Smart money

Uday Kotak
EVC and MD

PHOTOS: PALASHRANJAN BHAUMICK

Uday Kotak has steered his bank into the top league

Kotak Mahindra Bank's Uday Kotak is India's extraordinary banker for more than one reason. Inspired by the Morgan Stanleys and J.P. Morgans of the world, the 55-year-old executive vice-chairman & managing director has built a bank from scratch – and put his family name on the line, while doing it.

There are only a handful like him who recognise the value of capital and the virtues of patience. Over 29 years, he has offered a huge, compounded 48 per cent return to the bank's shareholders. The bank's price/book value, at 6.69, is the highest of any bank in the world. Incidental to that wealth creation is the roughly ₹30,000 crore valuation of Kotak's own 40 per cent stake in Kotak Mahindra Bank. That makes Kotak the richest individual promoter of any Indian bank.

It's been a long journey from the 1980s, when he started off with a single bill discounting product, supported by three tables and chairs in an office at Navsari building in Mumbai's Fort area. But the middle class values have stuck on like glue. When Kotak needed a spot in Mumbai's tony Bandra Kurla Complex, for instance, he could have easily just picked one. Instead, he acquired a stressed asset from the defunct non-banking financial company Apple Finance in 2003. After gruelling negotiations with a consortium of lenders for nine long years, the asset now serves as headquarters to the bank.

In 2008-09, when Indian banks went overboard in lending to infrastructure companies, Kotak quietly stepped aside. Today, he takes comfort from the fact that he has very little infrastructure loans on his balance sheet. Should he be blamed for being averse to lending? Those who did lend to infrastructure say they were 'nation building'. Moreover, of what purpose is a bank that will not lend?

With his capital at stake, this is, perhaps, where Kotak's promoter instincts naturally kick in. In banking, Kotak Mahindra is known less for marketshare and more for quality of the balance sheet. "When you leverage eight, 10 or 12 times your capital, there is very little room for error. So we kept asking ourselves: is there commensurate return for the risk we are taking? If the answer was 'no', we stepped back. You're better off being stupid today, than be sorry tomorrow," he says.

President and group chief financial officer Jaimin Bhatt concurs. "The gearing is so much in banking that I am not losing the opportunity to make money but I am losing the money itself," he says. "The bane in banking has been low capital," adds Arvind Kathpalia, group chief risk officer; "because people have been playing with their capital."

It is perhaps unfair to say that Kotak does not take risk – because when you set aside more capital than is required by regulation, there is less available to be deployed. The bank thus needs to generate industry average returns, against higher capital limits.

The advances growth pulled off its highs, because of a quick compression of the commercial vehicles book. Sensing stress in the business, the book has nearly halved since peak. Perhaps a better yardstick is the bank's personal loans portfolio that is heavily skewed towards the self-employed category, instead of salaried.

This is a tougher category to lend to, which requires specific credit appraisal skills and regular monitoring cycles that can add to cost. "It's a market we understand well," says Kotak. "And the returns are significantly higher to justify the cost."

Now, as the Indian economy shows small shoots of recovery, most public sector banks are saddled with weak loans that in turn have caused capital constraints and will restrict future growth. Flush with capital, on the other hand, Kotak Mahindra Bank stands out like a beacon. "If India has to grow faster, the financial system is going to need a serious amount of capacity and capital. And this is where we see an opportunity," adds Kotak.

How large is the opportunity? The Indian market is dominated by public sector banks that control almost 75 per cent of market share. If they play their cards right, Kotak says, the private banks can now double their market share from 19 odd per cent today over the next few years.

And he is gunning for a front seat. The annual report tagline has changed from 'Prudence and Simplicity' in 2012-13 to 'Bigger, Bolder, Better'. He says he will trace a path at marathon pace, instead of a sprint. For the first six months of the financial year, the bank's consolidated assets have risen 10 per cent to ₹1,34,401 crore. Advances have increased faster at 19.34 per cent to ₹81,418 crore, and net profit has closed at ₹1,416 crore.

But, more than growth, Kotak is preparing for impending structural changes in consumer behaviour. There is a sea change arriving in Indian financial services that need preparation for. It will be a flood in which technology takes centrestage and traditional is pushed to the backseat.

