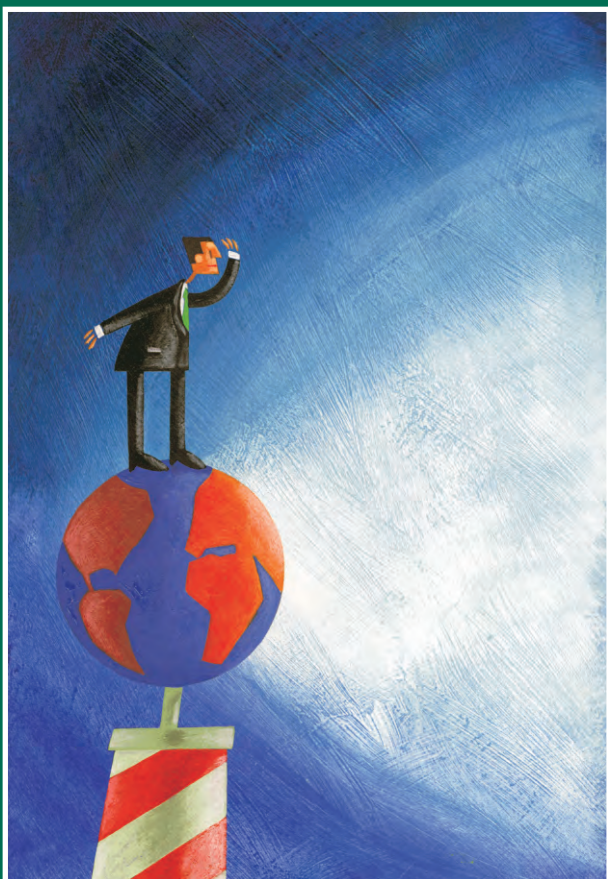




Blueprint for Transformation at Public Sector Banks



THE BOSTON CONSULTING GROUP

‘I act because I must’

— Mahabharata, III.32.2-4

BLUEPRINT FOR TRANSFORMATION AT PUBLIC SECTOR BANKS

“At first, people refuse to believe that a strange new thing can be done; and then they hope it can be done; then they see it can be done; then it is done and all the world wonders why it was not done before.”

— Frances Hodgson Burnett
The Secret Garden

With the introduction of new private banks in the early nineties, Public Sector Banks (PSB) in India were thrown a challenge to transform. The industry had to unwind a legacy built over two decades after nationalization. Different banks have taken different routes towards the same goal over the last decade. Some have covered more ground. Others have covered less. The broad direction is now clear.

This essay is a synthesis of pragmatic lessons gathered by BCG over the course of the last decade of engagements in PSBs’ transformation efforts. The ideal sequence of interventions may vary among banks. However, in our experience, this roadmap acts as a broad blueprint of interventions over a 3-year period for all banks. The blueprint is summarized as a 15-point agenda.

1. Strategy – what to be; what not to be?
2. Direct sales and marketing – seeding a cultural change
3. Back-office centralization – freeing up more staff for sales and service
4. Branch transformation – shaping up for the next generation
5. Collections – gain the right to grow fast
6. Wholesale bank – ring-fencing the talent
7. Second generation technology initiatives – gaining an edge post CBS

8. Organization structure – pragmatic reflection of strategy
9. Regaining people advantage – getting line management to develop human resources
10. Sustainable financial inclusion – incubate a new stand-alone viable model
11. Subsidiaries – circumvent constraints; create value
12. International footprint – control the corridors
13. Preparing for PSB consolidation
14. Getting started – taking people along
15. Making change happen – seeing is believing

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In our experience, accomplishing complete transformation takes 3-5 years of concerted relentless effort. Following is a brief overview of each initiative and the pragmatic choices that we have found to be successful.

