Sunday, 5 July 2020

A Bank For The Buck

One Day in Malaysia

- Coca-Cola decided to leave India after the Janata government, citing the new law, ordered it to hand over its formula - a trade secret held in a bank vault in Atlanta for decades - and dilute its stake in the Indian unit
- The HDFC insiders had one condition, though: If HDFC's shareholding in the bank dropped below a certain level, the mortgage company could ask the bank to change its name. The final agreement on the name doesn't have any clause on charging a royalty for lending the brand name, something that the diversified Tata Group does with its many subsidiaries
- Deepak declined to be on the bank's board, despite being closely involved in creating it, primarily because he was on the board of a number of blue-chip companies that any bank would want to do business with. Had Deepak joined the bank's board, HDFC Bank could not have done business with these companies as India's banking laws prohibit a bank from lending money to a company whose director is on the bank's board. Simply put, Deepak could not remain on the boards of the blue-chip companies and the bank at the same time
- The RBI still doesn't like the CEO of one finance company to be on the board of another finance company as that may create a conflict of interest. There is no written law on this though
- Deepak chose not to be on the board but Thakur, Aditya and Vinod could always lean on his broad shoulders. In the initial stages, he was the bank's face to the regulator, investors and even consumers
- Deepak is not on the board of the bank but he does not miss a single meeting - always attending as a special invitee

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Roasting a Toast

- For over two decades, since the nationalisation of fourteen large banks in 1969, followed by another seven in 1980, no private bank had been allowed to set up shop
- 40% of the loans would go to the so-called priority sector of farmers and small-scale industries, a rule that stands even today
- Parliament amended the Banking Regulation Act of 1949 to lower the govt's absolute ownership in state-run lenders to 51%, despite resistance from the powerful trade unions that controlled the industry in those days

- Today, almost everybody in the HDFC Group admits that NatWest didn't add much value, but in the initial days the partnership was a great selling point for the new bank
- Historically, most JVs in India - particularly in the financial services space - have not succeeded as the foreign partners either wanted bigger stakes in the Indian entities or aspired to have a full-fledged presence on Indian soil. A case in point is the partnership of Goldman Sachs Group Inc. with Kotak Mahindra Group for investment banking. Goldman Sachs stayed with Kotak Mahindra till it understood the Indian market. ICICI Bank's investment banking arm, ICICI Securities Ltd (I-Sec), faced the same fate and had to part with its foreign partner J.P. Morgan & Co. Kotak Mahindra Bank bought Goldman Sachs' entire 25% stake in its investment banking and securities outfits in March 2006, fourteen years after the alliance, as Goldman Sachs wanted to be in India on its own. J. P. Morgan & Co. pulled out of I-Sec in March 1998, five years after forming the JV with I-Sec with a 39.6% stake

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The Dirty Dozen

- ICICI is flamboyant, innovative and quick as a flash when it comes to seizing an opportunity. HDFC Bank is staid and waits for opportunities but emerges a winner at the end of the day
- Not too many people could be hired from any particular bank, as this would make it difficult for HDFC Bank to evolve its own culture
- HDFC Bank is what it is not only for the things it has done but also for the things it has not done
- Luis was keen to work for an Indian organization, but the problem was that professional outfits did not pay a decent salary in those days. And those that paid a decent salary were not professional in their approach
- HDFC Bank the head of compliance reported directly to the chairman and not to the managing director and CEO. This was an exception that exemplified the bank's strong focus on corporate governance - the tradition continues
- Neeraj was aware of Aditya's reputation of being a quick and effective decision-maker. That was very different from what he had seen at Bank of America, which had a matrix organizational structure where a division head typically had a dotted relationship with the local CEO but reported to the global head of business in another geography. The decision-making process was superior and faster in a single-country organization than in a matrix organization structure that came with its share of checks and balances

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There's a Baby on the Trading Floor!

