementation etc. have acted as new center in facilitating the growth. Increased competition has ensured that the existing large Banks also change their focus and reinvent their IT landscape to take the competition head-on.

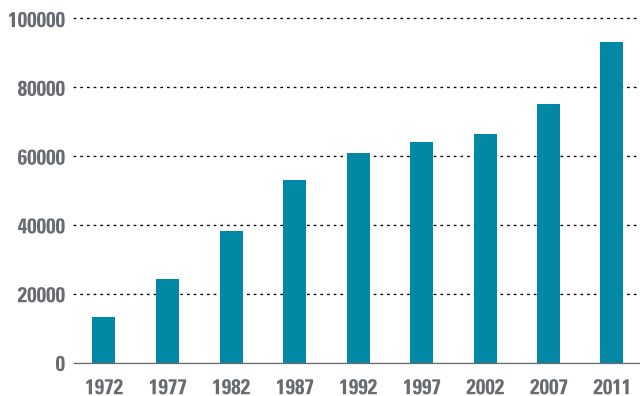
Over last two decades the banks have focused not only on expansion of the branch network but also on the increase in the utilization of existing resources and maximization of revenues and deposits. Hence we have seen more than 14 times increase in the deposits per branch. The number of branches itself increased by about 70% since the 1992 numbers.

Growth in deposits at Banks and GDP of India



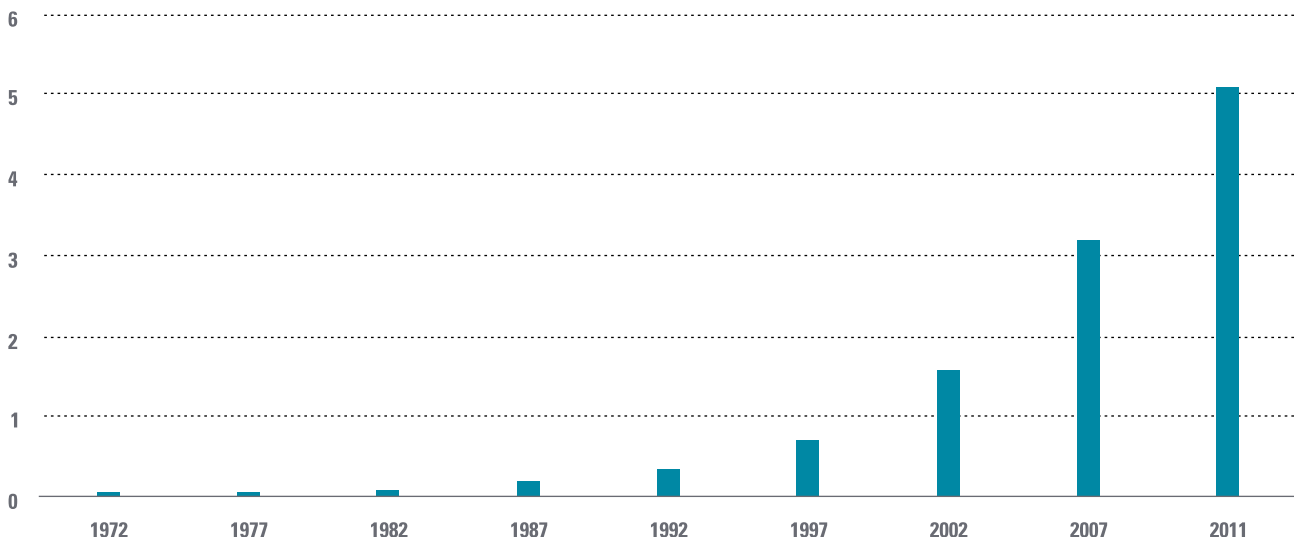
Source: Reserve Bank of India, KPMG Analysis

