

# Banking

NOVEMBER  
2011



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## Contents

- ❖ Advantage India
- ❖ Market overview and trends
- ❖ Growth drivers
- ❖ Success stories: HDFC, Axis Bank
- ❖ Opportunities
- ❖ Useful information

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## Advantage India

### Growing demand

- Increase in working population and disposable incomes are likely to propel demand for banking services
- Rural banking is expected to witness strong growth in the future

### Innovation in services

- Mobile and internet banking to improve operational efficiency
- Vast un-banked population highlights scope for innovation in delivery

FY25F

Total asset size:  
USD28.5 trillion

## Advantage India

### Business fundamentals

- Rising fee incomes improving the revenue mix of banks
- High net interest margins, along with low NPA levels, ensure healthy business fundamentals

### Policy support

- Wide policy support in the form of private sector participation and liquidity infusion
- Budget FY11 to infuse INR60 billion of tier I equity capital in public sector banks

FY11

Total asset size:  
USD1.5 trillion

Source: IBA report titled "Being five-star in productivity-- Roadmap for excellence in Indian banking".

# Banking

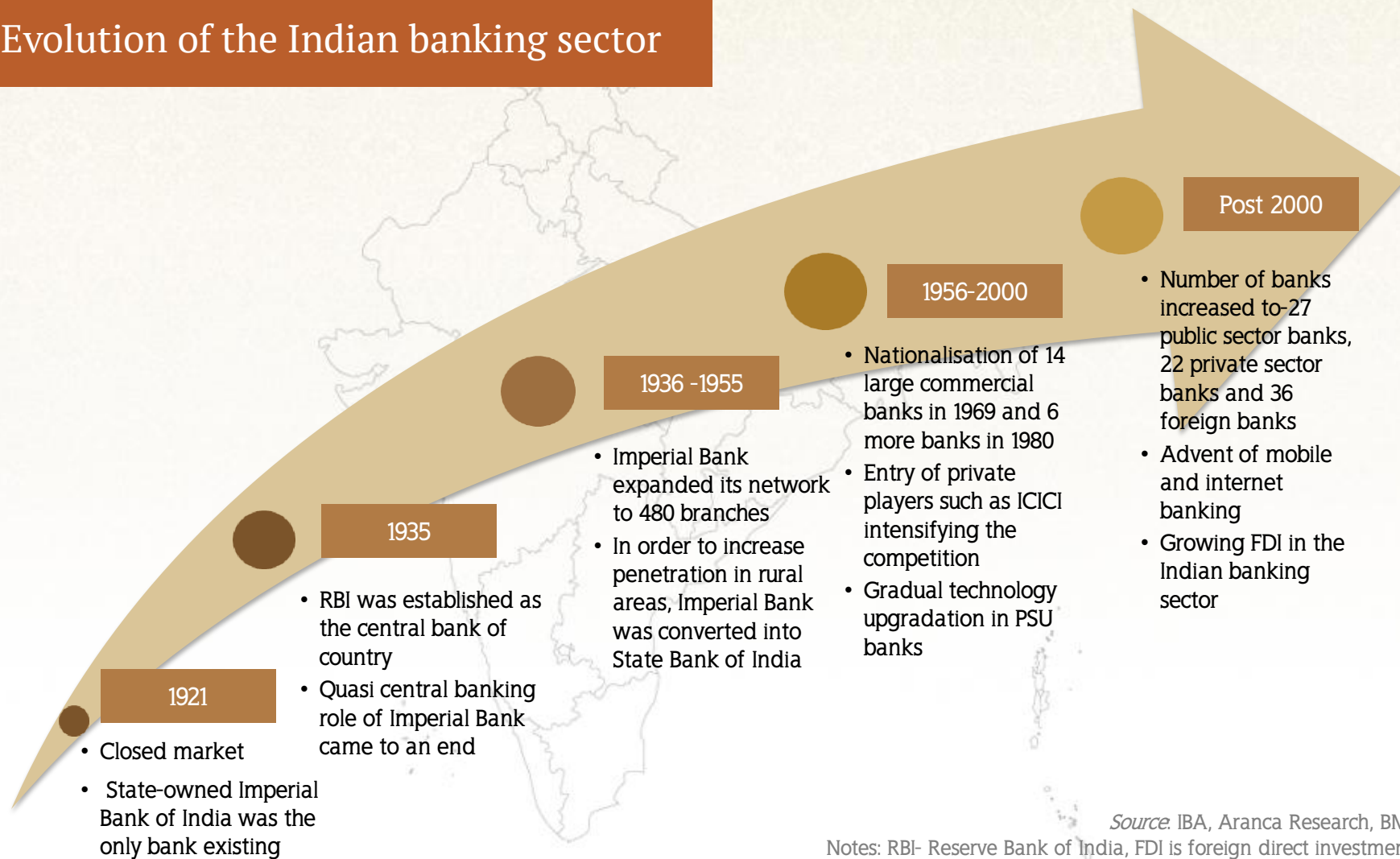
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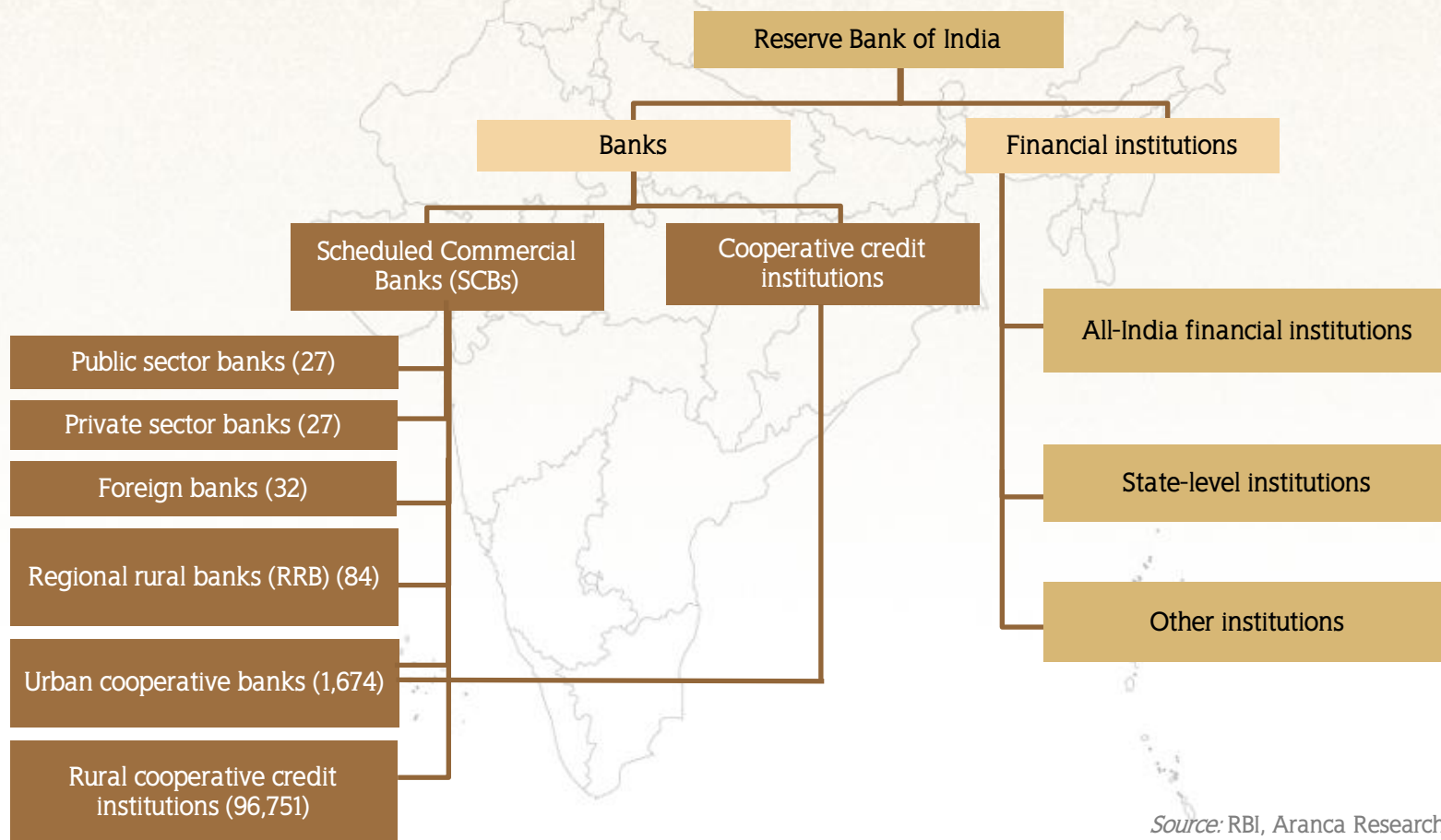
## Evolution of the Indian banking sector