- Trade unions resisted computerization in banks till the first decade of this millennium as they feared the machines would replace them and shrink employment opportunities

- When a customer swipes a card at an ATM, there are two ways to verify the balance money in the account. One is the online real-time system that checks with the host on how much money is available in the customer's account. The other is the offline system in which details of a customer's account are fed to the host server only at the end of the day. That leaves a bank open to a potential credit risk. A customer can go to a bank branch, withdraw the last rupee from his or her account, then head to an ATM and withdraw money again as the main server wouldn't know until the end of the day that the customer had already withdrawn all the money from his or her account. Now all banks follow the online real-time system, but in the 1990s even some new-generation private banks had opted for the offline system. They lived with that mainly because the then popular banking software, Bancs 2000 of Infosys Ltd, did not provide for a centralized service. HDFC Bank opted for a centralized online real-time system both for its ATMs and for its Internet Banking. This enabled managers to view a single statement for each custom across all channels, regardless of how the bank was accessed. In some sense, this was its first step towards riskless banking
- The bank doesn't say "don't spend" but it questions the reason behind every spending. If you need it, you will get it, but give me the cost benefit of doing it
- Even senior bankers cannot treat anybody to a round of beer without Aditya's permissions. Every liquor bill from across India and across the hierarchy comes to Aditya for clearance. There is no prohibition on liquor but it is the bank's policy to keep a check on the money being spent. Aditya has the last word on any foreign travel too

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Business Before the Shop Opens

- The industry's obsession in those days was not profitability but a big balance sheet. For some banks, it's true even now. Towards the end of every financial year, in March, typically, a bank may get money from a company in the form of deposits and the money may, in no time, travel to the company's group firms as credit. Nobody can catch a bank for this circular trading as money is fungible. How does one prove the same fund is used for giving loans? After all, the colour of money is the same. Besides, entities at both ends may not necessarily be the same firm - they could be two separate firms from the same group
- A lot of us asked why we weren't pricing it at a premium. We could have got a premium but Deepak said, "Leave money on the table for investors. They will appreciate this in the long term." Today, when we have arguments with our promoters, one of the big lessons I learnt from our float is to price an IPO cheap
- In any business where the public sector competes with the private sector, the private sector will win. State-owned banks had the strength of distribution but not service; multinational banks had service but they were not allowed to open branches. So a private company that used the working model of a foreign bank but was free of the constraints of public sector banks in terms of unionized employees and government interference would succeed, he reasoned

- An NYSE listing teaches a company to be precise and moderate in the use of language. It cannot be pompous and make aggressive, forward-looking statements without substantiating them

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Doing Ordinary Things in Extraordinary Ways

- The team's contacts in the corporate world were extensive. Aditya, Harish, Samir, Paresh and Rajan managed to push through quite a few deals. In their presentations, they emphasized that they did not want any privileges based on pure relationship. They would offer products better than what the companies already had. Only then should the companies sign on the bank
- The bank suggested to Asian Paints Ltd and ADB Ltd that they could have their vendors online with the bank and it would offer them loans at a relatively cheaper rate. For Tata Motors Ltd, it drew up a complete supply chain. Each of these solutions helped HDFC Bank grow
- Ishaat Hussain, a director on the board of Tata Capital Ltd, said that big industrial houses like the Tatas and the Birlas do not face any difficulty in accessing bank finance, but their customers and suppliers find it difficult. HDFC Bank grabbed that important niche. It became a pioneer in vendor and dealer financing
- Conglomerates such as the Tatas look for two things from their bankers: One, the transaction should be smooth and fast; and two, the bank should respond to their monetary requirements quickly. 'There should be a bond between a banker and a borrower. I want a bank on which I can rely upon and which should be ready to help and give money in times of difficulty,' Ishaat said
- Clients always wanted to deal with one of the top executives personally. A senior banker would take the local representative with him to meet the customers. After that, the local recruit could handle the delivery
- Don't bullshit your customers. They will figure it out soon. Tell them what you can do and also what you cannot. So they do not have false expectations
- Everybody has pain. Advise them on how to alleviate pain. We didn't charge extra for that. It's free advisory. Just to convince them that we aren't taking advantage of their weakness
- Today, HDFC Bank is the market leader in transactional banking services. A lot of transactional banking services involve movement of money and this is probably why it has the cheapest rate of funding among all banks. Clearing, cash managements, payment of dividends, tax collections and anything that involves processing high-volume transactions is transactional business. It was not a new business, but what HDFC Bank did was recognize transactional banking as a huge opportunity, give it the right focus and scale it across products and geographies
- Normally, when interest rates rise, banks hurry to raise their loan rates but are slow in offering higher interest to depositors. Conversely, when the rates fall, banks are quick to cut their deposit rates but take time in passing on the benefit to borrowers. There is a reason behind this. The impact of any hike or cut in loan

rates is felt immediately as a bank's entire loan book is re-priced, but that's not the case with deposits as the new rates are applicable only when the existing deposits mature or new deposits flow in

