ICICI

Posted on

Leveraging Opportunities

KV Karnath, the Managing Director and CEO, ICICI Bank, was in Sri Lanka recently to open the bank's first branch. Business Today spoke to him to learn about the bank's emergence as India's largest private sector bank, the increasingly valued role of technology to the banking sector, and the future prospects of the Indian banking industry and its ramifications for Sri Lanka.

By Dinesh Weerakkody Assisted by Shabana Ibrahim

ICICI Bank has transformed itself over the last few years to become a one-stop retail finance powerhouse. Tell us how you transformed a state owned development bank into a new age consumer bank that is world class in many aspects?

ICICI Limited went through 40 years of activity as a project finance company. We were always listed from day one in the stock exchange in India. We are a private company, but in-between for a period of almost 25 years some of the Indian financial sector players got taken over by the government. The government indirectly owned the majority of our shareholding so we were deemed a government company. We continued as a development bank and in the 1990s when we raised additional capital, the government's share got diluted and our character changed slowly to a private company. In the 90s we setup several subsidiaries dealing with investment banking, commercial banking, venture capital and a variety of other investments. The parent was always ICICI Limited. The name Industrial Credit and Investment Corporation of India Limited describes what it was doing and the acronym was ICICI.

How did ICICI bank emerge as the fastest growing retail bank?

In the late 1990s we found that ICICI Limited and its core business of project finance, which made us a single product company, looked very risky in the context of changing times. Changing times was where you had a situation where globalization happened and India was opening-up and you had global competitors, so the type of lending that was happening in the past, licensed and directed and so on would not work. We said we need to change, that is where we had the drive to change and we said that the opportunity we saw was for consumer credit. We decided to go into consumer credit. Looking at what had happened in the last five or six years, it really started with the 2002 parent and commercial bank merging.

The parent was the larger institution, the commercial bank was a very small institution, but we reverse merged the parent into the commercial bank to create India's largest private bank and we said our focus was going to be consumer credit, however, we would also continue with corporate lending as we already had the skills set, the people.

ICICI Bank is also India's foremost technology bank; tell us how you got there?

We also said we need to do things differently and we decided to bank on technology as a differentiating factor. As we had decided to focus on consumer finance, the Bank decided to implement technology and provide the convenience to our customers. The consumer finance market grew rapidly and the customers also adopted the technology, so these two early calls we made, worked out to be right. That was the core of our success . Today, ICICI Bank is India's foremost technology bank. ICICI Bank uses IT as a strategic tool in all the business operations, so as to gain a competitive advantage. The IT based initiatives have been aimed at enhancing value by integrating diverse products, offering customer convenience and improved service while optimising costs.

ICICI Bank is also credited for bringing in the retail finance phenomenon to India?

Our retail expansion coincided with the interest rate scenario, where interest rates started declining from '99 to 2004. Interest rates then went into a rather sharp decline. You had a situation where interest rates in mortgage declined from 15% in 1999 to 7.5% in 2003. That expanded the market and ince we had taken the early call and said that consumer credit was ooing to be a major driver, we had opened a network of customer contact points in over 1,500 locations, making it accessible to the customer. The decline in interest rates and our nen,•ork made retail finance much more affordable and accessible. We had a fairly quick expansion of the market as a result, and in our market share a well. Today the consumer credit market size in India is USD 50 billion and growing at 45%. We have a one third hare of that market. I do not see it lowing down, and expect ICICI Bank to grow with the market. Consumer credit is today accounting for over almost 65% of our balance sheet. Rapid transformation of our balance heet has taken place in the last five years.

What about corporate banking?

As far as our core corporate banking franchise is concerned, the business continues. We do syndications, trade finance, cash management and all technology-enabled services.

How big is your international banking business?

There the philosophy was simple. We said that in international banking the initial focus would be the Indian who is abroad or the Indian corporate that is doing business abroad. Basically a simple philosophy of following our customer. Again leveraging technology and capability to serve our customers was our objective.

What would you say as your next big opportunity?

Rural India. We also have a very strong rural focus and we are looking at this segment as the next big opportunity.

How much of India is banked?

Today, I would say 40% of India is banked. Maybe out of a billion plus people, 300 million or 400 million odd people would actually have access to one form or the other of banking services.