Number of Bank offices



Source: Reserve Bank of India, KPMG Analysis

Deposits per branch



Source: Reserve Bank of India, KPMG Analysis

Need for constant innovation

Based on the above mentioned parameters it can be concluded that over the last two decades banking sector had been growing consistently by increasing the market penetration with substantial increase in foot prints in Tier – I to Tier IV cities and towns. This was done by increasing the banking touch points including Branches, Banking Correspondents, Contact Centers, ATMs (Close to 1 Lakh ATMs as on Jul'12), online electronic channels like internet banking and mobile payments/ banking. Mobile payments/ banking is rapidly gaining ground with over 37 Lakh transactions for July'12 with a combined value of close to INR 350 crore.

With near saturation in the Tier I and Tier II cities, in the near future the organic and expansion based growth may not be the easy option for increasing the asset or liability base for the banks. Indian Banking is now entering a challenging phase with an increasing list of concerns for CEO / MD office with following key concerns:

- Multiple new entrants eagerly waiting to enter the already competitive banking space
- Constant push from the regulator, looking at improving guidelines especially for priority sector lending
- Regulator and Government pushing for financial inclusion which would require huge investments and inconsistent revenue streams.

With multiple challenges tying the banking sector, it is a good time for the Banks to look at the other sectors for the ideas that can drive the next wave of growth and innovation. This could throw up a solution to any one of many challenges or help a Bank in a competitive advantage. Organisations regularly adopt business logic and practices from different industries and sectors; it is now the time for players in banking sector to systematically scan and adopt some ideas being used in other sectors for achieving improved margins, customer satisfaction and regulatory compliance.

Some of the insights that the banks can look at from the other sectors are:

- How are industry leaders improving and sustaining their customer reach?
- What can we learn from other industries about continuous product innovation?
- What methods are they following to reach the untapped segments which banks can also deploy?
- How are they achieving operational efficiency to reduce cost and increase profit?

We are aiming to assist banks in identifying possible key sectors and processes that can be adopted for Banking Sector.



CASE STUDY

Volvo¹⁰

The challenge

Volvo Corporation (VTC) having presence in 140 countries was a late entrant in the Indian market, setting its operations in 1998 hence missing the initial entry rush of MNCs in the Indian market.

Majority of the buses plying on Indian roads were built on truck chassis, primarily manufactured by TATA and Ashok Leyland.

During that period luxury bus travel was considered to be a non-existing segment in the Indian market that over the time has been perceived as a highly cost sensitive market. Volvo entered the Indian market in this eco-system with the city buses that were typically ten times the cost of existing "City Buses" and long haul buses which cost about five times more than the then "Deluxe Buses".

The buses were essentially considered as a low cost public transport.

The eco-system of buses at the time of Volvo's entry in India could be shown as below:

| | Regular Buses | Deluxe Buses |
|------------------|---|--------------------------------------|
| City Buses | Fixed Seats, Non AC | Recliner Seats, Non AC |
| Inter City Buses | Fixed Seats, Non AC | Recliner Seats, Non AC, Video System |
| All Buses | Front Engine, little suspension and ordinary brakes | |

The approach

Volvo did not enter the bandwagon by providing low cost products in India; indeed VTC slowly started paving the way to create a new market segment from what was perceived as a non-existing space. Volvo offered quality services both to operators and consumers and waited for the market to evolve

(by pushing the right enablers) to Volvo's standards instead of the more intuitive other way round approach.

Volvo evolved and grew substantially since its first deal of 20 coaches in 2001 to over 5000 by December 2011. Key steps that Volvo took to push for the idea of luxury travel in India are:

Operations

- Displayed Business model and Life cycle costs to justify Benefits of Volvo buses
- Maintenance frequencies were substantially lower than existing buses ensuring longer hauls
- Created Volvo as a synonym to luxury travel with brands like Garuda, Shivneri and Airavat

Customers

- Ran demo drives services with Volvo buses to create awareness of the concept of luxury travel in India
- Ran advertisements on theaters and TV to create awareness and sell concept of luxury bus travel
- Provided luxury services, better comforts in intercity travel

These along with the other factors like improving road infrastructure in India with the advent of ambitious nationwide schemes like golden quadrilateral, north-south and east-west corridors along with the development of expressways such as Mumbai – Pune Expressway pushed for the growth of Volvo in India.