- As the balance maintained in the current account are often very volatile, banks generally levy a certain service charge for operating a current account. The money kept in such accounts comes free to a bank as no interest is paid on current accounts
- A bank's cost goes up for retail loans because of higher customer acquisition and servicing cost

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The Change in Course

- Any bank that starts with a limited branch network has very little choice but corporate banking because retail customers cannot be acquired without a distribution infrastructure
- Corporate business in comparison with retail business requires much less investment in physical infrastructure in terms of technology, branches and people. As a start-up, HDFC Bank had to earn its way before it could invest in all of those requirements
- Retail banking is a volume game. A bank needs wide distribution, a lot of branches, a plethora of products and a completely different mind-set. One needs to have many products to straddle the economy of the country
- The unsecured part of the retail business is particularly vulnerable. Overtly aggressive banks sold credit cards and personal loans as if there was no tomorrow. In most cases, they were sold not by the banks' staff but by the so-called direct sales agents who did not care much about the quality of the borrowers and their ability to repay. Their focus is always on the numbers as the commission comes from the number of customers and not the volume of business
- As of 2012, HDFC Bank is the second-largest collector of direct tax after the SBI. In FY12, it collected Rs 1.5 lakh crores. The bank earns a minuscule commission but gets one-day free money, called a float
- The only business in the retail space where the bank could not enter was home loans as its promoter HDFC, India's oldest mortgage company, had reservations about the bank competing with its parent, though HDFC Bank investors were keen to see it have this product in its retail portfolio, a product that its peers ICICI Bank and SBI were selling aggressively. They worked out a formula to solve the issue. The bank started sourcing housing loans for HDFC with the right to buy-back upto 70% of such loans
- As a business philosophy, it exits any business that fails to capture any of the top three slots in a few years. Small ticket personal loan is one such business. HDFC Bank dropped it as it could not make much progress. Similarly, in 1996-97, it started investment banking but abandoned the business as it did not progress well, only to revive it much later in 2010-11

- Globally, banks have never failed because of lack of technology or great products or people. One can live with that. What the failed banks really missed is risk management - they did not manage the risks well. Herein comes the understanding of the risk-reward trade-off or balancing of business growth with risk taken in delivering that. When one talks about large companies, one may give up little in margin but one takes fewer risks

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The Entire Pyramid

- Companies hate a bank that shuts the tap when they need money the most. So a few borrowers withdrew from HDFC Bank, but the bank seems to have no regrets. ‘We took hard decisions which many other banks didn’t. If we had a loan outstanding to any company that we considered unviable or where we were uncomfortable with management integrity or transparency of information, we asked it to pay back first before giving fresh money,’ Ashima says
- Ashima finds promoters of small firms extremely sharp. ‘The kind of wealth you see in these companies is unbelievable. They would teach us a couple of things on how to invest. Unlike professional managers, they deal with their own money. Their strategies are very different,’ she says
- Going by its internal norms, theoretically, not more than 12% of advances should be given to one industry but, in practice, the threshold is much lower - between 6% and 8%
- What they officially say is that they have very limited appetite for certain segments such as Greenfield projects from new promoters, film financing, hotel and real-estate construction business. They are not banned as such but loans to these sectors are given with extreme caution and after approval from the highest level
- ‘We pick up early signals. The moment we know a company is heading towards trouble we review our exposure strategy and collaterals. We may decide to hold, cut the loan exposure or even completely exit. We give the company time to find another bank as our replacement,’ Maheshwari says. A company may take three or six months or even a year to find a replacement but it obliges. It is a smart strategy, as if HDFC Bank were to formally announce its exit the company would find it difficult to get another lender. Maheshwari recalls one incident where the bank made an exit but the same account came back to it through Centurion BoP
- For FY10, HDFC Bank miserably failed to meet the sub-target of the so-called priority sector lending norms. Banks are required to give 40% of their loans to farmers, small-scale industries and economically backward classes. Within the overall 40% limit, 18% should go to agriculture; within this sub-target of agriculture, 13.5% should be given directly to farmers and the rest 4.5% can be disbursed through intermediaries such as MFIs. Banks that fail to meet these targets are punished. For instance, if a bank does not give 13.5% credit directly to farmers, it needs to put the shortfall in NABARD. The interest earned on this forced lending is much less than what a bank can earn from other loans
- By one estimate, the value of gold with Indian households could be as much as Rs 28 trillion, 50% of fixed deposits in the Indian banking system in June 2012