Source: IBA, Aranca Research, BMI

Notes: RBI- Reserve Bank of India, FDI is foreign direct investment

## The structure of Indian banking sector



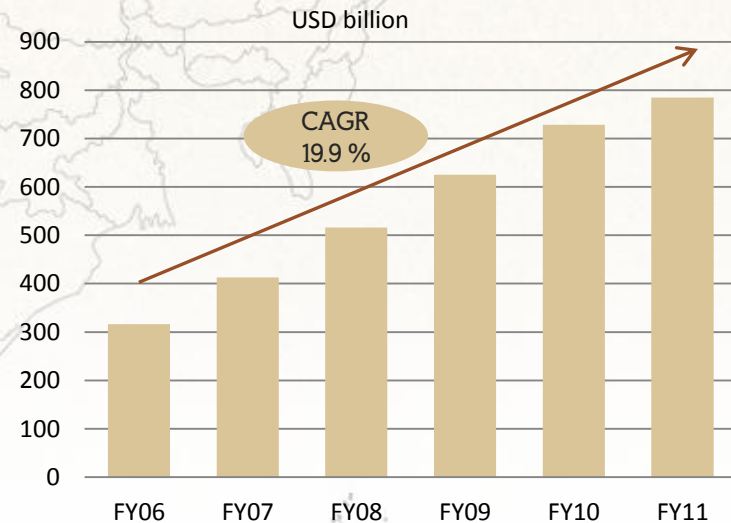
Source: RBI, Aranca Research

## Indian banking sector has grown at a healthy and steady pace ... (1/2)

- Credit off-take has surged at a CAGR of 19.9 per cent over FY06-11
- Loan growth has been driven by strong economic growth, rising consumerism and income levels
- Demand has grown for both corporate and retail loans

CAGR: Compounded annual growth rate

Growth in credit off-take over past few years



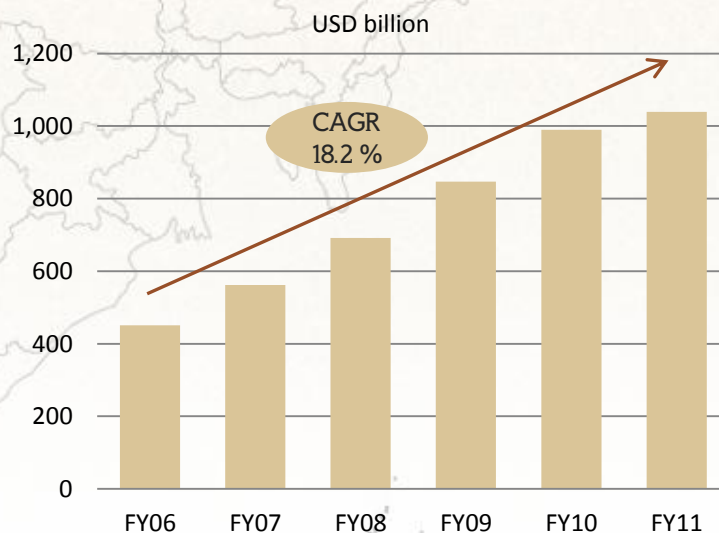
Source: Reserve Bank of India (RBI), Aranca Research

## Indian banking sector has grown at a healthy and steady pace ... (2/2)

- Deposits have grown at a CAGR of 18.2 per cent over FY06-11
- Deposit growth has been mainly driven by strong growth in savings amid rising disposable income levels