1. Strategy:

One needs to start by creating alignment on a vision for the bank and a strategy to achieve that vision. Strategy is about choices. It is as much about what not to do as it is about what all to do. Many organizations achieve mediocre success by trying to be every thing. For any bank, it encompasses the following typical steps:

- 1.1. In-depth analysis of strengths and weaknesses of the bank compared to peers: From an external perspective, each bank has many strengths to build on – strong brand, or branch presence, or affinity in local geography, or technology. Each of these lends itself to choices for a bank's strategy. A deeper analysis will reveal latent strengths.
- 1.2. Honest assessment of bank's weaknesses: Employee age, skills gaps, and poor marketing focus are typical weaknesses of many public sector banks. Where does a bank lie? Are their latent weaknesses in culture that do not meet the casual eye but need to be addressed?
- 1.3. Choices of geography: Should the bank aim to dominate home geographies or aim for pan Indian presence? How should the bank make its presence felt in the geographies of its choice? What should be a bank branch's foot print map over the next 3 years?
- 1.4. Choices on product segments: How large should the schematic retail portfolio be? How much should fee products contribute to the bottom line? Which fee products to emphasize on? Should the bank make a major push into technology-centric products like cash management and credit cards?
- 1.5. Choice on customer segments: Should the bank emphasize on large corporates or local mid-market? What is the ideal composition of SME in the book? What is the optimum size of financial inclusion business? How should the bank serve NRIs? What will be the strategy to attract young customers and HNIs?

- 1.6. Choice on channels: How much growth should the bank target in next 3 years to stay true to its strategy, across branches, ATMs, internet, call centres, and mobile banking? How should these 5 channels be integrated to give customers a seamless experience?
- 1.7. Customer service and branding: How will the bank look and feel different to the customer? What will it stand for as compared to its peers?
- 1.8. Subsidiaries and joint ventures: In what areas will the bank have subsidiaries and joint ventures? Who will be the ideal candidates for such partnerships?

It is important to articulate answers to these questions and create a shared understanding amongst the top management team before kick starting the change program.

2. Direct sales and marketing:

In our experience, sales and marketing is a natural starting point for a cultural transformation. Making staff reaching out to customers and developing business is fundamental mindset shift. We have found the following choices useful.

- 2.1. Sales force controlled at regional level: It is advisable to not provide control of sales force to branches, to begin with. Branches tend to absorb sales personnel in routine jobs. Sales force coordinated at regional level can feed the branches with business.
- 2.2. Structuring the sales force on product lines: We have found it most optimal to structure different sales force for personal banking, business banking and retail loans. This is due to different skills required in different segments.
- 2.3. Sales force systems: Systems are crucial to make the sales force effective – lead generation from branches and market, day-to-day route planning, MIS to track performance of individual sales personnel, target setting, and performance management. Our experience has been that

with introduction of best practices in branch rhythm, internal and external lead generation, sales process, MIS, and incentive mechanisms, more than 30% jump in sales productivity can be achieved without compromising the service.

3. Back-office centralization:

A very primary step in transformation is to centralize branch back office work into processing hubs at district / regional level as much as possible. This ensures full leverage of CBS through remote processing. Productivity improves and staff is released for more value added roles in sales and service.

- 3.1. First set of processes to be considered are branch back office processes such as inward and outward clearing, pension processing, account opening, cheque book and ATM PIN issuance etc. With centralization of repetitive tasks, we have found that there is 60-70% improvement in efficiency for the same tasks. Thus, work force is released for sales and other roles.
- 3.2. The second set of processes relate to credit centralization in hubs. Schematic retail credit and SME credit can be centralized in a few hubs servicing 40-50 branches. Scarce credit skills can thus be most optimally utilized. These hubs are supposed to receive complete paper work from branches and sanction loans in a specified time period (TAT). In our experience, it is important to also grant a sales force to these hubs to generate their own leads and grow business. Business generated directly by hubs is parked in branches in case of SME loans. Retail loan hubs can be special branches in themselves. This ensures that hubs improve not only TAT but also business growth.

4. Branch transformation:

Branches continue to be the core channel for banks despite explosive growth in alternate channels. Being the most visible face of the bank, branches have to be completely redesigned to attract young customers and the HNIs, and to send a powerful message to

customers about change in the bank. Concurrently with the sales force (Point 2) and back-office centralization (Point 3), branches have to be restructured with the following key changes:

- 4.1. Physical layout of branches has to change to ensure larger space for customers: Back-office of the branch (whatever minimal remains after centralization) has to be concealed to keep the ambience pleasant.
- 4.2. Branch network has to be segmented according to customer segments to ensure focus and customization: Branches in dense commercial markets need to be designated as “Business Banking Branches” and formatted according to customer needs of small businesses (Eg. confidential meeting rooms, separate cash area). Branches in residential areas need to be dedicated “Personal Banking” branches (separate area for HNIs, larger customer seating space, etc). The targets, processes, resources, and layout of different branch categories have to reflect their customer needs.
- 4.3. Role descriptions for staff in branches have not changed for decades: With introduction of CBS, back-office and credit centralization, the role of branches has to be redefined as high performance sales and service centers. Accordingly, the role of staff in branches has to be redefined. New categories of roles need to be created (eg. branch sales). The number of staff in branches has to come down with rationalization of processes.
- 4.4. Service roles in branches have to be made explicit to reduce pressure on the branch manager. We have found that a dedicated relationship manager to serve high value customers (typically with a balance above Rs 1 lac in SB, Rs 3 lac in CA) gets very positive and immediate feedback from customers. Such relationship managers have to generate leads for the sales force. They can over time become wealth management advisors for HNI customers. Additional roles need to be clearly defined in branches to educate customers on alternate channels, update customer information, direct walk-in

traffic, and to generate leads from customers.

- 4.5. Growth in branch network is a significant driver for a bank's top line growth. However, aggressive branch rollout pulls down a bank's financial performance in the initial years because traditional branches take 18 – 24 months to break-even. It is advisable to create a small format of branches (eg. 500 sq ft). Such format can be rolled out fast (because finding right locations is easy) and it breaks even within one year. Thus the roll-out can be cost neutral to the bank.
- 4.6. Train the branch manager as a local CEO. Our experience shows that the biggest source of energy in transformation is to galvanize the middle management – the branch managers. They need to be empowered and enabled to act as CEOs of their local territory and use all the new ideas introduced by the bank to build their business. One primary tool that we have found to be very effective is to train the branch manager to develop a business strategy for their local branch catchment. (as against being given a top down target for every product that the bank sells).

5. Collections:

The initiatives mentioned in points 2, 3 and 4 above create capabilities to turbo charge growth. However, the bank gets a right to rapidly grow assets only after tightening up its collections apparatus. Quite similar to centralized expertise consolidated at regional level for sales and credit, it is crucial to create specialist cells for collections at the regional level. There are two key principles that underpin the collections apparatus.

- 5.1. Firstly, the speed to action against defaulters determines the eventual level of NPA in the bank. The specialist cell has to provide expert assistance to branches in identifying early warning accounts and in quickly reaching out to customers immediately after a default. The type of action has to vary by overdue buckets.

Accounts overdue by 0-30 days need different treatment as compared to accounts overdue by 30-60 days and so on. It may be prudent to sub segment a bank's collection cell teams for different buckets because different strategies are required.

- 5.2. Secondly, the defaulters have to be split into "genuine" and "willful" categories early in the process and different actions should be taken depending upon the category of defaulter. The genuine defaulters need to get restructuring assistance. Stern action should be initiated against willful defaulters early on. Willful defaulters typically can be identified based on how difficult they are to deal with, whether they avoid discussions, and how quickly the loan became a default after disbursal.
- 5.3. Once the collections expertise is consolidated at the regional level, the bank can pursue aggressive growth in retail lending with full conviction. We have recently seen large banks pursuing aggressive home loan growth but seeing their NPA rise to high levels. This is not a wise strategy.
- 5.4. A separate PDC and customer file management apparatus have to be created along with the collections apparatus. These activities are new for a bank and are best outsourced.

6. Wholesale banking:

The complexity and sophistication of wholesale banking has risen steadily over the last decade. Corporate customers are globalizing and are demanding better service, lower prices, and more customized products. Skills and talent is at a premium in corporate banking. Fee income is important due to imminent pressure on margins. In our experience, the following initiatives are meaningful:

- 6.1. A separate vertical has to be created for wholesale banking. Specialized wholesale branches have to report directly to the HO to reduce the number of tiers in the credit approval process to two.

- 6.2. The structure of branches has to be changed to introduce roles of relationship managers (RM) to build business with the customer and Credit officer (CO) to conduct credit appraisals and manage routine activities. The RMs should have enough time to meet customers often, understand their needs, and capitalize on opportunities to deepen relationships. The RM has to be assigned targets to grow the total income (as against advances) from customers while staying above the hurdle of minimum return on capital.
- 6.3. A simple technology-based system needs to be introduced to measure TAT on loan proposals, track the number of times a customer is met by the RM, and to track account level profitability and level of cross-selling (number of products per customer).
- 6.4. Talent is at the heart of wholesale banking. Both credit skills and marketing skills are unique and scarce in the public sector. The personnel in wholesale banking have to be ring-fenced and groomed specially. A career track has to be created so that the staff can be groomed for corporate banking through a series of postings in SME banking and eventually in corporate banking.
- 6.5. Systems generating account-level profitability have to be put in place. The RM for each corporate account needs to be able to get a full picture of the total NII and fee earned from the account across all products offered by the bank. An IT based system to help calculate account level RORAC (Return On Risk Adjusted Capital) should be put in place. This helps in price negotiation with customers. Finer rates can be offered on loans if the customer compensates by purchasing other products from the bank.
- 6.6. A distinct transaction banking division has to be created to focus on fee-based transaction banking products for corporate and institutions - cash management, government business, channel finance, trade finance, correspondent banking, services to other financial institutions like