- RBI norms stipulate that 25% of a bank's branches should be in rural and semi-urban centres
- The law restricts MFIs from collecting money from borrowers on a weekly basis and makes government approval mandatory for borrowers taking more than one loan. Subsequently, an RBI panel capped the loan rate by MFIs at 26% and the margin at 12%
- In MFIs, the intermediation through business correspondents, mostly the NGOs, also did not work well as the NGOs put their own interests first. 'They did what we wanted them to, but also did some irregularities,' says Rajender Sehgal, country head of the financial institutions group. 'Suppose there are 300 groups one NGO caters to and only a hundred are eligible for loans, they will not disburse the full amount to the eligible groups. Instead, they will cut their money and distribute it among others who are not eligible for loans. We found out such irregularities.' The NGOs started pretending to be the loan givers to influence the SHGs, and in certain pockets there were problems of misappropriation of money too. They took the money from the borrowers when they were repaying but did not give it to the bank. It happened in Odisha, Himachal Pradesh and Maharashtra. So, business correspondents who play a useful role will continue to do so but instead of directly collecting cash, now they use a handheld device, called a point-of-sale terminal, in which the borrowers swipe a card and the data gets transferred to the bank instantly, depending on the bandwidth of the telecom connectivity in that location. This gives the bank some control over collections. Along with this, the bank also directly calls on the customers once a month. Its field officers do so in close coordination with the business correspondents. The bank hands over money only at the branches. 'This is critical as, for a borrower, the person who is physically giving the money is the loan giver. They think of the business correspondents as their lenders. It's important to tell them it's the bank's money,' Rajender says

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Merger, Merger on the Wall

- The biggest gain was Times Bank's thirty-nine branches, about two-thirds of HDFC Bank's own branch network then. It was adding about twenty branches a year at that time. At one stroke, the merger took the bank forward by two years. H. N. Sinor, then managing director of rival ICICI Bank (it was still subsidiary of the project finance institution ICICI), had told me when I reported the merger that they also looked at Times Bank and did not find it attractive, but they missed its branch network. This is very critical when the regulator is not liberal in giving branch licences
- Typically, in any merger integration of people is as important as integration of business, if not more

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Anatomy of a Big Bang Merger

- Integration of two banks is very different from integration of two manufacturing outfits. Here, beyond business models and employees, millions of customers have to be integrated. Cheques, debit and credit cards, ATM cards, demand drafts - every single instrument needs to be uniform

- The big difference between the Times Bank merger and Centurion BoP merger was that the former was an accretive merger from day zero but the latter took three years to become an accretive merger. The stock market initially gave it a cold shoulder but that's the risk Deepak and Aditya took consciously - the biggest gamble that the normally risk-averse bank has ever taken

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Warts and All

- When it comes to non-rupee-related derivatives, Indian banks are allowed to do this only on a back-to-back basis. So, HDFC Bank, like many others, didn't take any market risk on the product; it was taking only credit risk
- The IPO scam, unearthed in April 2006, involved depositaries, depositary participants and many market operators who allegedly used or abetted certain entities in creating 59,000 fictitious demat accounts to corner shares of many IPOs meant for small investors. Apparently, in 105 IPOs between 2003 and 2005, scamsters cornered shares meant for retail investors by creating multiple identities
- Purely from a process point of view, if one were to look at what KYC requirements are - the 'ticking-the-box' that one needs to do in terms of ensuring that the people actually exist, they have ration cards and photographs, and so on - the bank met the process. Where it slipped up and didn't do what it should have done is to go beyond the obvious. 'This customer does exist but given this profile, should he or she be investing in an IPO?' The bank didn't ask this question
- The IPO scam also speeded up the process of converting branches into sales outlets and pushing all processing into back offices. This system has got a significant advantage because, when a customer walks in, if the branch manager knows the person well, he or she can get influenced and accept the documents even if they are not upto the mark. As volume grows, the branch manager may find it difficult to meet all the customers and may starts delegating responsibility to junior colleagues. Under pressure to bring in more and more accounts, a branch can be flexible in checking the documents and verifying the originals. But when these documents come to a back office, the process is much more streamlined. And the back-office employees can actually go and check if they find anything suspicious