CAGR: Compounded annual growth rate

### Growth in deposits over past few years

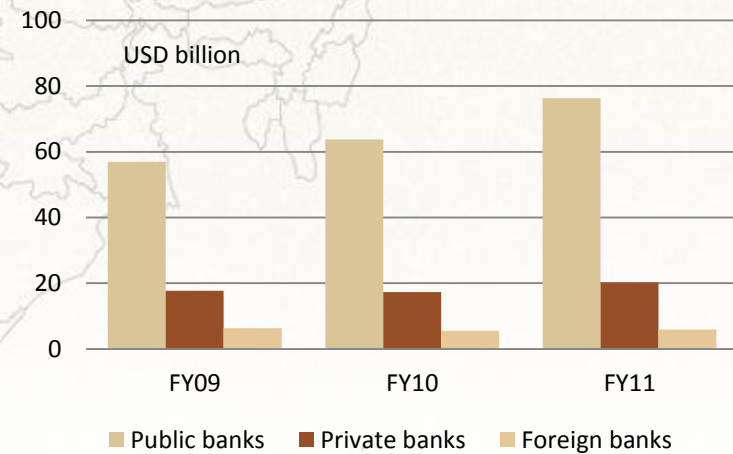


Source: Reserve Bank of India (RBI), Aranca Research

## Income from interest, as well as fees, has seen robust growth ... (1/2)

- Public sector banks account for over 70 per cent of the interest income in the sector
- Public sector banks lead the pack in interest income growth with a CAGR of 16 per cent since FY08
- Overall, the interest income for the sector has grown at over 13 per cent CAGR during the period

Interest income growth in Indian banking sector

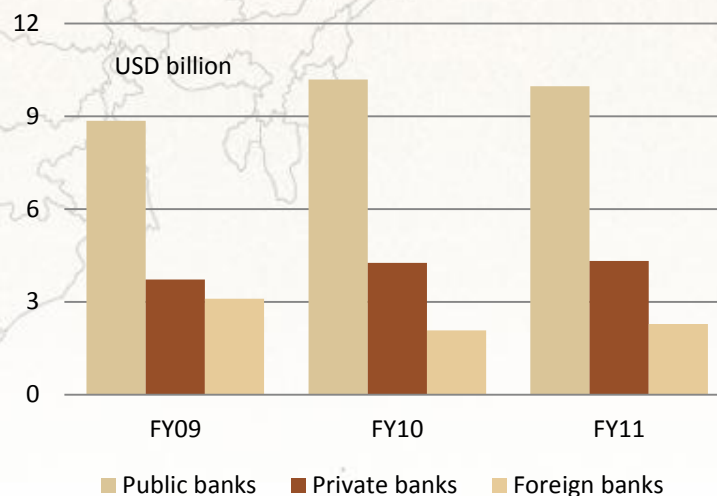


Source: IBA, Aranca Research

## Income from interest, as well as fees, has seen robust growth ... (2/2)

- Public sector banks account for over 60 per cent of the other income in the sector
- Other income for public sector banks has risen at a CAGR of 6 per cent since FY09
- Overall, the other income for the sector has risen at 3 per cent CAGR over the period

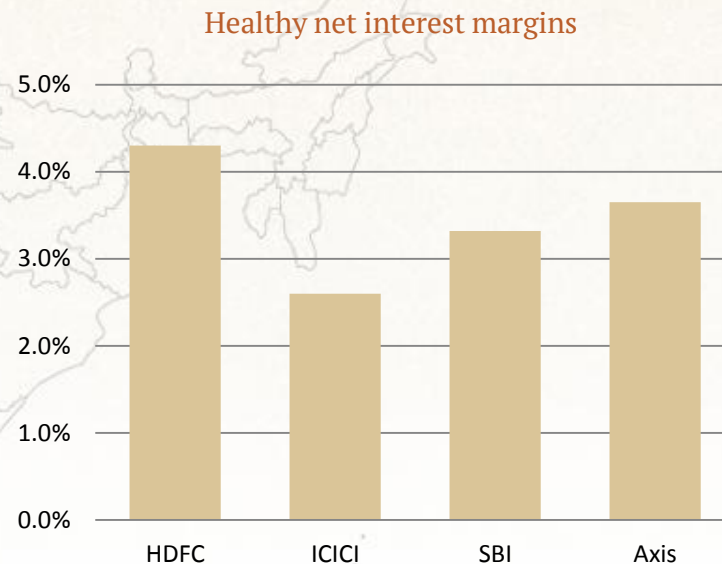
Other income growth in Indian banking sector



Source: IBA, Aranca Research

## High NIM, Low NPA place Indian banking among world's best ... (1/2)

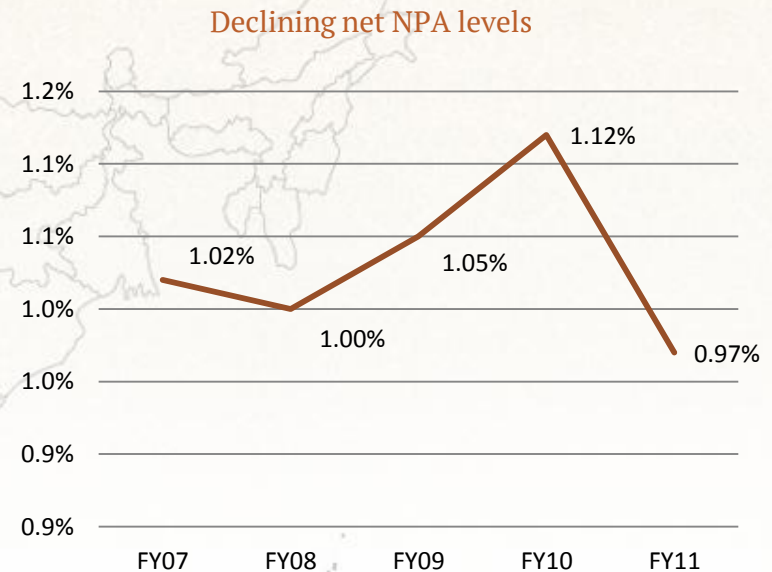
- Indian banking sector enjoys healthy net interest margins (NIM) compared with global peers
- HDFC leads the large banks with a NIM of over 4 per cent
- Prominent Chinese banks have NIM's between 2-3 per cent, significantly lower than Indian peers
- Despite virtually zero cost funds, the banks in the US have NIM's comparable to Indian peers