You talked about the need for an international focus and following the customer. As you know Colombo is heavily over-banked. So do you still see an opportunity for ICICI? The way we have looked at it is that in every market we have entered, initially it appeared that the market was over-banked. For example in India when we decided to focus on consumer credit, we were not the first entity to target this segment, there were established players in this segment. But we decided to take the challenge. We believed that technology would enable us to dramatically bring down costs, which did happen .. On the consumer behaviour, it has been a worldwide phenomenon that when per capita income rises to around USD 6,000 to USD 12,000, the consumer aspirations change.

The consumer wants a home, a car, a credit card etc. So we took that call and that call came right, in terms of technology, market expanding etc. Seven years back, the consumer credit market was pegged around USD 5 or USD 6 billion market and today it is around USD 50 billion. When we went to Canada, again we went through the same philosophy and it was a mature market with very little space for us. Today we have more non-Indian customers than Indian customers in Canada. About 70%

of our customers both in Canada and UK are non-Indians. What did we offer which was distinct, which made them come to us? We offered them Internet banking. Is internet banking unique? Aren't others offering it? Yes, they are, but what we did is by running the whole bank at Indian costs and back-ending a lot of technology work to India, our internet banking costs were 10% of the costs of our competitor banks. Whatever costs we saved, we offered it as a higher interest rate to the customer.

In Canada if the interest rate is 3% or 3.5%, you offer 0.5% more, that's a big jump for the customer, so that's what got us a growing franchise in these countries. If I were to use the same scenario in Sri Lanka, there are a lot of foreign banks, but to me the picture is similar to what I saw in India seven or eight years ago, strong focus of government banks, they have their own challenges, so we try to see what is it that we can do differently. In Sri Lanka I firmly believe that this market in the consumer credit segment is set for rapid change. Aspirations will change as per capita incomes would and I am a firm believer that this country will grow at dramatic pace. Consumer credit will be one major growth drivers. We will use the same strategy that we used in India. Create reach and affordability. I believe that borrowing costs are going to be the same for everybody and if the economic environment is such that the rates come down, that will further boost the market. Otherwise you have to see how you can bring down rates by lowering costs and managing risk efficiently. You make the lending affordable to the customer and that is what we want to do. We also want to use technology to the fullest extent. I was told that remittance to India from Sri Lanka takes ten days. Why should it take ten days? To me it should not even take ten minutes. These are the types of products that you can offer. In the Indian market, in the space of two years we have a 20% market share of the remittances into the country. To the customer who wants to deal online, an online proposition right up to his account or his beneficiary's account in India, completely online, or he wants intermediate physical instrument, we actually print a draft in India and mail it to his beneficiary.

The origination takes place online, request comes online, it hits our print shop, we print it and overnight courier it to his beneficiary. Again not ten days but in a day or 48 hours we can get it to the beneficiary. We want to look at this market, what is the customer's request, how does he want to deal, and is there an opportunity? In all the markets that we have gone into whether it is Middle East, UK or Canada,what we first look at is there a partnership opportunity with a local bank. For example even in India, where we do a draft for a remittance customer, we enter into correspondent banking engagements with other Indian banks that have a large mass of branches to get the draft cashed. In the UK we work with Lloyds Bank as our partner. We will in due course, not immediately look at whether there is a partnership model that could work here for the remittance business. Basically the idea is to leverage our core competencies, which are technology, our product suite and our learning from the Indian experience into this market.

In terms of reach and growth, what is your Sri Lankan strategy?

Very simply in the first step, which is a one-year to 18-month horizon, we would like to look at eight to ten branches in Colombo and the major towns of the country, with a completely networked presence. Initially we will work with other bank ATMs and then we will see whether an ATM network makes sense and we will roll it out. All those corporates from India who also have a link into Sri Lanka are our customers. We will see how to work with them, provide them our online services and maybe a learning platform for operations in the island country. That will be the second thing that we would need to look_ at. Third is the opportunity to work with corporate and local entities.

Often the Sri Lankan banks are accused of having huge spreads. Do you see an opportunity there for competitive pricing?

We will go ahead with the philosophy that the product has to be affordable to the customer. When we first got into the market in India, mortgage was at 15%. We found that though interest rates are high, a mortgage could be priced at 12.5%, so we brought the interest rates in alignment with what we thought was fair to the customer and giving us a good return. That itself expanded the market, so even in Sri Lanka, we will look at trying to see whether the spread is justified or not, then price the product appropriately.