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The Common Sense Banker

- To get a loan a little cheaper or to get a little more interest on deposits, if a corporate customer ever told Samir 'Main Aditya se baat karta hoon,' Aditya in turn would tell the unfortunate fellow, 'Tu mere logon se baat kar, main ye sab nahi dekhta hoon'
- The most important ability for a banker is how to say 'no' without damaging a relationship

- Aditya has this simple logic - to understand technology, one does not need to be a techie. As Ram explains, Aditya is one guy who, without knowing the technology, knows what technology has to deliver. He would say 'a car is a car and one just needs to know how to drive'
- Aditya has a unique way of keeping politics out of work. If anyone ever comes to him and complains about a colleague, he simply picks up the telephone and calls the colleague, 'Come here, your friend is saying this about you. Let's discuss.' So, either the person has to have the guts to openly speak his cause of complaint or he will die over there and never go back to the boss with false complaints! Everyone knows that if one goes and tells the boss anything about a colleague, one has to substantiate, one has to have the guts to face that person

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Whose Bank Is It Anyway?

- The successful leaders aren't the most 'visionary' or the biggest risk-takers; instead, they tend to be more empirical and disciplined. They rely on evidence over gut instinct and prefer consistent gains to blowout winners. Successful companies are definitely not more innovative than others. They don't always adopt internal changes as a response to a changing environment
- Performance of some of the foreign banks in India is also volatile. Typically the CEO, an expat, comes in for a three-year term. He cleans up the balance sheet in the first year, grows it in the second and repeats in the third year what his predecessor has done. Then he gets a promotion and moves on. The experience of some of the state-run banks where the chairman's tenure is not very long is similar. The incoming chairman typically invests the first year in cleaning up the balance sheet - undoing the incumbent's doing - but he leaves behind the same legacy, like his predecessor, in his strive for growth: rising bad assets that eat into the bank's profitability. And the cycle continues
- HDFC Bank is never worried about the market share. You'd need to create value over a long term. Buying a market share today is the easiest thing one can do but later it becomes extremely expensive. HDFC Bank hasn't bought the market share. It has bought solidity
- Here is what Deepak has to say on the brand issue: 'All the HDFC Group companies need to contribute towards enhancement of the mother brand to make it resilient, which will benefit everyone during rough periods. They should be careful or refrain from doing anything that will eat into the mother brand'
- The market has been speculating on a possible merger of HDFC with the bank ever since ICICI, the project finance institution, merged with ICICI Bank in 2002. The context of that merger is different though. ICICI was crumbling under huge-asset-liability mismatches. Survival in a changing environment was becoming increasingly difficult for it as the inherent cost advantage that such institutions were enjoying by virtue of their access to long-term cheap funds was disappearing and commercial banks were getting into project financing in an aggressive way. The regulator was pulling down the wall that separated financial institutions from banks

- ‘We have a Rs 1.67 lakh crores balance sheet. If we were to merge with a bank, then we would need huge reserve requirement. That’s the biggest issue,’ Keki says. In September 2012, under RBI norms, banks were to invest 23% of their deposits in government bonds or SLR and keep 4.5% of their deposits with RBI in the form of CRR, on which they do not earn any interest. Besides they need to have 40% of their loan exposure to the so-called priority sector - where the size of loans is smaller and hence the transaction cost is higher and return is relatively lower
- ‘If the law is changed and tax exemptions are given when a holding company pays dividends to its shareholders and invests in its subsidiaries, the holding company structure makes sense,’ Keki says