Source: Company reports, Aranca Research

## High NIM, Low NPA place Indian banking among world's best ... (2/2)

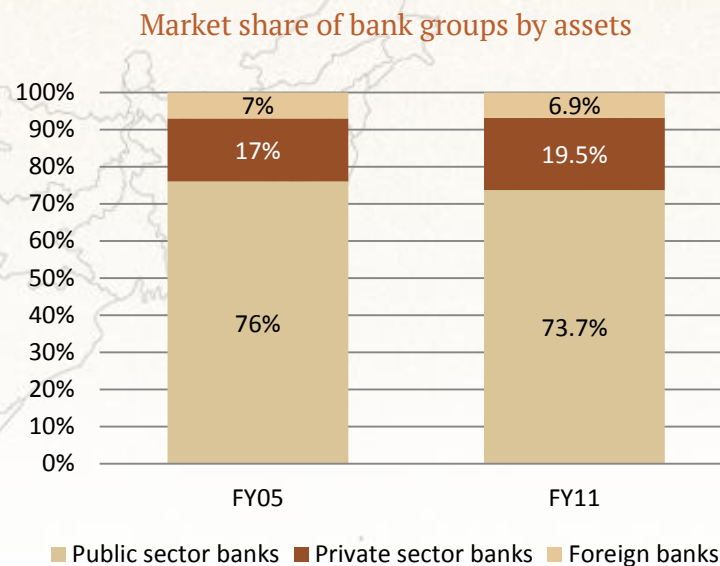
- Despite the global financial crisis the net non-performing assets (NPA) of Indian banking sector have declined over past few years.
- Net NPA levels declined from 1.02 per cent in FY07 to 0.97 per cent in FY11, indicating significant improvement in asset quality.



Source: Reserve Bank of India (RBI), Aranca Research

## Private/foreign banks are aggressively increasing asset size ... (1/2)

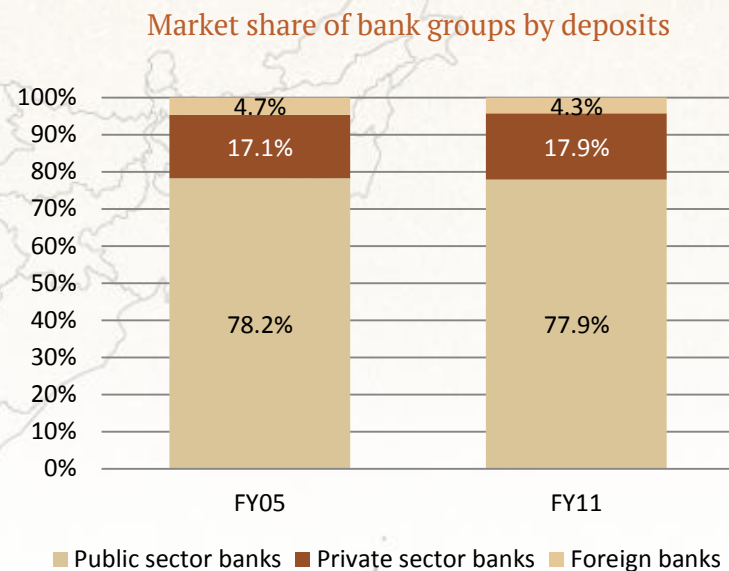
- Although public sector banks continue to control majority of the banking assets, their share is gradually declining
- Share of public sector banks in total assets have declined from 76 per cent in FY05 to 73.7 per cent in FY11



Source: IBA statistics, Aranca Research

## Private/foreign banks are aggressively increasing asset size ... (2/2)

- Share of public sector banks in total deposits have also declined from 78.2 per cent in FY05 to 77.9 per cent in FY11
- This is largely due to the fact that foreign and private sector banks are rapidly capturing share in savings deposit



Source: IBA statistics, Aranca Research

## Notable trends in the Indian banking sector ... (1/2)

### Improved risk management practices

- Indian banks are increasingly focusing on adopting integrated approach to risk management
- Banks have already embraced the international banking supervision accord of Basel II
- Most of the banks have put in place the framework for asset-liability match, credit and derivatives risk management.

### Diversification of revenue stream

- Banks are laying emphasis on diversifying the source of revenue stream to protect themselves from interest rate cycle and its impact on interest income
- Focusing on increasing fee and fund based income by launching plethora of new asset management, wealth management and treasury products

### Technological innovations

- Indian banks, including public sector banks are aggressively improving their technology infrastructure to enhance customer experience and gain competitive advantage
- Internet and mobile banking is gaining rapid foothold

## Notable trends in the Indian banking sector ... (2/2)

### Focus on financial inclusion

- RBI has emphasised the need to focus on spreading the reach of banking services to the un-banked population of India
- Indian banks are expanding their branch network in the rural areas to capture the new business opportunity

### Derivatives and risk management products

- The increasingly dynamic business scenario and financial sophistication has increased the need for customised exotic financial products
- Banks are developing Innovative financial products and advanced risk management methods to capture the market share

### Consolidation

- With entry of foreign banks competition in the Indian banking sector has intensified.
- Banks are increasingly looking at consolidation to derive greater benefits such as enhanced synergy; cost take-outs from economies of scale; organisational efficiency; diversification of risks

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## Growth drivers of Indian banking sector

### Economic and demographic drivers

- Favourable demographics and rising income levels
- Strong GDP growth (CAGR of 8.1 per cent expected from 2011-16) to facilitate banking sector expansion
- The sector will benefit from structural economic stability and continued credibility of monetary policy

### Policy support

- Extension of interest subsidy to low cost home buyers
- Simplification of KYC norms, introduction of no-frills accounts and Kisan Credit Cards to increase rural banking penetration
- RBI is considering giving more licenses to private sector players to increase banking penetration

### Infrastructure financing

- India currently spends 6 per cent of GDP on infrastructure; Planning Commission expects this fraction to grow going ahead
- Banking sector is expected to finance part of the USD1 trillion infrastructure investments in the 12th Five Year Plan, opening a huge opportunity for the sector

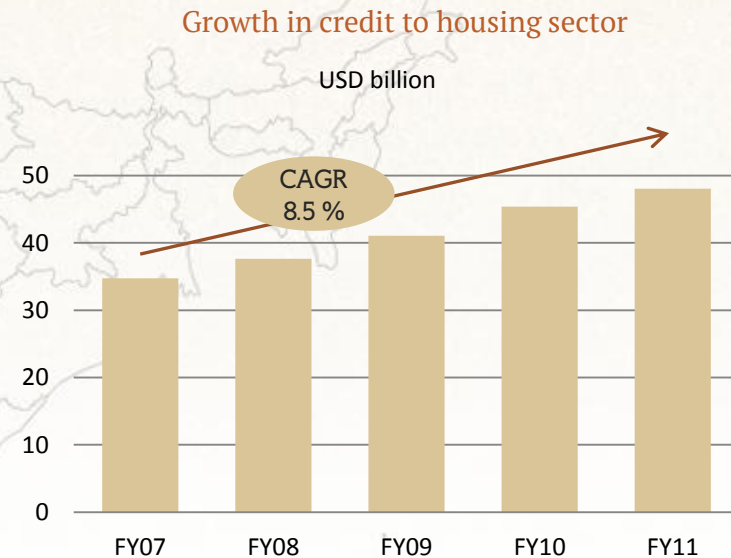
### Technological innovation

- Technological innovation will not only help to improve products and services but also to reach out to the masses in cost effective way
- Use of alternate channels like ATM, internet and mobile hold significant potential in India