"Banks in India are complacent about how customer

Total Assets Growth

(₹ 000s)	Total Assets	Growth %
1 State Bank of India	23,959,816,098	12.32
2 ICICI Bank	7,475,256,770	10.77
3 Bank of Baroda	6,761,141,057	20.87
4 Bank of India	5,781,546,036	26.68
5 Axis Bank	3,863,500,593	13.45
6 Union Bank of India	3,550,144,600	13.46
7 Citi India	1,449,806,200	12.93
8 HSBC India	1,318,805,011	24.22
9 Kotak M. Bank	1,222,366,338	5.53
10 Yes Bank	1,090,047,684	9.99

behaviour is going to change due to digital. And the faster we move towards that, the more consumer-oriented we become," says Kotak. "There is huge differentiating opportunity here for any Indian bank."

Take the technology shift in corporate lending to begin with. Kotak Mahindra is gunning for a spot in cash management and trade services, dominated by players like Citi, HDFC Bank and Axis Bank.

Indian companies depend on banks for their cash management needs, a service that deepens corporate-banking relationships and has implications for the latter in both interest and fee income. Cash management also generates 'float' for the bank – money in transit – that can be filled into periodical 'buckets' and deployed for onward lending. It is a tougher market to break into, but comes with associated fees and annuities income.

Unlike lending, cash management isn't capital-intensive. This business has traditionally been defined by a bank's distribution network. But already the system of cash and cheques is giving way to electronic transfers. "The source could eventually be e-commerce," says K. Manian, president, corporate & investment banking.

Manian sees flows shifting to payment gateways. The visible focus of e-commerce is still on retail, but increasingly it will move to small and medium businesses and companies, he says. "Why should a large consumer goods company not sell in the e-commerce space? A manufacturer could sell to a vendor, or directly to the customer. Purchases are going to increasingly move online. That's the transition that will happen," he adds.

Core capital

(% Tier I)		2014	2013
1	Kotak M. Bank	16.05	14.71
2	HSBC India	15.89	15.91
3	Citi India	15.35	14.81
4	ICICI Bank	12.78	12.80
5	Axis Bank	12.75	12.23
6	IndusInd Bank	12.71	13.78
7	Yes Bank	9.80	9.50
8	State Bank of India	9.72	9.98
9	Bank of Baroda	8.64	9.20
10	Bank of India	7.57	8.20

There is a similar trend emerging in catering to the retail customer too. The average age of Kotak Mahindra's 3.5 million customer base is 30. But even here, there are distinct profiles to cater to. "The 25-year-old customer is tech-savvy, with little or no concern of security implications on the Internet," says Shanti Ekambaram, president, consumer banking. "Online banking is a way of life."

The 45-plus customer, however, expects preferential treatment. They may want to visit a bank or have a relationship manager visit them. When it comes to online banking,

The subsidiaries

Over the last one year, lending to Indian companies has been restricted to refinance while the focus shifted to the subsidiaries and dealmaking. Kotak Mahindra Bank was part of IDFC's ₹1,000 crore qualified institutional placement and Tata Power's ₹1,993 crore rights issue. It also took part in mergers and acquisition deals, where the cumulative value totals upwards of $2 billion.

The subsidiaries have grown and turned more profitable during this time. Kotak Mahindra Insurance, for instance, has increased its new business premium to ₹1,271 crore in 2013-14, up from ₹1,164 two years back. Profitability of the arm touched ₹290 crore, up from ₹211 crore during the same period.

New regulations may increase foreign direct investment by joint venture partners in Indian insurance companies. But even though Old Mutual, Kotak's partner in life insurance has the right to acquire additional shares should policy permit the firm sees no impending need for capital, says Gaurang Shah, president, asset management, life insurance & international business.

Kotak Securities catered to 900,000 secondary market customers in 2013-14 – up from 750,000 customers in 2011-12. Its net profit has risen to ₹160 crore from ₹126 crore two years back.

Kotak Mahindra Prime, the auto finance arm, continues to rely on financing not just the customer but also the dealer and manufacturer. In exclusive tie-ups with manufacturers it gets access to the dealer network, which has an inherent advantage in recommending the bank to their customers. On a gross income of ₹2,524 crore, Prime posted a net profit of ₹491 crore in 2013-14.

Kotak Mahindra's offices have been established in London, Dubai, Singapore, Hong Kong and the US too, to channel foreign institutional investor funds into the Indian markets. "The core focus is concentrated on India," says C. Jayaram, joint managing director.

