BANKING

April 2010

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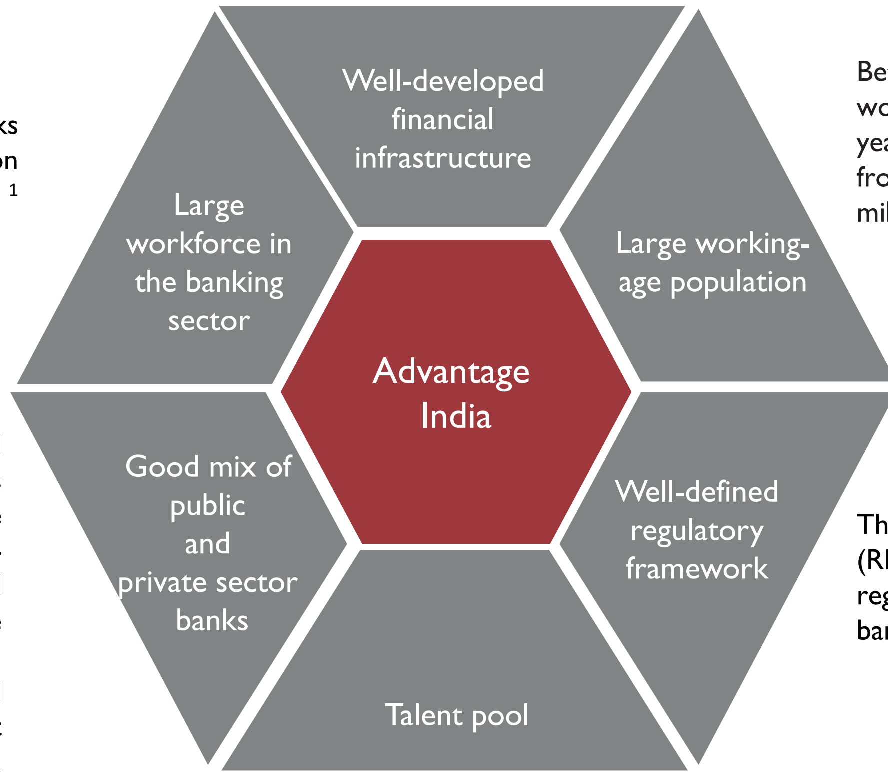
Advantage India

India has a well-organised and regulated capital market, in addition to an efficient credit infrastructure.

Scheduled commercial banks employed about 100 million people in 2009. [1]

Between 2006 and 2026, the working population (25–60 years) is expected to increase from 675.8 million to 795.5 million.[2]



A good mix of public and private sector banks provides stability and growth to the economy. In addition, non-banking financial institutions, co-operative banks, primary agricultural societies etc., are spread across the country to meet local needs.

The Reserve Bank of India (RBI) has well-formulated regulations for the Indian banking sector.

As of 2009, India had approximately 32 million graduates and 2.4 million post graduates. To leverage these skills, a number of foreign banks have shifted their back office operations to India.[3]

Sources:

[1] "Statistical tables related to banks in India", Reserve Bank of India website, www.rbi.org.in accessed February 9, 2009

[2] Insurance industry: amidst interesting time and the way forward," EY CBK, September 2009, via RAD