> “A positive factor in Sri Lanka is the literacy level is so high that there’s a natural bias for a customer to look for convenience. The tipping point will be convenience and that was our experience in India”

You mentioned that technology had helped business growth. What will you do differently to create that value proposition?

Just to put it in context, if we look at our bank, and this is true of all banks, 95% of transactions take place in the branch. Today, let us say 25% take place through the branch, the 40%-45% takes place in the A TM and the balance takes place on the internet or through the call centre. In India we offered a mass platform. We are not necessarily a high-end bank, we are a mass bank. Our aspiration is to become a rural bank also, but as I said that is the next horizon. There again we will have to work in partnerships. We are a mass bank today and as a mass bank we believe in call centers and the internet, all these have become our mainline channels. The philosophy adopted, was first to be available to the customer in a distinctly different manner than other banks, even physically, so we said we are available to the customer from 0800 to 2000. Our branches are open for 12 hours, six days a week in India. We are a very lean-branched bank. Only 600 branches, whereas the largest bank has 10,000 branches. Our ability to use technology across every function is the differentiating factor.

Sri Lankans in general are averse to technology. So to me it seems you will have to pioneer the effort to make technology accessible and wanted?

We will have to test this hypothesis. I honestly have to admit that we'll have to test that hypothesis. When we started business in India the customer was averse to technology, he was averse even to use an A TM, but to our pleasant surprise it turned out to be that hypothesis was not correct. We will have to test that hypothesis here. A positive factor in Sri Lanka is the literacy level is so high that there's a natural bias for a customer to look for convenience. The tipping point will be convenience and that was our experience in India. Convenience became the key differentiator and we'll have to test it out whether that is a differentiator in this market also.

Yours is very much a people business. So at the front end you need to make sure you are getting the best people. How do you find good people and keep them motivated?

Many young people are excited to work with us for the same reasons. One is because of the excitement of working with a bank, which is at the cutting-edge of whatever it is doing be it use of technology, products, rolling out a product, or growth The second key reason why people come to us and are working "with us is because of the growth opportunity. We are a bank that is growing at 30%-35% compounded annually in terms of the balance sheet. The third key reason·because we are a young bank where the average age is 27 or 28. Even the executive directors on the board are a young lot. Out of the five directors, two are in their early 40s. The appeals of a young, fast-growing, exciting bank where things are happening is what I believe attracts and retains people from all over the world. In places like Canada a diverse multicultural busine is being run, where almost 20 languages are spoken in the bank.

> “If you look at the financial sector in India is slightly open. Entry is not barred in any area, except in insurance where foreign partners can own only 26% stake in an insurance joint venture”

Will you be importing talent for the local operations?

We haw already started with 22 people. Three are from specific skill set that we have got from India, the re t are from here. Having seen the skills that are available here, we do not think we need to bring in any. With reoard to keeping costs low ornetime we are on the spot and then we tart thinking. We said we want to keep costs low, but we want to get into all these products. Let’s a ume the e are all specialist products, like mortgage financing, auto financing, back office, documentation check, each one is a specialist. There may be a limited number of these specialists back here, what do we do?

I said can you open a virtual office in India, which is an online office with screens and certain skill sets sit there in that office, and they interact with people on the ground here, so you don’t have to physically relocate people. What do we want? We want knowledge. To me knowledge is an asset, which does not deplete and if we can get knowledge to be used and allow that knowledge to be passed on and accessed, you have got the biggest winner because, I can then do busine with the lowest possible costs. I do not have to have to relocate five or ten people, spend that cost on them and pay them salaries. I use them where they are. I use virtual access media to get that knowledge to the markets where it is needed. We have not done it in Sri Lanka. We do run back offices here. Keeping specialist skill sets accessible to this office from India, virtually online.

I am sure ICICI bank has an unique culture and a skills set; do you normally grow your talent or import them? We historically had to grow. When I say historically, we were a project finance company right up to ’96, ’97 but we used to go and select the best talent from the best business schools and the graduating class of CP As every year. We had a pool of talent with us. Today if you see our managers, they all come from that old pool. When we built the consumer credit business in ’98, ’99 we had to pick people from outside to support our expansion. Today ‘”Ve are· the ones providing people to the larger market in India and Indians around the world in our region. We get poached rather than us poaching. Today we recruit 7,500 people in India a year. We receive 300,000 resumes a year to select the 7,500 people. Monthly resume run rate is 25,000 resumes, which are screened, tested, interviewed and then recruited.