The wealth management outfit continues to be a leader in the industry. The firm was launched barely around the millenium against stiff competition from foreign banks. But Kotak uniquely positioned itself with solutions in the capital markets space. The markets took off, and so did the wealth management unit.

There has been some concern on Kotak Mahindra's own products being sold to wealth management customers but Kotak says the recommendations are all open architecture.

In financial services the culture of the employee is very important, says Kotak. "When you give the employee a target, it's a little bit like a dog and its biscuit. Stop giving the biscuit and the dog stops jumping. How do you ensure that employees work as a culture for customers rather than working for targets?," he asks.

Last month, the bank acquired a 15 per cent stake in commodity exchange MCX for ₹459 crore. The investment is purely financial unlike an existing stake in the Ahmedabad Commodity Exchange. "In a growing country like India, we think this is an investment that will pay," says Kotak.

Next on the cards is a foray into general insurance, for which the nuts and bolts are still being put in place. ◆

they prefer a more simplistic interface," says Ekambaram. Catering to both profiles is important because, while the 25-year-old is the future of Indian banking, most of the money is still held by the 45 plus, she adds.

The focus remains on adding convenience. The bank, for instance, launched a product recently that allows a customer to transfer ₹10,000 to another person electronically. The sender no longer needs a cluttered IFSC code or bank account number, but only an e-mail address and a phone number. An e-mail is sent to the receiver with a one-time password, and is able to receive those funds into any bank account of his/her own.

Such technological changes are the tip of the iceberg but hold potential to upset the applecart. Kotak Mahindra's branch network has expanded to over 800 from about 600 in March 2014. But structural shifts will shape the future of branch banking too. "Ten years from now, a lot of Indian banks will ask why they need so many branches," says Kotak.

Branches remain relevant from a customer acquisition point of view (and thus Kotak Mahindra's continued branch expansion), and because India remains a cash economy. "However, there is a distinct shift in customer behaviour in which 90 per cent of transactions are done outside of the branch," says Dipak Gupta, joint managing director. "Branding, that goes along with branches, is relevant. But that is the cost of advertising, not furniture and fixtures," he adds.

Young retail customers are

Jayaram: focus on India

Gupta: a shift in customer behaviour

moving away from the branch, but that is still not the same with current account customers. Branches that cater to small and medium companies are still packed on a weekday. Cash accepting machines at Kotak branches have been tweaked to offer receipts, because the bearer still needs an acknowledgement with stamp.

The last big opportunity remains rural India. To reach out to a farmer who makes payment in cash and to rope him into the financial mainstream still requires physical infrastructure as support.

Kotak says he is borrowing from India (urban centres) to lend to Bharat (rural India). Savings bank customers at Kotak Mahindra are offered 6 per cent interest, against an industry standard of 4 per cent.

"A 6 per cent savings deposit rate at a time when term deposits are at 9 per cent is not a bad rate for banks at all," says Kotak. "And if you are building a bank for growth on a sustainable basis, I think it is a fare rate for customers".

It is the lending opportunity, however, that Kotak is more excited about. There is wealth in these places that exists in cash, and needs to be channeled into the financial mainstream. "Where else in the world do you have a country where two out of three people do not have a bank account? There are 800 million people in India that do not have a bank account. And at least 25 per cent of these have money," he says.

After 10 years of testing rough waters, Kotak Mahindra has plunged into tractor financing. Its strategy depends on the tractor manufacturer

Net Interest Margin

(%)	2014	2013
1 Standard Chartered	5.17	5.11
2 Kotak M. Bank	4.84	4.31
3 Citi India	4.40	4.50
4 HDFC Bank	4.02	4.19
5 IndusInd Bank	3.46	3.15
6 HSBC India	3.44	4.48
7 Axis Bank	3.22	2.93
8 State Bank of India	2.91	2.97
9 ICICI Bank	2.81	2.61
10 Yes Bank	2.65	2.36

Return on Assets

(%)	2014	2013
1 Citi India	2.12	2.12
2 Kotak M. Bank	2.11	2.12
3 HDFC Bank	1.92	1.84
4 IndusInd Bank	1.76	1.62
5 Axis Bank	1.74	1.67
6 ICICI Bank	1.64	1.57
7 Yes Bank	1.55	1.51
8 HSBC India	1.25	1.8
9 Bank of Baroda	0.82	0.95
10 SBI	0.64	0.92