Volvo found the untapped and hence un-identified market in the public transport sector. This gave Volvo an opportunity to not only become the market leaders in this space but also are in the position to define and change this market segment to stay ahead of the tailgaters like TATA and Mercedes-Benz.

The download

Can Indian Banks, in ever increasing competitive markets create a new market segment or product that can replicate the Volvo story in the banking sector?

Some of the possible areas where Bank's can look for a next wave of the banking innovations can be:

- Family Banking: Giving privilege banking services to not only the HNI customers and their specific accounts, but also the complete family portfolio by calculating the TRV (Total Relationship Value) of the family instead of individuals.
- Unified Social Media Strategy: With growing purchasing power of the Generation –Y, it is important to capture their attention by catering to their customized changing needs, operating hours and touch point preferences including social media and increased focus on non-branch banking model. For more details you may see KPMG in India's Though Leadership: *Social media in Financial services*.

¹⁰ Inputs based on case study by Geetanjali Shukla, published in business today

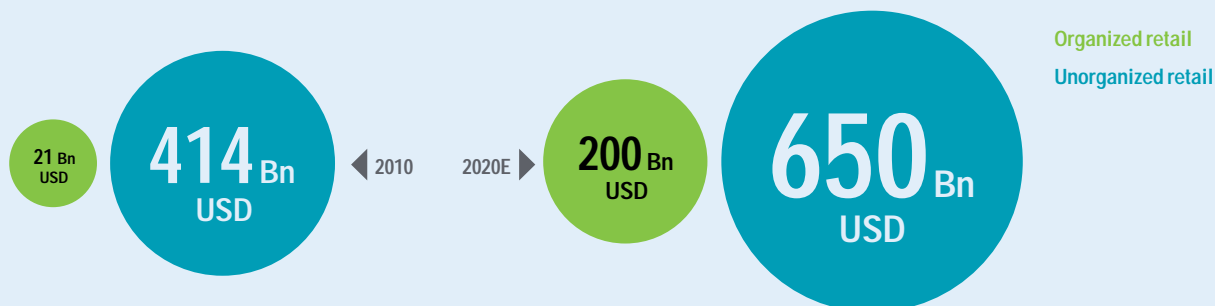
CASE STUDY

Indian retail

Indian Retail Industry is one of the key high growth sectors accounting for about 22 percent of country's GDP (Gross Domestic Product) and accounting for 8 percent of the total employment of India with the cumulative FDI (Foreign Direct Investment) for period Apr'00 – Jun'11 of USD 69.26 million.

The below graph shows the estimated increase in the market size of Indian Retail Sector, which is expected to grow at a CAGR (compounded annual growth rate) of about 7 percent, while the Organized Retail is expected to grow at staggering 25 percent.

Market share



Source: FICCI

The challenge

This sector had been facing multiple challenges but is coming up with new and unique solutions to respond to these issues¹¹ like:

- **High Real Estate Costs:** Organized retail being a footfall dependent sector needs large space to set up their operations and that at prime locations in the city. However, real estate largely being an unorganized sector, these high reality rates are already eating up the profit margins of these stores, with rents in India already outperforming the other global cities.
- **Shortage of Skilled Manpower:** With about 75–80 percent of the staff at retail stores being Front-end or retail assistants this sector needs lot of customer related skills. However, in the education sector across the country, very few retail sector specific courses like merchandizing, supply chain etc are offered.