[3] NASSCOM Strategic Report 2009

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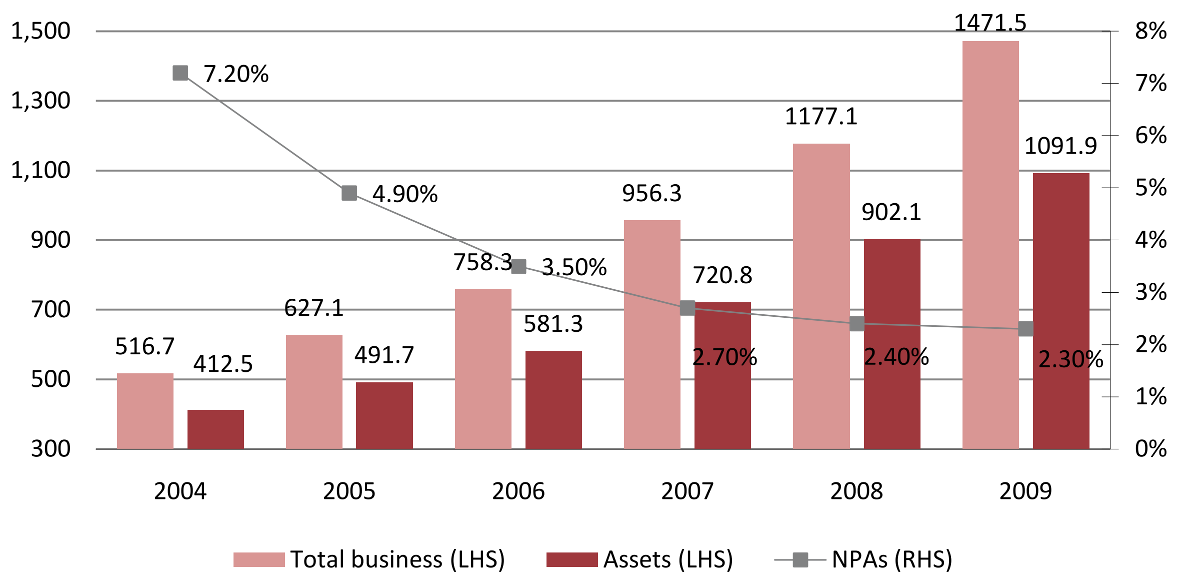
Market overview

Globalisation and liberalisation of the Indian economy, and the interest of foreign banks to expand their presence in India through the inorganic route, have fuelled the growth of the banking industry.

Growth through key parameters (US$ billion)

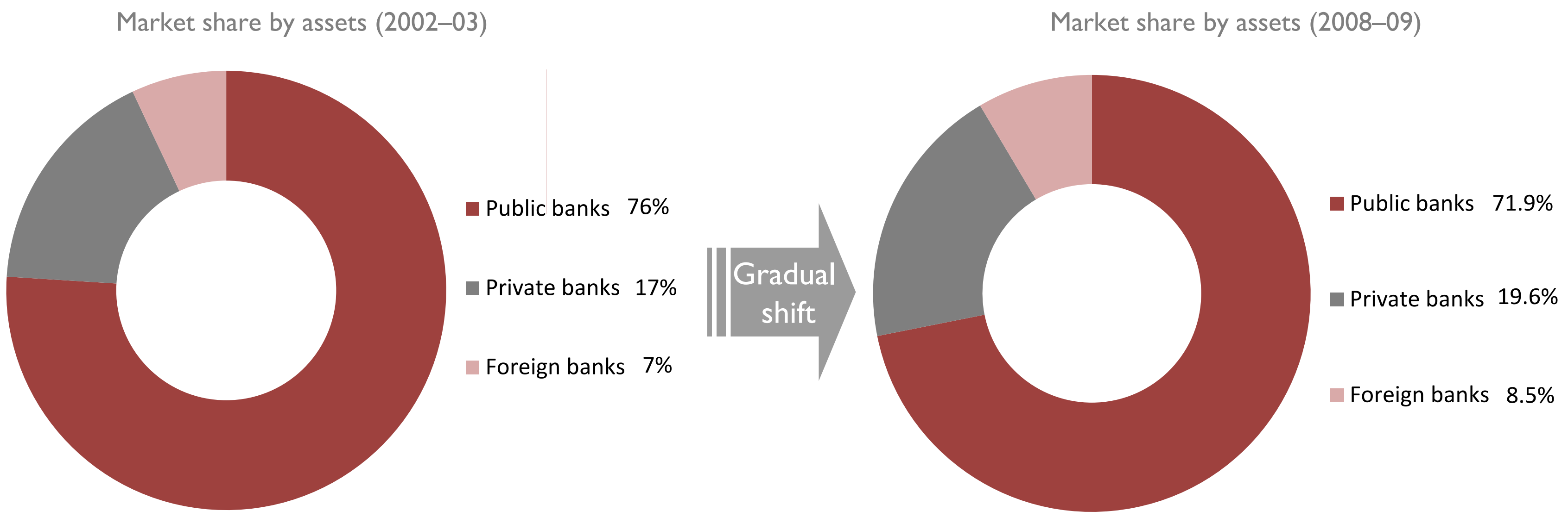


The banking penetration calculated on the basis of total number of credit accounts to total population was 9.4 per thousand in 2007–08.

Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010
NPA — Non-performing assets, RoA — Return on assets

Market analysis … (1/3)

There has been a gradual shift in business from public to private and foreign banks.

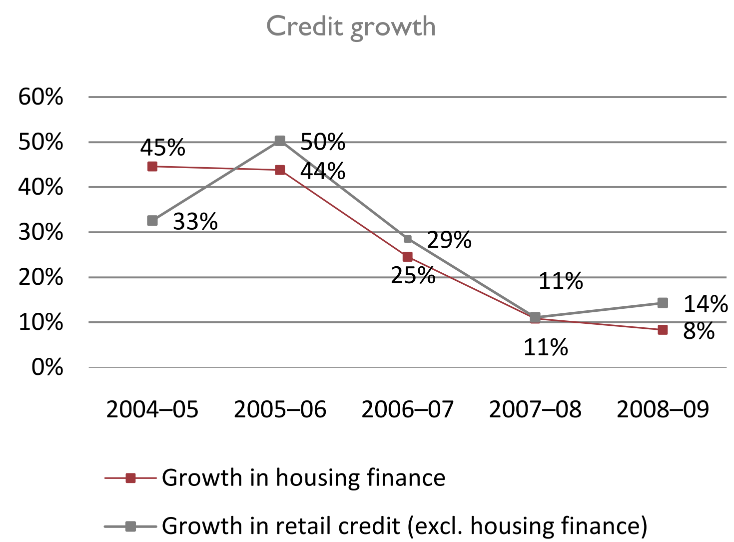


- The banking system in India is dominated by Scheduled Commercial Banks (SCBs) with a pan-India presence. As of March 2009, SCBs controlled most of the assets, with the rest being controlled by a large number of small co-operative credit institutions with a very limited geographic reach.
- Within SCBs, public sector banks accounted for 71.9 per cent of the assets and the rest was held by foreign banks and private sector banks.

Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

Market analysis … (2/3)

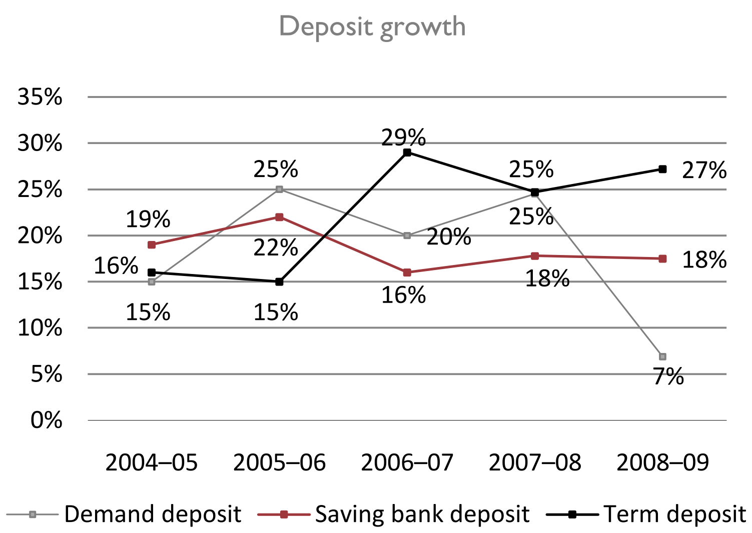
- Credit demand from corporate organisations has helped maintain credit growth in recent years.
- Upside risks to inflation and liquidity might call for interest rate environment to remain at current levels in the near future, thus, impacting the credit growth further.



Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

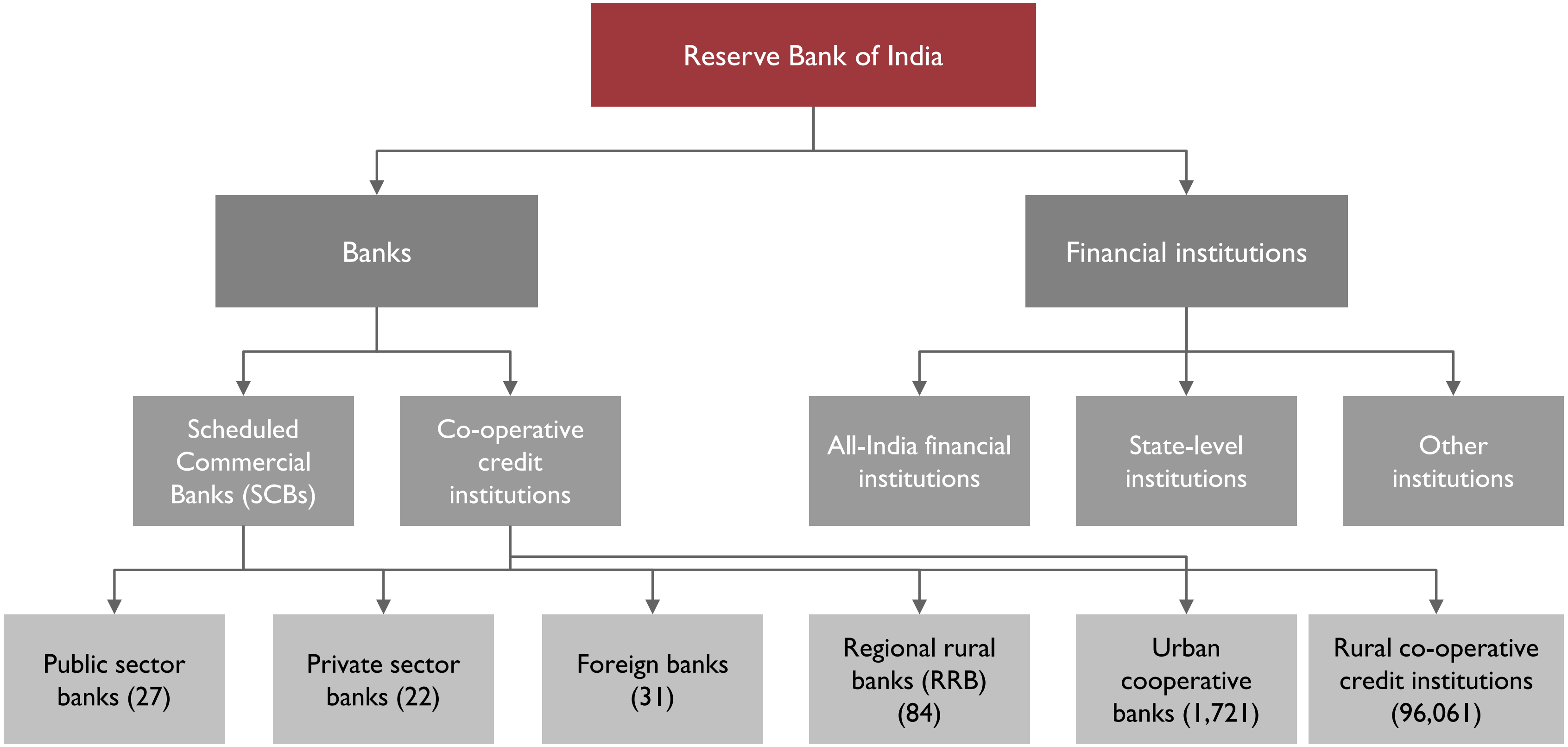
Market analysis … (3/3)

- Sharp growth in term deposits during 2006–07 as banks rely more on these deposits than finance advances.
- Growth in savings deposit is expected to increase by an increase in the amount per account and a steady increase in the number of savings accounts as banks reach out to new markets.



Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

Structure of the Indian banking system

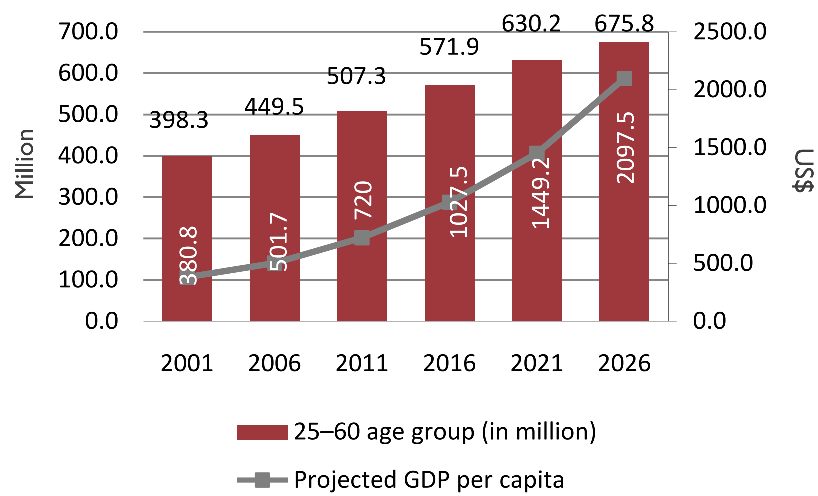


Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

Growth drivers … (1/3)