Return on Equity

(%)	2014	2013
1 Yes Bank	24.94	24.81
2 HDFC Bank	21.59	20.52
3 Axis Bank	17.63	18.74
4 IndusInd Bank	16.89	17.15
5 Citi India	16.14	18.33
6 ICICI Bank	15.68	15.21
7 Kotak M. Bank	14.43	15.46
8 Bank of Baroda	14.11	15.58
9 Bank of India	10.79	12.25
10 SBI	10.29	15.32

The top team: Arvind Kathpalia, Mohan Shenoi, D. Kannan, Narayan S.A., K.V.S. Manian, Gaurang Shah, Jaimin Bhatt and Shanti Ekambaram (seated)

market but the bank has expanded into almost all states barring a few along the border. With a lending book of over ₹4,000 crore, Kotak Mahindra is now the largest Indian bank in this space.

The customer here is as demanding as in urban India, says S.A. Narayan, president, commercial banking. "You have to judge the customer well. About 90 per cent plus of this business are cash collections. And we have to go and collect in most cases. The farmer may not pay in one shot. Crops may fail or succeed. Moreover, it is not as easy to pick a tractor from a defaulting customer, as it is to pick a car, because the former is a means of livelihood, while the latter may be luxury," he adds.

It is cash transactions that are driving the branch network, and financial inclusion will need active government policy as enabler. "There is a significant opportunity of bringing Indians into the formal financial system. You have created a system where a farmer doesn't pay tax, because he is not in the formal system. There are instances when a farmer with bags full of money enters a luxury car showroom and says: 'here is the money, where is my car?'"

It is trends like these that Kotak keeps a close eye on. "I am collecting pebbles on the seashore, while a vast ocean lies in front of me," he says.

A recent P.J. Nayak Committee report deals extensively with the structure of corporate governance in Indian banking, widely believed to be weak in public sector banks, due to promoter interference. "Corporate governance is about a simple principle. You have to ask yourself 'am I doing what is right' and 'am I doing it in the interest of all shareholders?' If you can look into anybody's eyes and answer these two questions honestly, then the corporate governance issue is taken care of," says Kotak.

There is talk about mergers of public sector banks and Kotak says it has to be thought through carefully. "The case of Air India and Indian Airlines is an example. It is extremely important to think through the implications of mergers like that. And also ask what you are planning to achieve through that," he says.

Finally, there is the issue of individual shareholdings in Indian banks, which must be scaled down as the bank continues to grow. The RBI's contention is that public money in the hands of individuals is less safe than in the hands of institutions.

Kotak disagrees. "When we became a bank, we had an approval from RBI to hold 49 per cent stake in the bank without any further dilution. The rules of the game were changed retrospectively," he says.

"Moreover, there aren't too many bankers in India with 'skin in the game'. A lot of problems today, particularly in banking come because it is other people's money. And the faster we get to the point where we have reasonable skin in the game, the better it is for banks," he adds.

While the P.J. Nayak Committee has recommended 25-26 per cent shareholding, Kotak is hoping that the number will be revised to 30-40 per cent. "This should be allowed to promoters or appropriate fit-and-proper investors in banking."

As he moves deeper into India, Kotak says that banking is a business of trust – that needs to be acquired from not just depositors but increasingly also of all stakeholders including investors. "Once they achieve that trust it is important that we do not break it. Size is important, but value is even more important," he says.

He expects India's GDP growth to close at 5.5 per cent this year, and to average 6.5 per cent over the next five years. "I hope we exit at 7 per cent plus," he says. "We are seeing global deflationary pressures. Oil has come down. Commodities are coming down. Inflation in the developed world is among the lowest it has been, despite all the quantitative easing. India will face challenges to growth, because of pressure on exports," he adds.

That leaves ample room for Kotak Mahindra to grow. But can it deliver on the same compounded growth rate on shareholder returns like it has in the past? "It is not automatically achievable, but anything more than half of that is also not a bad number," he adds.

◆ RYAN MAXIM RODRIGUES

Gross NPAs

Gross NPAs/Total Advances (%)

		2014	2013
1	Yes Bank	0.31	0.20
2	IndusInd Bank	1.12	1.03
3	South Indian Bank	1.19	1.36
4	Axis Bank	1.34	1.20
5	HSBC India	1.65	1.76
6	Kotak M. Bank	2.00	1.60
7	Citi India	2.40	2.60
8	ICICI Bank	2.70	2.90
9	Bank of Baroda	2.94	2.40
10	Bank of India	2.99	2.34