Notes: GDP- Gross Domestic Product, KYC- Know Your Customer, RBI- Reserve Bank of India, ATM- Automated Teller Machine

## Housing and personal finance have been key drivers ... (1/2)

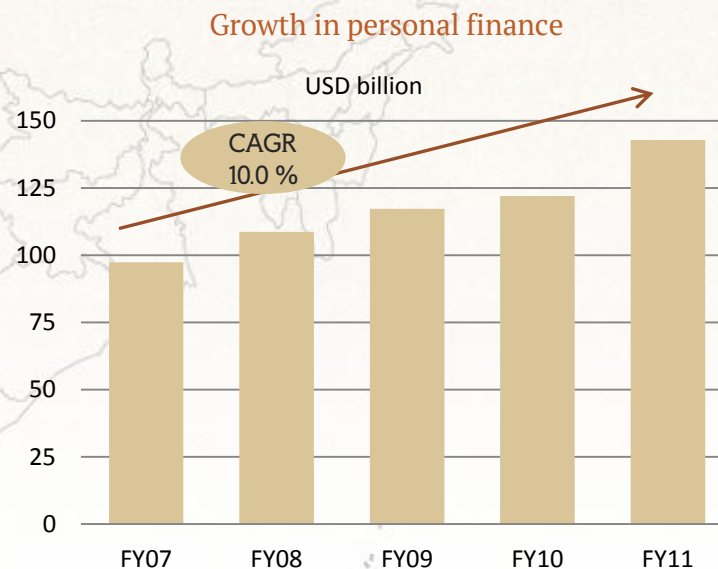
- Rapid urbanisation, decreasing household size and easier availability of home loans has been driving demand for housing
- Demand in the low- and mid-income segments exceeds supply three- to four-fold
- This has propelled demand for housing loan in the last few years



Source: Reserve Bank of India (RBI), Aranca Research

## Housing and personal finance have been key drivers ... (2/2)

- Growth in disposable income has been encouraging households to raise their standard of living and boost demand for personal credit
- Unlike other emerging markets such as China credit-induced consumption is still less in India

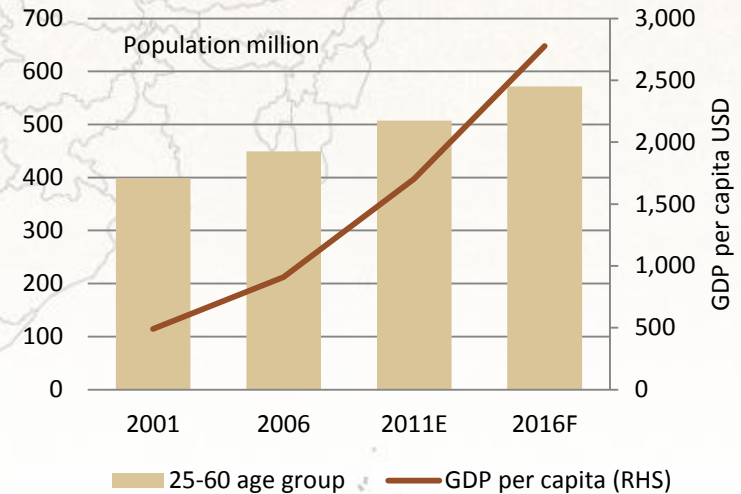


Source: Reserve Bank of India (RBI), Aranca Research

## Strong economic growth to propel banking sector expansion ... (1/2)

- Rising per capita income will lead to increase in the fraction of the Indian population that uses banking services
- Population in 25-60 age group is expected to grow strongly going ahead, giving further push to the number of customers in banking sector

India's working age population and GDP per capita

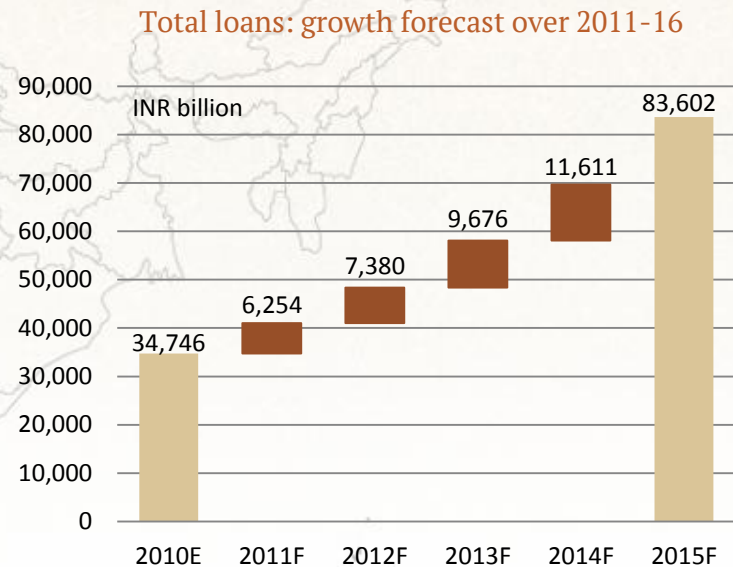


Source: World Bank, IMF, Aranca Research

Note: E-Expected, F-Forecasted, GDP- Gross Domestic Product

## Strong economic growth to propel banking sector expansion ... (2/2)

- India's GDP is forecasted to grow at a healthy CAGR of 8.1 per cent during 2011-2016
- Strong GDP growth will facilitate banking sector expansion
- The sector will also benefit from economic stability and credibility of monetary policy