The approach

With the increasing competition and a challenging business scenario the industry has came up with innovative approaches for these issues:

- **High real estate cost** However multiple retailer have already started looking to integrate the two sectors of Real Estate and Retail in their offering baskets with key examples being Raheja Group (with Shoppers Stop, Inorbit Mall, Hyper city), Future Group (with Real Estate Funds and tie-ups with various developers), Reliance Fresh (with Real Estate Funds and buying out multiple hypermarket properties) etc.
- **Shortage of skilled manpower** Many retail operators intuitively had been investing in overqualified and costlier resources for managing their operations (e.g. hiring graduates for billing and stock keeping functions etc.). However off late, many of these retail stores have been working close with the dedicated Retail Colleges like Post graduate Program in Retail Management in association with Pantaloon (Retail) India Ltd provided by Asian School of Business Management.

The download

Can the Financial Services sector and specifically Banks look in altering their business and operating models to respond to the challenges raised by increasing costs of operations? Bank's can look for a next wave of the banking innovation.

- **Human resource crunch:** Large number of retirements are due in next few years with more than 1 Lakh employees¹² in Public Sector Banks (Executives, Officers and Clerks) getting retired between 2010 – 15. This added with the numbers in other banks (private, cooperative etc.) would create a huge talent crunch across the banking sector. Hence it is important for the Banks to focus on creation, retention and growth of the Bank's employees. Our article on HR in this thought leadership talks in great details about latest HR tools for developing a mature and cutting edge HR department for the Bank.
- **Redefined business model:** Banks can go back to the drawing board to look for an improved business model to search for the gold at the bottom of the pyramid, where all banking players had still been skeptical of finding real value for their investments.

¹¹ FICCI and case studies by KPMG analysis

¹² A K Khandelwal report of the committee on HR issues of Public Sector Banks
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CASE STUDY

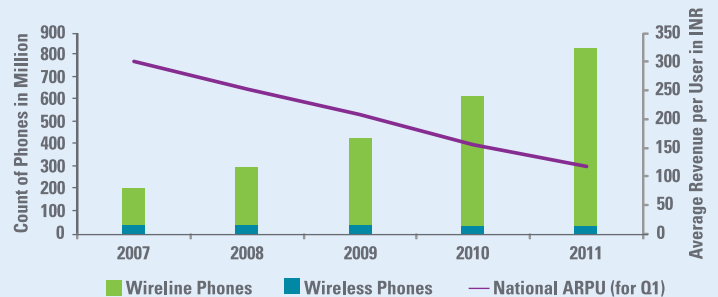
Telecom

Telecom sector is very similar to banking sector; this sector is also facing tough competition amongst the telecom players along with stiff and ever tightening regulations.

The challenge

While, the number of wireless phones in India has grown close to five times over last 4 years, average revenue per user is coming down alarmingly and has reduced by about 60% in the same time and came down to an all time low of Rs. 117.67 for the period of Jan – Mar'11.

Growing numbers but reducing revenues



Source: Department of Telecommunications, COAI and KPMG Analysis

The approach

With the tightening of the budgets and increasing operations cost, telecom companies were forced to consider and evaluate innovative and new areas for increasing operational efficiency and reduce the costs.

With this background three of the India's biggest private telecom operators came together to form a joint venture in Indus Towers) formed with the partnership of Airtel (42