- Increasing emphasis by banks on fee-based services to boost income growth.
- Favourable demographics and rising income levels
    - Rising literacy rate, specially in rural India, has increased the need for banking.
    - Between 2006 and 2026, the working population (25–60 years) is expected to increase from 675.8 million to 795.5 million giving rise to a favourable market for banks.
    - Projected per capita GDP is expected to increase from US$ 380.8 in 2000–01 to US$ 2,097.5 in 2026, reflecting higher disposable income.

Working population assessment and GDP per capita till 2026



Source: "Insurance industry: amidst interesting time and the way forward", EY CBK, September 2009, via RAD

Growth drivers … (2/3)

- Significant latent demand for retail banking services, given a low penetration level of approximately 59 per cent. Key factors driving the growth of retail banking are
  - 'Any where', 'any time' banking
  - Improved processes and bundled product offerings
  - Faster service
  - Customer-specific products or offerings on a regular basis
  - 'Bank' customer has replaced 'Branch' customer
  - Focus on understanding customer needs or preferences
  - Segmentation or differentiation of customers
  - Customer-driven strategies
- Large number of micro, small and medium enterprises (MSMEs) with significant growth opportunities in their respective sectors.
  - The MSME sector assumes importance in the economy due to its employment potential and regional dispersal. The total credit provided by public sector banks to the MSME sector in 2009 was US$ 39.8 billion, which formed 11.3 per cent of ANBC/CEOBSE (Adjusted Net Bank Credit/Credit Equivalent Amount Off-Balance Sheet Exposure) and 26.5 per cent of the total priority sector advances of these banks.

Growth drivers … (3/3)

- Large amount of money is remitted by non-resident Indians (NRIs), one of the largest diasporas in the world.
- Conducive banking environment with well-capitalised banks provides a base to meet the growing need for banking services.
    - India has a well-balanced mix of public and private sector banks. While public sector banks provide stability to the banking system in the country, private sector banks add the necessary dynamism to it.
- Stringent regulatory framework
- Adoption of best practices from other countries
    - With an increasingly global footprint, the Indian banking industry has adopted certain global best practices such as International Financial Reporting Standards (IFRS) and Basel II. These not only position India at an international level, but also provide confidence to foreign players planning to establish businesses in India.
    - As of March 31, 2009, all commercial banks in India, excluding RRBs and local area banks, have become Basel II compliant .

Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

Key trends … (1/2)

Improved risk management practices	• Net NPAs, as a percentage of advances, reduced to 1.1 per cent in 2009–2010 from nearly 8.1 per cent in 1996–97.
More emphasis on fee-based services	• Banks have started laying more emphasis on fee-based services, such as distributing mutual funds and insurance policies, credit cards, wealth management and equity trading services.
Development of newer modes of banking	• India has now entered the era of online banking, e-commerce and m-commerce, which makes banking simple. Also, the use of ATMs and credit cards has increased tremendously in the last few years.
Product innovation	• There has been a major change in the products offered by banks, from a few standard credit and deposit products to a number of customised offerings to suit the requirements of various categories of customers.

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INDIA BRAND EQUITY FOUNDATION
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Key trends … (2/2)

Alliances with non-traditional players	• Banks are now looking for acquisition targets among other categories of financial institutions, such as non-banking financial companies (NBFCs), development financial institutions (DFIs), brokerage firms, etc., to provide the entire gamut of financial services.
Improved information systems	• Banks are aiming to have an improved credit infrastructure, with the formation of Credit Information Bureau (India) Limited (CIBIL). Other credit information bureaus are expected to further boost the credit infrastructure.
Improving performance of PSU banks	• Higher growth, improved productivity for branches, better customer profiles, implementation of technology and improved products, coupled with significant positive structural changes, have led to the improvement of PSUs on almost all financial and operational parameters.
Increased scrutiny	• Due to the global financial crisis in 2008–09, tighter regulations for non-banking entities are being implemented. Main focus of the regulations has been to provide a level playing field between bank-sponsored NBFCs and non-bank associated NBFCs besides other issues of regulatory convergence and regulatory arbitrage.