currency chest. The transaction banking division needs to have its own sales force and sales targets that are double-counted with corporate banking RMs. In the traditional structure of PSBs, these products become orphans who are not a priority for any one to sell.

- 6.7. Treasury is a source of significant fee income through foreign exchange and derivative sales. We have found that a dedicated treasury sales force to proactively reach out to corporate clients (in partnership with client relationship managers) leads to immediate revenue uplift possibility.

7. Second-generation technology initiatives:

Introduction of CBS in all branches is a remarkable and major achievement. However, it is the first step. Second generation technology investments include CRM, work flow automation, data warehousing for risk management and customer analytics, document management system, and special product package like wealth management. Unlike CBS which is the most basic and mandatory IT investment, next generation investments in technology have to be managed in a “Return on Investment (ROI)” mode. A business case based on revenue uplift or cost saving has to be created for each IT project and meticulously managed against the promised deliverables. Basic consistency in IT architecture has to be maintained to ensure flexibility for the future and to avoid complexities in building up IT.

8. Organization structure:

The importance of a change in the organization structure or ‘restructuring’ is often over estimated. Many banks overemphasize the value in moving from four tiers to three tiers. In fact in our experience, different businesses need different tiers. Retail businesses need a 4-tier structure, SME businesses need a 3-tier structure and corporate businesses need a 2-tier organization. An overall 3-tier structure is counter-productive for retail businesses and suboptimal for the span of control for senior executives. We feel that a change in the organization

structure for PSBs should be restricted to a few high impact changes:

- 8.1. RO structures should be strengthened with specialized cells for centralized SME credit processing, centralized retail loan processing, collections and sales and marketing teams.
- 8.2. The head office has to be organized into business verticals, support units, and control units. Business verticals need to include large corporate banking, mid corporate banking, transaction banking, personal banking, retail lending, rural and agriculture banking and SME banking. No product should be left an 'orphan' without any sponsor department.

9. Regaining people advantage:

Galvanizing human resources is by far the single most powerful lever of transformation for PSBs. Given the legacy and culture, public sector banks cannot borrow ideas from text books or from the private sector to manage their HR. In our experience, the following 8 initiatives need to be undertaken:

- 9.1. It is important to recognize the need for recruiting young staff in significant numbers. A recruitment engine needs to be put in place that can ensure steady increase in head count with business through the year. Massive one-time recruitment (like many large banks did recently) hurts the organization pyramid as the large batch grows senior. Recruitment strategy needs to create a value proposition to attract the youth towards the bank in the same way as young customers are being courted. Banks need to carefully identify the recruitment pools to hire from.
- 9.2. Career management of employees and succession planning for key positions are interlinked processes that crucially depend upon the ownership of senior line executives. The HR department should be an enabler. The real HR work is done by the line executives. In our experience, it works wonders if career committees ("People

Forums”) at various levels comprising key line executives are mandated to debate and own the career management of key junior staff. Employee files need to be upto-date for these committees to have quality deliberations. The HR department has to collate and manage much richer data on each employee and provide inputs to these People Forums.

- 9.3. Technology has revolutionized businesses. Now it is the turn of HR to be revolutionized. Rich data on employees’ performance, strengths, development areas, personal aspirations, and potential need to be at hand. Using technology, postings can be optimized through multiple constraints of personal choice, demands of employee’s career path and development plan, business exigencies, and service constraints. Postings and promotions can happen faster and well on time.
- 9.4. Performance management systems will be at the heart of people retention. It makes the best staff feel recognized and groomed. Imminent reforms in government stipulations on incentive schemes for PSBs would mean that the bank can implement global best practices in an incentive mechanism. Our experience shows that the top 75% (and not 25%) should get incentives that are calculated monthly and disbursed quarterly, people should start getting incentives from 90% of the target achievement, majority of incentives should be linked to group performance, it should be based on a common currency of points across different products and should acknowledge inputs (eg. lead generation) as much as output (eg. sales). It is time for banks to start implementing balanced score cards.
- 9.5. Another major initiative that deserves to be on the strategic agenda is outsourcing. Non-core activities need to be outsourced to the extent possible. This is crucial to get costs right. Cost per head of FTE in the public sector is higher than in the private sector currently and it will have an upward