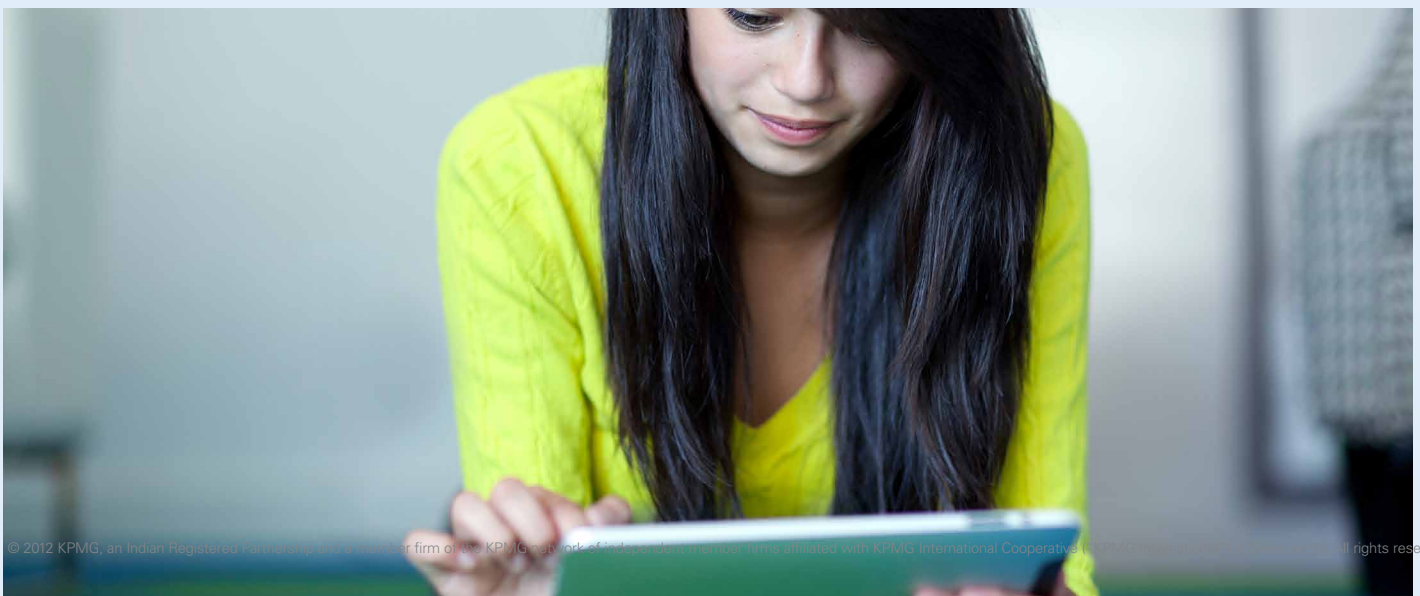
percent), Vodafone (42 percent) and Aditya Birla Group (16 percent). This joint-venture helped these companies to substantially reduce the capital expenses incurred in the back-end telecom infrastructure business by outsourcing these activities. Indus Tower is now the world's biggest telecom tower company with a tower base of more than 1.1 Lakhs.

The download

Unified Banking Infrastructure: Public Sector Banks have already started moving in the similar direction with their recent integrated procurement strategy for the regional operation, but can Private sector banks also move in the same direction by outsourcing the non-core activities to specialized companies and create economies of scale further reducing the operating costs?

Possible options that can be looked at for unified and shared "non – core" banking operations like:

- Common KYC
- Shared ATM Infrastructure
- Shared Procurement and maintenance of non-core services
 - ATM Cards Procurement
 - Debit/ Credit/ Gift Card Embossing etc.



With increasing pressure from all sides i.e. demanding customers, tightening regulatory guidelines and ever increasing operating expense, it is high time for the banks to think out of the box for innovative solutions that can not only reduce the cost but can also push the top line to higher limits, while keeping the regulators happy with bank's performance.

Above highlighted cases are just a few examples from the endless lists of success stories in other industries that Banks can learn from.





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Banking sector in India has come a long way from tedious manual processing to simplified and efficient technology driven processing. From following traditional banking practices to adopting technology heavily, banks have changed the way they work. However, even today, owing to intensive competition in Indian banking industry, commercial banks are under substantial pressure to further change the ways in which they do business. Explosive growth in technology has drastically changed the way customers expect to interact with a bank.