Is retention of your top talent a big issue in India?

Yes, there is so much of opportunity for the talented people in India. Attrition rates are running between 10% and 15% in India. What we have done is build attrition into the base skill. There is going to be attrition. If you needed 6,000 people, you recruit 7,500 people. You assume that off your pool 1,000 or 1,500 people will leave. You need to recruit, train and get them on the bench, so that you do not say ‘well I lost people.’ On an ongoing basis we build our bench strength.

You operate globally, what are the systems and processes you have for good risk management?

Risk management processes are worked out as local and central. Primary risk management is local, risk management best-practices come from the central office, all policies are locally drawn, but monitored by the central office, because everything that you do has to fall in line.

How restrictive is the Indian banking environment?

Broadly it is more or less aligned to what is happening here. If you look at the financial sector in India is slightly open. Entry is not barred in any area, except in insurance where foreign partners can own only 26% stake in an insurance joint venture. In banking you are allowed to have branches. Typically subsidiaries are not encouraged, but a full branch is given. The number of new branches that you can open in a year can be up to 15-25 branches, but we are not running or setting-up too many branches. There are no restrictions in their doing what they want to do in this context. On the market side lending rates are completely freed-up, borrowing costs, the savings rate is still administered, so lending and deposit rates are freed-up, the exchange rate is marketed, the Central Bank monitors it, very quick alignment to Basel I and II . We are at Basel I now and we will move to Basel II.

Will it require additional capital?

It will not require additional capital because looking at risk and other factors, we will be fine. The Reserve Bank of India has required that for mortgages the risk weightage is higher than what is prescribed under Basel II, so some additional capital will be required but we have finished our capital raising. We raised a significant amount of capital in December, we raised around USD 1.75 billion through the market. We are listed on the New York Stock Exchange, so we issued stocks there and in the domestic exchange. We had a great response, the entire USD 1.75 billion issue was oversubscribed more than five times. The other good thing is that in India like elsewhere in the world, Tier 1 hybrid instruments are now probably going to be allowed. The Central Bank has brought a paper on that. These are perpetual preference shares, perpetual debt etc. In this regard Indian banks, today in terms of capital are pretty well positioned.

On the governance side has India looked for some inspiration from Senator Oxley's work?

Our market regulator is a very proactive. It has been so for sometime and that has·now been taken forward. We now have almost the equivalent of the Sarbanes-Oxley. It is called 'Clause 49' where all the listing requirements are included and it is aligning and tightening our governance to what is required even in the US type of context. Companies are very quickly falling in line. The key there is the need for independent directors, the way the independent directors act etc, the CEO not being on the audit committee and on other committees, plus independent directors needing to man a given number of committees.

On CSR, what are some of your initiatives?

We have taken this seriously long before CSR became a buzzword. As far as I can remember, even if I go back 10-15 years we were doing a lot of this work. Somewhere in the '90s after I took over, maybe in '97 or '98, we thought that maybe we should focus on a few areas rather than doing a whole lot of things. Firstly taking education to the slum children, we picked Mumbai because that is the biggest metropolis. We now have more or less addressed this in the slums of Mumbai, so it's a far-reaching project. We work with NGOs and partners. We anchored the funding, then we catalyzed funding by getting funding from overseas donors, domestic donors etc. to run this, and it is run as a 'Baal Wadi,' that is a child education center in the slum itself, with standardized curriculum etc. Basically trying to get the child who otherwise would have missed education. Then we try and get the child into a municipal school, this is one area. Secondly we wondered whether we could work on infant mortality. The problem we thought in infant mortality was not after the child is born, but the mother’s health during pregnancy, so we wondered what we could do to address infant mortality through better health management of the pregnant mother. The third is a larger role, which we believe is connected to our core business franchise. That is how to basically make microcredit available to the poor to make them sustainable and that is basically lending through micro-credit self-help group centers. If you have to scale-up anything, it has to be a business model and the best way to address a social responsibility is to try to address economic weakness. If you do it in a scale-up model, you are addressing wealth creation. Wealth creation even in small lots at the lowest end of the ladder starts improving the quality of life. Handouts cannot go around, our philosophy is that in micro-credi we use a phrase ‘no wide space’ meaning that everybody is aligned. There are 600 districts in India, I wan be in all 600 districts in India. 1ha is our next horizon.