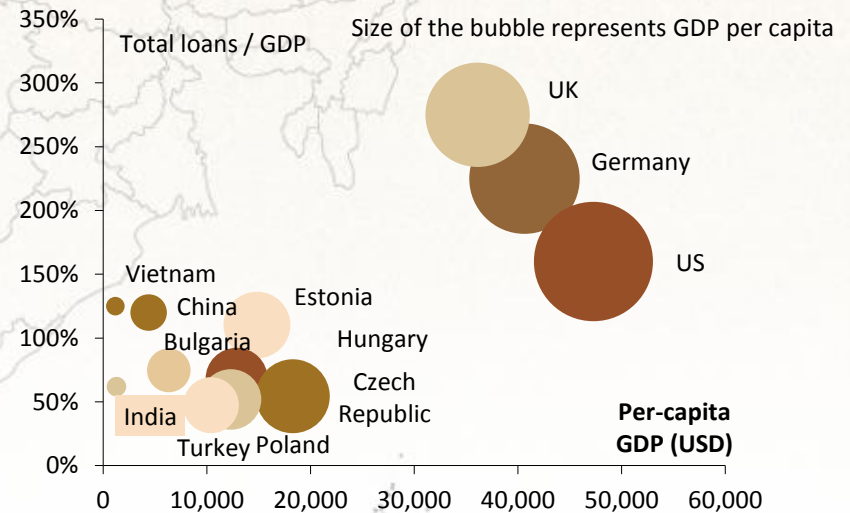


Source: Business Monitor International Ltd (BMI),  
Aranca Research

## Low banking penetration indicates huge latent demand ... (1/2)

- Despite healthy growth over the past few years, the Indian banking sector is relatively underpenetrated
- Loans-to-GDP ratio is low (62 per cent) relative to many of its emerging markets peers as well as developed economies such as the US and UK

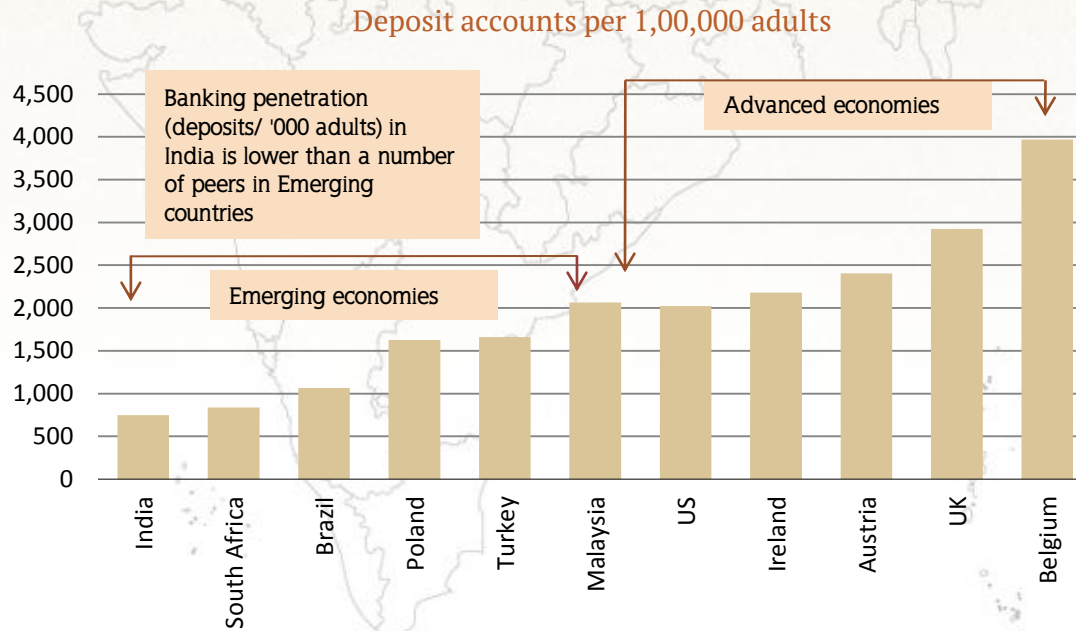
Loan/GDP vs. GDP per-capita in select countries



Source: World Bank Financial Access report 2010, IMF, Aranca Research

## Low banking penetration indicates huge latent demand ... (2/2)

- Limited banking penetration in India is also evident from low branch per 100,000 adults ratio
- Branch per 100,000 adults ratio in India stands at 747 compared to 1,065 for Brazil and 2,063 for Malaysia



Source: World Bank Financial Access report 2010, IMF, Aranca Research

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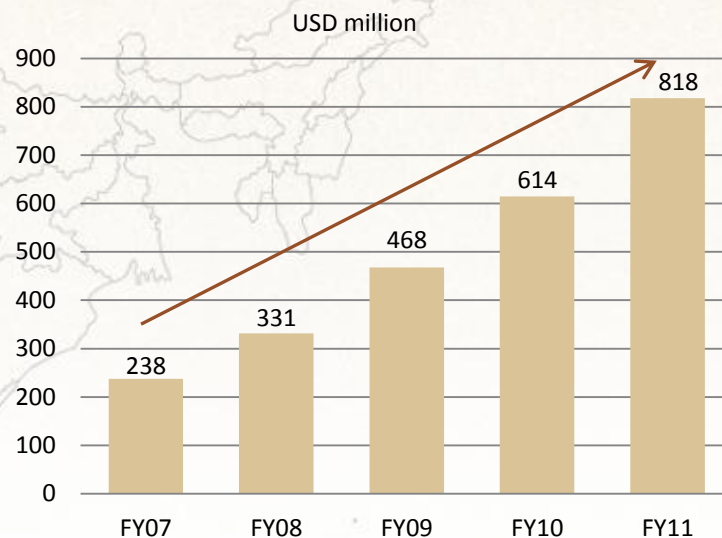
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## Success stories in the Indian banking sector ... (1/4)