As per various studies conducted and also mentioned by RBI Governor in speech at IMI, Delhi, Indian banking industry is set for an exponential growth in the coming years with its asset size poised to touch USD 28,500 billion by the turn of the 2025 from the asset size of USD 1,350 billion (2010). Thus it is fairly obvious to presume that scope for such growth rates would inevitably bring in even more competition for the Indian banks in future. This shall further be triggered by regulatory impulses and increased openness of the Indian economy.¹³

Public sector banks which account for nearly three fourths of the one million people working in Indian banks face the prospect of retirement of nearly 55 per cent of their staff in the next decade. As also mentioned by Dr K. C. Chakrabarty, Deputy Governor, Reserve Bank of India, if ever there was a time for right sizing the organization, hiring the right talent, revamping the workforce and bringing about a cultural transformation, the time is now.

Public sector banks which account for nearly three fourths of the one million people working in Indian banks face the prospect of retirement of nearly 55 per cent of their staff in the next decade

One of the major challenges faced by banks today globally is in the management of human resources, particularly the work force at upper and middle levels of organization. **Having exploited competencies of technology in revamping multiple facets of business ranging from core banking and treasury to managing risk, it's time to utilize technology in nurturing the biggest asset of any organization – the people.**

Some of the major challenges in the arena of Human Resource Management, which the banks need to look at, are explained in the subsequent sections of this document.

People and HR issues faced by organizations in India



Source: Department of Telecommunications, COAI and KPMG Analysis

¹³ IBA-FICCI-BCG report titled "Being five-star in productivity-Roadmap for excellence in Indian banking" and has also been mentioned by RBI Governor in his speech at International Management Institute, Delhi

Resource development and training

In a competitive environment like of today, which is further hindered by sluggish economic growth, only innovation can bring any value to an organization. Innovation can be stimulated across people/workforce if companies follow a holistic approach towards HR. HR needs to work on planning, creating and managing a talented work force. HR should focus on aligning people related factors such as leadership, HR processes, technology driving those processes and organization structure around innovation to cultivate a more innovation driven organization and culture. At the same time, HR should understand the skills required to fulfill the growth requirements of the bank and develop and execute a plan for acquiring,

developing and retaining talent in light of forecasted growth.

Many leading companies today use templates that guide employees in charting their career development plans. Banks need to incorporate something similar. Banks need to assign the ownership of such plans to immediate managers so that they provide the required visibility and support required by employees to develop at the required pace. This has also been emphasized by Khandelwal committee¹⁴ citing that the line managers should have an explicit objective of people development in their own annual goals. Banks can assess the effectiveness of such development programs by mapping them against the actual career progression of employees.

Are your employees being trained in the right direction?

Even today when all the public sector banks have implemented CBS and other state of art systems, a majority of staff is deployed on non-customer facing roles and a less percentage of staff is responsible for sales. As also cited by Khandelwal committee for public sector banks, even after introduction of technology, majority of time and resources are spent in doing routine clerical work in branches. Banks today need to reposition their key branches as sales and service outlets. For this purpose, banks need to look at developing a stronger sales team and this is not possible without strong support from HR and technology enabled platforms.

Some of the leading companies across industries are using learning programs that are a simulation of actual work

environment to prepare the upcoming talent. Banks need to look at providing for continuing education of their employees. Computer based training techniques which have a better reach, overcome geographical limitation and have reduced training costs is one mechanism that banks can use to fulfill their training objectives.

Tie-ups with leading educational institutes are another mechanism for training employees that some of the public sector institutes in the country follow. NTPC for instance, has tied up with International Management Institute and IIT-Delhi to provide full-time executive MBA and M.Tech. programmes to its staff for honing their technical and managerial skills.



¹⁴ Government constituted a Committee on Human Resources issues of Public Sector Banks (PSBs) under the Chairmanship of Dr. A.K. Khandelwal – called Khandelwal committee

Developing the next generation of leaders

Some of the leadership challenges faced by organizations today are in identification of future leaders from a spread of older workforce as well as the Gen-Y, managing changing customer needs and business environment, responding to changing economy and competitive landscape, leading a technology driven environment.