Key players … (1/3)

Public sector banks	Private banks	Foreign banks
Allahabad Bank	Axis Bank	The Royal Bank of Scotland
Andhra Bank	Bank of Rajasthan	Abu Dhabi Commercial Bank
Bank of Baroda	Catholic Syrian Bank	American Express Banking Corporation
Bank of India	City Union Bank	Antwerp Diamond Bank
Bank of Maharashtra	Development Credit Bank	AB Bank
Canara Bank	Dhanalakshmi Bank	Bank International Indonesia
Central Bank of India	Federal Bank	Bank of America
Corporation Bank	HDFC Bank	Bank of Bahrain & Kuwait
Dena Bank	ICICI Bank	Bank of Ceylon
IDBI Bank Ltd	IndusInd Bank	Bank of Nova Scotia
Indian Bank	ING Vysya Bank	Bank of Tokyo Mitsubishi UFJ
Indian Overseas bank	Jammu & Kashmir Bank	Barclays Bank

Key players … (2/3)

Public sector banks	Private banks	Foreign banks
Oriental Bank of Commerce	Karnataka Bank	BNP Paribas
Punjab & Sindh Bank	Karur Vysya Bank	Calyon Bank
Punjab National Bank	Kotak Mahindra Bank	Chinatrust Commercial Bank
State Bank of India	Lakshmi Vilas Bank	Citibank
State Bank of Bikaner & Jaipur	Nainital Bank	DBS Bank
State Bank of Hyderabad	Ratnakar Bank	Deutsche Bank
State Bank of Indore	SBI Comm & Intl Bank	Hongkong & Shanghai Banking Corpn
State Bank of Mysore	South Indian Bank	JP Morgan Chase Bank
State Bank of Patiala	Tamil Nadu Mercantile Bank	JSC VTB Bank
State Bank of Travancore	Yes Bank	Krung Thai Bank
Syndicate Bank		Mashreq Bank
UCO Bank		Mizuho Corporate Bank

Key players … (3/3)

Public sector banks	Private banks	Foreign banks
Union Bank of India		Oman International Bank
United Bank of India		Shinhan Bank
Vijaya Bank		Societe Generale
		Sonali Bank
		Standard Chartered Bank
		State Bank of Mauritius
		UBS AG

Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

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Investments — M&A … (1/2)

Date of merger	Acquirer bank	Target bank	Assets of target bank as a percentage of acquiring bank's assets* (%)	Number of branches of target bank
February 2008	HDFC Bank	Centurion Bank of Punjab	20 (March 2007)	394
August 2007	Centurion Bank of Punjab	Lord Krishna Bank	11 (March 2007)	110
April 2007	ICICI Bank	Sangli Bank	0.5 (March 2007)	190
March 2007	Indian Overseas Bank	Bharat Overseas Bank	6 (March 2006)	102
October 2006	IDBI	United Western Bank	8 (March 2006)	230
September 2006	Federal Bank	Ganesh Bank of Kurundwad	1 (March 2006)	32

Investments — M&A … (2/2)

Date of merger	Acquirer bank	Target bank	Assets of target bank as a percentage of acquiring bank's assets* (%)	Number of branches of target bank
October 2005	Centurion Bank	Bank of Punjab	106 (March 2005)	136
August 2004	Oriental Bank of Commerce	Global Trust Bank	17 (March 2004)	104
February 2003	Punjab National Bank	Nedungadi Bank	2 (March 2002)	173
March 2001	ICICI Bank	Bank of Madura	36 (March 2000)	350
February 2000	HDFC Bank	Times Bank	75 (March 1999)	39

*The date within brackets is the date as of which the percentage of target bank's assets to acquirer bank's assets has been calculated.