How do you plan to cover 600 districts when you have only 600 branches?

We will work with partners like micro-credit institutions. There are 240 micro-credit institutions, we fund 60 of them, and we will work on setting up 40, finding the right persons who have the commitment to do this, we will give them a common processing platform in terms of software and hardware by working with respective companies. Internal proceses we standardize them because we have core competence in these things. They will run the branches, we won’t run the branches because our cost structure cannot work in the village, so you need somebody with a cost strucutre maybe 1/10th of ours to work in the village, so they’ll be in the village. 200, each working in three districts covers 600 districts, that’s the way we are looking at it. Then we will work with other partners like people who have a positive interest in the village. Somebody wants to work with a farmer selling seeds, somebody wants to sell fertilizer, somebody wants to sell deweeding agents and somebody wants to sell a tractor. One set of corporates who are in rural India, another set of corporates who want to buy seeds, village produce, network these people with the farmer and try to deliver value there.

Will there be a need for further consolidation in the India Banking sector for Indian banks to expand and grow globally?

In India it has to happen, but I think the time is not yet right because it is a sequencing issue. You need to fir t get technology consolidation, then rationalization of staff, skill set imprO\’ement and then consolidate. Otherwise you will have somebody , -ho has 4,000 branches and somebody who has 5,000 branches and not 0et anywhere. Once we get the proper combination going many of us will look to expand globally.

If the economy grows at 8% your bank will continue to grow organically at a blistering pace, but the real growth for you will come from acquisitions. Is ICICI poised for such acquisitions?

Our growth so far has been organic. In the late ’90s we took an inorganic growth because we were learning new businesses, we were learning retail lending and we acquired auto finance companies and the like. In 2001 we acquired a bank because we needed some distribution and reach. Now we find that organic growth is the best way to grow, so currently the focus is organic.

A lot of development banks now are actually doing commercial banking than development banking. Why?

My view is that even development lending has to be commercial today and it has to be competitive. What we are now doing is that every single function we had as a development bank is still there. Lending is at market rates. In fact development lending was at market rates even in the last ten years. From ’90 onwards we were raising money in the market and lending in the market, so it was a lending activated market. It had evolved. Before that it was at a directed rate, the rate was set, so if the rate is market determined which means what is determined in the market? That is premium. You borrow at a given rate, you have cost of operation, then you add a risk premium, then your profits and that’s your lending rate. The risk premium is market determined, so if it’s a new start-up project, you should have a higher risk, so higher lending rate. That is the model to lend for development but it has to be a market development model and I would be happy if any player continues to do that because that is required for economic development. Our belief is that a development bank, which was labeled as a development bank in today’s market place has to diversify. I am not saying it has to give up its developmental focus. It has to diversify its operations so that internally you can hide your risk. Otherwise for example when we were doing only project finance we were extremely vulnerable to systemic downturn, so all of our companies come under pressure because there was a systemic downturn. The organization is impacted for the next four years. You now need to counter-balance this risk as a diversification. I would think that every bank has to look at diversification.

ICICI has grown at a blistering speed, what impact has it had on Non-Performing Assets (NPAs)?

At one stage we were around 5% today we are less than 1%, so I think it is due to the diversification that we have done. Furthermore in India what has also happened is that Indian companies have literally reinvented themselves in the last three or four years. What did they do? They stripped their bad loans clean, they improved processes, productivity, and quality, brought down costs and today they are globally competent.

As a final question what will the banking industry in India look like in five years time?

I would think that the best benchmark is China. China has been growing at around 10% for the last 15 years. Our belief is that when countries transform from a less developed state to maybe to a developed state, there is huge opportunity. It is a long haul and China is 15 years into it. We are maybe four years into it, so we have another ten years of growth maybe 8%-10% to happen in India. If that is so our banks should be where Chinese banks are ten years from now. The top five banks in India today are smaller than the fifth bank in China. I look at it as a huge opportunity to out grow out of that small size mindset. Significant double-digit growth has to happen in India in the banking sector and double-digit growth has to also happen in the economy.