A lot of companies in other industries today are using processes and tools which are data driven and hence provide an unbiased approach to identify key talent indicators. Such indicators are then being used by the senior management to identify the promising talent pool (that possesses the potential to quickly develop the required breadth and depth of capabilities) in their organization at an early stage. For instance, a lot of

public sector organizations in India such as NTPC, ONGC use Assessment and Development Centres (ADCs) to evaluate employees for higher level jobs and leadership positions. ADC comprises of multiple assessment techniques such as job simulation exercises.¹⁵

Beyond conventional HR measures, such prospective leaders should be made to feel like co-stakeholders, should be provided a seat on boards, may be by providing equity options, generous performance linked payments and above all should be treated as extended promoter family members.



¹⁵ As per Khandelwal committee report on HR issues of Public Sector banks - 2010

Surging expectations and falling loyalty

Primarily in the private sector, managing employee attrition is one of the major issues that banks are facing today. Even public sector banks today need fresh and brighter talent (called the 'Gen-Y') to fulfill the talent gap that shall be introduced by the retirement of nearly 55 percent of staff in the next decade as such gap cannot be replaced only through internal promotions.

Some leading companies are using advanced workforce analytics aided by technology to identify employees who are potential 'resignees'. They analyze past and current employee data ranging from performance ratings, professional relationships, compensation levels to even person's daily travelling time to office.

Are you hearing your employees enough?

Focusing time and attention on addressing and solving problems that impact individual's ability to their best work, is critical to the success of any

organization. In the world of mobile technologies and social media, banks can look at using social media tools as a means to know what employees have to say and as a means for supporting employees.

Employees can express concerns, ask queries using the online platform provided to them. In the world of BYOD, with a larger population now using smarter handheld devices, banks can exploit the mobile platform to move an inch closer to their employees. Employees can use their smart phones to voice their opinions, participate in discussions anywhere, anytime.

Are you managing their knowledge?

Banks need to deploy state-of-art information systems for capturing, maintaining and retaining knowledge, such that it is available to right people at the right time. Only effective knowledge management can support sustainable development of a bank where various

departments build on each others' knowledge and experience.

Banks can also create knowledge sharing portals (online communities) to share knowledge. Mobile devices can provide quick on-demand access to such knowledge from almost anywhere in this world. Online knowledge sharing communities shall provide specialists and senior employees to share their knowledge and hence provide a more engaging and convenient learning mechanism for people who join new.

Mere implementing online communities may not be enough, HR functions within the banks will have to perform the roles of moderators and have to encourage people to participate and hence sustain such knowledge sharing models.

HR has a major role to play in championing knowledge management as depicted in the diagram below:



Source: Leading practices in Strategic Human Resources Management- a review for healthcare practitioners, KPMG publication

Developing a high performance culture

NTPC has come up with some interesting initiatives outside the work domain to improve the happiness quotient of their employees. Some of such initiatives include a marriage portal for their employees and wards, usually posted at remote locations of the country and a 'First Day First Show' movie screening facility. NTPC also has a free counseling and support program called 'Snehal'. NTPC has been ranked 3 among EconomicTimes' 'India's best companies to work for 2012' survey.

American Express, ranked 6 in the same survey, has an internal ombudsperson available for discussion for unsatisfied employees who can discuss issues ranging from promotions, performance appraisals to work schedules. Forbes Marshall, ranked 5, has 'family spirit' as one of its core values. It involves

spouses of all the employees all the way through, right from the orientation to retirement dinners.