Source: Statistical tables relating to banks of India — 1979–2007, 6 May 2008, Reserve bank of India website, www.rbi.org.in accessed February 9, 2009

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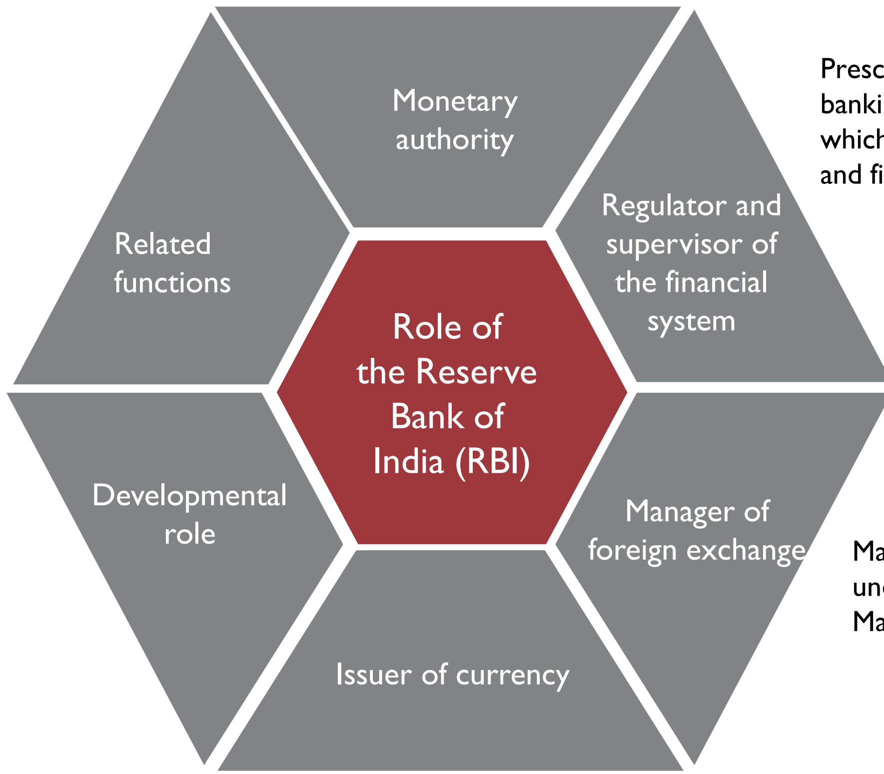
Policy and regulatory framework … (1/4)

Formulates, implements and monitors the monetary policy.

Acts as a banker to the government and performs merchant banking function for the central and the state governments.

Prescribes broad parameters of banking operations within which the country's banking and financial system functions.



Performs a wide range of promotional functions to support national objectives and increase financial inclusion.

Manages foreign exchange under the Foreign Exchange Management Act, 1999.

Issues and exchanges or destroys currency and coins not fit for circulation.

Sources: RBI website, www.rbi.org.in, accessed on February 3, 2010

Policy and regulatory framework … (2/4)

- The RBI is the sole regulator for the industry while the Ministry of Finance (MoF) is responsible for forming the enabling legislative framework.

- Up to 74 per cent of the total aggregate foreign investment is allowed in private banks from all sources (FDI, FII and NRI), subject to the following conditions

    - There is a limit of 10 per cent for individual FII investment with the aggregate limit for all FIIs restricted to 24 per cent, which can be raised to 49 per cent with the approval of the board or general body.
    - There is a limit of 5 per cent for individual NRI portfolio investment with the aggregate limit for all NRIs restricted to 10 per cent, which can be raised to 24 per cent with the approval of the board or general body.

- Banking Regulation Act, 1949, states that no person holding shares in private banks is entitled to exercise voting rights in excess of 10 per cent of the total voting rights of all the shareholders of the bank.

- All entities investing in private sector banks through FDI will be mandatorily required to have a credit rating.

- The FDI norms are not applicable to public sector banks where the FDI ceiling is still capped at 20 per cent.

Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

Policy and regulatory framework … (3/4)

Regulations governing the sector

- Reserve Bank of India Act, 1934, governs the RBI functions.
- Banking Regulation Act, 1949, governs the financial sector.
- Acts governing specific functions
  - Public Debt Act, 1944/Government Securities Act (proposed) governs government debt market.
  - Securities Contract (Regulation) Act, 1956, regulates government securities market.
  - Indian Coinage Act, 1906, governs currency and coins.
  - Foreign Exchange Management Act, 1999, governs trade and foreign exchange market.
- Acts governing banking operations
  - Companies Act, 1956, governs banks as companies.
  - Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980, refers to nationalisation of banks
  - Bankers' Books Evidence Act
  - Banking Secrecy Act
  - Negotiable Instruments Act, 1881

Sources: "About us", *RBI website*, www.rbi.org.in, accessed on February 3, 2010

Policy and regulatory framework … (4/4)

Guidelines for entry of foreign banks in India

- Currently, India abides by the World Trade Organisation (WTO) norms, which direct the RBI to grant licences to12 branches of foreign banks operating in India, every year. However, RBI has been exceeding that number every year.
- In February 2005, RBI released a roadmap for the presence of foreign banks in India. The roadmap is divided into two phases
    - First phase (March 2005–March 2009) entails foreign banks to establish their presence by way of setting up a wholly-owned banking subsidiary (WOS) or conversion of the existing branches into a WOS. Permission for acquisition of shareholding in Indian private sector banks by eligible foreign banks will be limited to banks identified by RBI for restructuring.
    - The second phase (from April 2009) decides on dilution of stake and permitting mergers/acquisitions of private sector banks with foreign banks, based on a review of the experience gained after due consultation with all the stakeholders in the banking sector.

Source: "Report on trend and progress of banking in India 2008–09", *RBI website*, www.rbi.org.in, accessed on January 12, 2010

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Opportunities … (1/3)

- Banking is now graduating beyond traditional boundaries of plain vanilla banking. The Indian banking sector has entered new areas such as wealth management, private banking, doorstep banking, electronic banking, credit cards, investment advisory services, etc. Alternate e-delivery channels are becoming popular with the Indian customers. Financial products such as mutual funds, life policies and non-life policies are competing with traditional banking products.

- Retail banking

  Retail banking still has low penetration levels. These services are not only related to the banking sector, but also to other related services such as insurance, wealth management etc. The following factors are likely to trigger the demand for retail products

  - Dramatic changes are expected in the credit portfolio of banks in the next five years.
  - Housing is expected to continue to be the biggest growth segment followed by auto loans.
  - Banks are looking to expand and diversify by focussing on the non-urban segment as well as varied income and demographic groups.
  - Rural areas also offer tremendous potential, which needs to be exploited.

Opportunities … (2/3)

- Corporate banking
  - The growing MSME sector provides a significant opportunity to the banking sector. The banking system envisages doubling of credit flow to the SME sector in the next five years ending 2011–12, with an annual growth of 20 per cent.
  - Product offerings can be increased by leveraging corporate relationships.
  - Rise in corporate credit requirement provides corporate banks an avenue to channelise funds.
- Microfinance
  - Increasing economic prosperity in rural areas, coupled with fierce competition in urban and metropolitan areas, has provided banks with the opportunity to cater to the rural market.
  - With a network of around 70,000 branches, of which around 46,000 are in rural and semi-urban areas, microfinance has emerged as one of the most promising areas for commercial banks. The growth of non-government organisations (NGOs) and self-help groups and their linkage with banks offer ample scope to facilitate microfinance activities in rural areas.

Opportunities … (3/3)

- Growing long-term fund requirements
  - Banks play an important role in channelising funds (savings of investors) for long-term development. These include infrastructure development and meeting the capital requirements of the MSME sector. For example, in the Eleventh Five Year Plan (2007–2012), the Planning Commission estimates the investment in infrastructure to increase from US$ 81.09 billion in 2009–2010 to US$ 124.15 billion in 2011–12.
- Remittance
  - Increasing immigration and NRI remittance offer growth opportunities for retail and NRI banking.
  - India has maintained its dominant position in remittance receipts in 2008 as well, with total remittances worth US$ 45 billion in 2008.
  - Debit or credit card transfers and instant money transfers through a special arrangement with overseas correspondent banks or the use of automated clearing house facilities are gaining importance in addition to the traditional modes of drafts and cheques.

Source: "NRI market: the potential", EY CBK, April 2009, via RAD

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Industry associations

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Note

Wherever applicable, numbers in the report have been rounded off to the nearest whole number.

Conversion rate used: US$ 1= INR 48.

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