### HDFC Bank

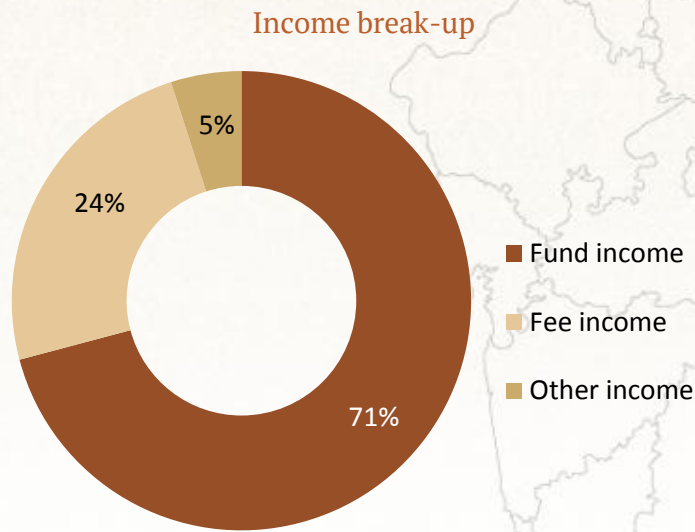
- Established in 1994, HDFC Bank is the second largest private sector bank in India. HDFC was amongst the first to receive an 'in principle' approval from the RBI to set up a bank in the private sector
- Divisions – Retail banking, Wholesale banking and Treasury operations
- Size – Number of branches and extensions : 1,986
  - Number of ATMs : 5,471
  - Number of employees: 55,752
- Recognition –
  - Strongest Bank in Asia Pacific (Asian Banker:2011)
  - Best Bank (Bloomberg UTV:2011)

### Net profit

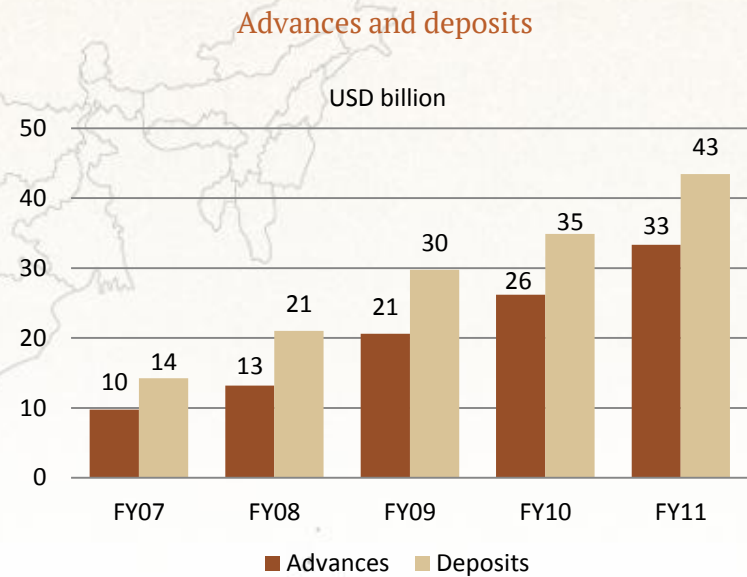


Source: Company annual reports, Aranca Research

## Success stories in the Indian banking sector ... (2/4)



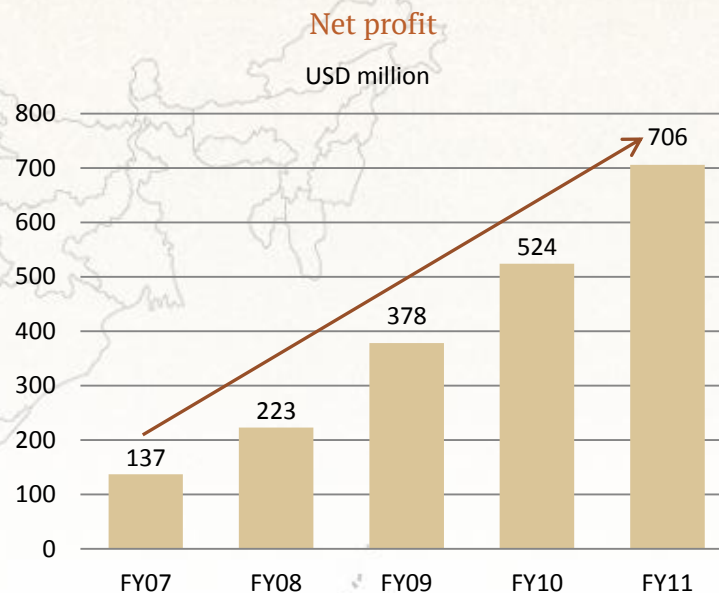
Source: Company annual reports, Aranca Research



## Success stories in the Indian banking sector ... (3/4)

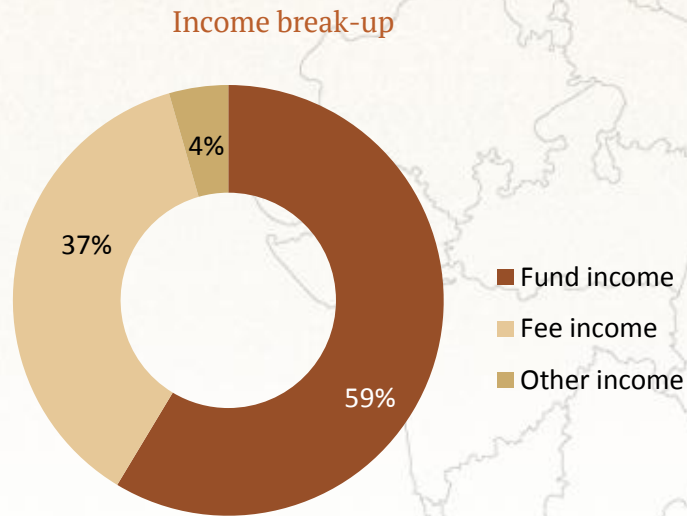
### Axis Bank

- Established in 1994, Axis Bank is the third largest private sector bank in India. The bank is capitalised to the extent of USD85.4 million with the public holding at 53.6 per cent as on 31st March, 2011
- Divisions – Treasury, retail banking, corporate/wholesale banking and other banking business
- Size – Number of branches and extensions : 1,390
  - Number of ATMs : 6,270
  - Number of employees : 23,600
- Recognition –
  - Best Domestic Debt House in India (Asia money :2010)
  - Best Bond House in India (Finance Asia :2010)