HDFC Standard Life Insurance provides a single window called 'E-Sparsh' to its employees for all queries/concerns. If the query is not resolved in a predefined time, it automatically converts into a grievance and is raised to higher authorities in the respective department. To retain employees and increase their 'happiness quotient', banks can learn from some of such initiatives.¹⁶

To summarize

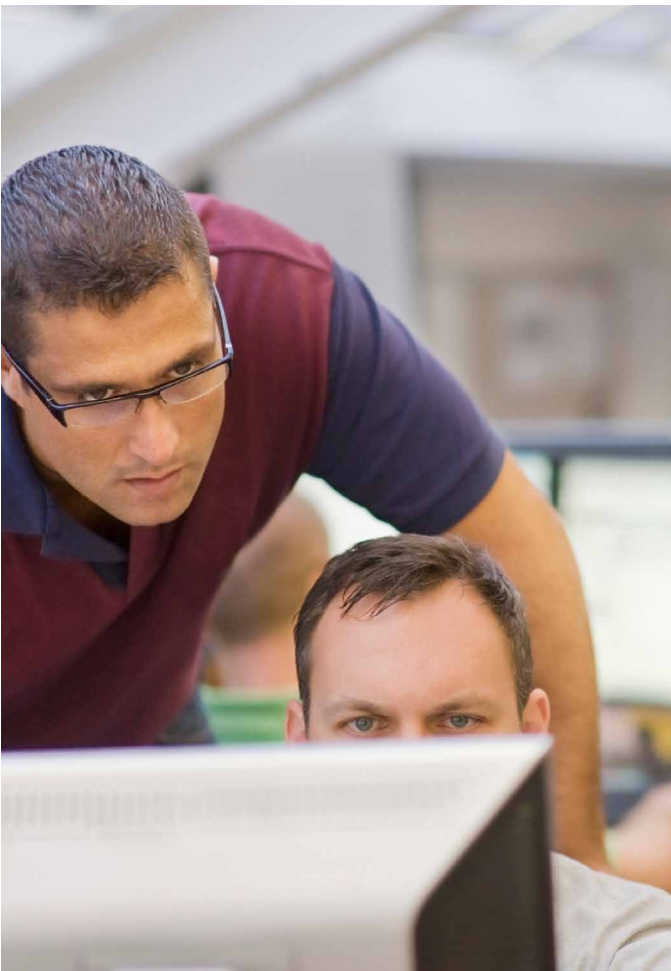
Technology as an enabler should be used to bring in efficiency in operations and functions of HR at each stage. HR along with business should use technological tools to measure success of various HR initiatives that they take up to realize its true value. Specific key parameters can be defined to measure the success of each HR initiative. Dashboards and reports can then be developed and used to provide a real time view of progress of such initiatives to the business management and HR, across the defined parameters. Similar practice is followed in ING where business units and HR share a comprehensive dashboard, supported by reports, to show progress on key metrics. Advancements in technology can aid in fulfilling such goals.

Social media can also be used as an important tool in hiring the right talent; social media websites like LinkedIn can be used to find experienced professionals, while other social media websites like Twitter and Facebook can be used to run recruitment campaigns.

Computer based training techniques which have a better reach, overcome geographical limitation and have reduced training costs can be deployed to impart training anywhere anytime. Data driven tools can be used to identify key talent indicators which can then be used to identify budding leaders at an early stage.

Mobile platform and recent drift towards smart phones can be utilized to hear employee opinions, educate employees and conduct discussions. Knowledge sharing portals can be used to engage and record knowledge lying in silos and can be conveniently accessed through mobile platforms.

Above all, core HR processes should be automated to reduce operational costs and improve operational efficiency.



¹⁶ Economic times listing of 'India's best companies to work for- 2012'

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About Times Grey Cell



Times Grey Cell (TGC) was founded as an exclusive platform for the next-generation knowledge masters to come together and talk about new-age trends, technologies, initiatives, practices, and outlooks, with an aim to help decision makers understand the shape of things to come as well as define the way forward for their businesses.

Bringing forth this vision, the TGC creative team identifies the prime sectors driving the economy, such as IT, BFSI, Healthcare, Education to name a few. The team also focuses on key subjects and issues within the sectors, and builds platforms in the form of conferences, seminars, symposiums, round-tables, and conclaves.

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