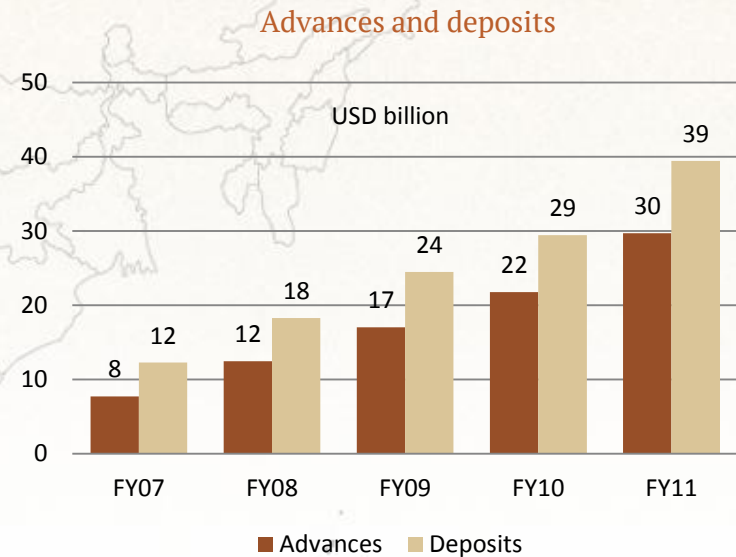


Source: Company annual reports, Aranca Research

## Success stories in the Indian banking sector ... (4/4)



Source: Company annual reports, Aranca Research



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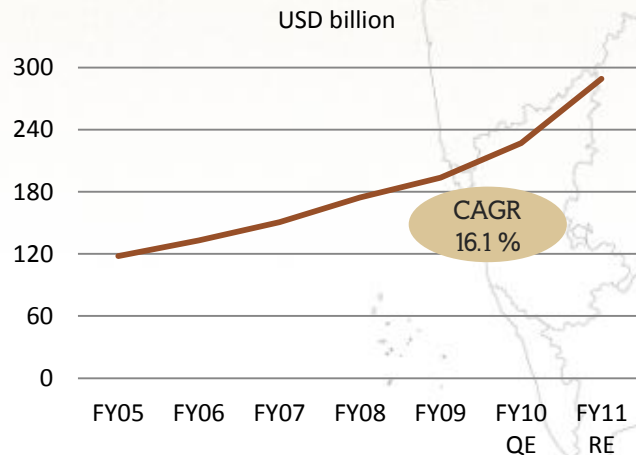
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## Rising rural income pushing up demand for banking

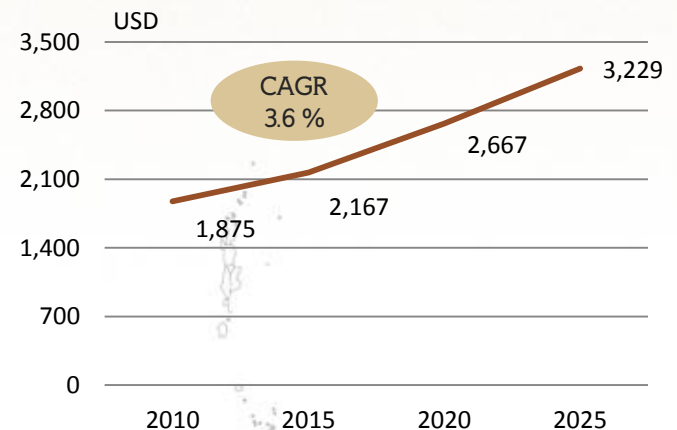
- The real annual disposable household income in rural India is forecasted to grow at CAGR of 3.6 per cent over next 15 years
- The Indian agriculture, forestry & fishing sector has grown at fast pace, clocking a CAGR of 16.1 per cent over past 6 years
- Rising incomes are expected to enhance the need for banking services in rural areas and therefore drive the growth of the sector

GDP of agriculture, forestry & fishing sector, at current prices



Source: MOSPI, Aranca Research

Real disposable household income in rural India



Source: McKinsey estimates, Aranca Research

Notes: CAGR – Compounded Annual Growth Rate QE – Quick Estimate , RE – Revised Estimate

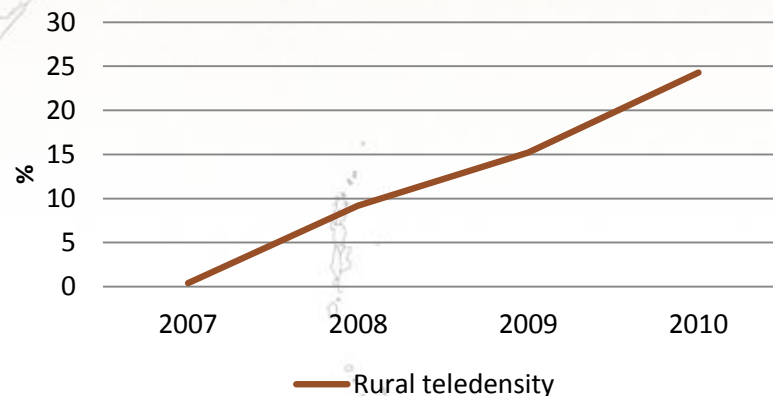
## Mobile banking to provide a cost effective solution

- Agriculture requires timely credit to enable smooth functioning. However, only one-eighth of farm households avail bank credit
- Local money-lending practices involve interest rates well above 30 per cent, therefore making bank credit a compelling alternative
- Tele-density in rural India soared to nearly 25 per cent in 2010 from less than 1 per cent in 2007
- Banks, telecom providers and RBI are making efforts to make inroads into the un-banked rural India through mobile banking solutions

### Banking penetration is low in rural India

- Of the 600,000 village habitations in India only 5 per cent have a commercial bank branch
- Only 40 per cent of the adult population has bank accounts
- Debit card holders constitute only 13 per cent of the population and only 2 per cent have a credit card
- 51.4 per cent of nearly 89.3 million farm households do not have access to any credit either from institutional or non-institutional sources
- Only 13 per cent of farm households are availing loans from the banks in the income bracket of < USD1000

### Soaring rural teledensity opens avenue of mobile banking



Source: TRAI, Aranca Research

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## Industry Associations

### Indian Banks' Association

World Trade Centre, 6th Floor  
Centre 1 Building,  
World Trade Centre Complex,  
Cuff Parade, Mumbai - 400 005  
India

E-mail: [webmaster@iba.org.in](mailto:webmaster@iba.org.in)



## Glossary

- **ATM:** Automated Teller Machines
- **CAGR:** Compound Annual Growth Rate
- **FY:** Indian financial year (April to March)
- **GDP:** Gross Domestic Product
- **INR:** Indian Rupee
- **KYC:** Know Your Customer
- **NIM:** Net interest margin
- **NPA:** Non-performing assets
- **RBI:** Reserve Bank of India
- **USD :** US Dollar
  - Conversion rate used: USD1=INR 48
- Wherever applicable, numbers have been rounded off to the nearest whole number

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