pressure due to negotiated wage settlements. By outsourcing non-core activities, the bank will get an option to effectively keep cost per head low and keep its higher cost manpower for value added roles.

- 9.6. The central HR department needs to be beefed up with skills, resources, and technology, in order to be the custodian of this transformation.
- 9.7. In our experience, whenever the top management takes clerical staff and sub staff into confidence and initiates measures to incentivize their performance (monetary or non-monetary), the results are always surprising. We believe that a special class III and IV role enhancement and employee engagement scheme should be launched.
- 9.8. Chief Manager and AGM cadres need to be the starting point of any HR intervention. High potential individuals from these categories have to be selected for grooming for senior positions in the coming years. This grooming will be done through a carefully managed career path.

10. Subsidiaries:

Certain specialized high skill businesses need manpower at market-linked compensations. Such areas need to be parked in subsidiary companies. These areas include capital markets and broking, wealth management and private banking, custodial services, and credit cards. Life insurance, non-life insurance and asset management subsidiaries are valuable because of the accretion to a bank's valuation. PSBs command a very valuable customer franchise. Private sector partners are willing to pay significant premium to partner with the banks.

11. Sustainable financial inclusion:

Financial inclusion has been taken up on a war footing. RBI and the government have weighed in with quantitative targets for coverage. Banks are pursuing the coverage goals aggressively. Sensitivity to the need for profitable and sustainable model of

financial inclusion has also been helpfully appreciated by the regulator and the government. Latest developments in technology and regulations make it possible to make the financial inclusion vertical scalable and profitable. We believe that the following new ideas need to be implemented:

- 11.1. The BC and technology provider need to be separated. Hitherto, the same company used to provide both.
- 11.2. Corporates who have a presence in rural areas need to be proactively approached for signing up as BCs. Unlike the BCs in the past, the Corporate BCs will need to be courted by the banks and not the reverse.
- 11.3. Rollout has to be scientifically optimized for maximum viability. There is a wide variance in prosperity of financially excluded villages.
- 11.4. Credit has to be introduced as an integral part of the portfolio of financial inclusion. SHG model should be integrated with the BC model to generate a viable scalable model.
- 11.5. A separate model for financial inclusion in urban centres needs to be developed. 35-40% of households in urban centres are excluded. Due to high concentration of demand, the model will break even much faster in urban centres and provide scale.
- 11.6. Employee cost per capita of PSBs is now higher than all segments in the banking industry. In order to make lower cost structures for a low ticket business, lower cost manpower is crucial. Banks have to consider creating subsidiaries / associate companies with a low cost manpower. These will work exclusively for and under the direct oversight of bank officials, book business in banks books, and service loans as well as deposits.

12. International footprint:

Rapidly internationalizing Indian businesses are demanding Indian banks to follow them. The very first requirements are to support corporate customers raise debt in international markets, finance international trade through buyer's credit, and finance international M&A. Branch presence in international financial hubs is critical. It is important to ensure presence in major trade corridors. Trade between emerging markets is expected to grow faster and banks should take positions accordingly. Second step is to garner a fair share of international remittances into India by securing presence in main remittance corridors of Middle East, SE Asia, Europe and North Americas. This is a crucial element in bank's NRI strategy. The final step is to expand through branch presence in local foreign markets through acquisition of domestic banks. Some of the SE Asian markets with substantial business interests of Indian diaspora are of particular interest. This last step should however be taken only if the bank has appetite to build a local strategy.

13. Preparing for consolidation:

The discussion on consolidation among the Indian nationalized banks will come up sooner or later. In every probability, the top few large banks will act as a pivot around which the consolidation blue print will revolve. On an average, the balance sheet strength and financial performance of the larger nationalized banks – PNB, BOI, Union Bank, BoB and Canara Bank is better than the smaller banks. How does a bank become a candidate for being a pivot? This will require strengthening of the organizational framework, visible vibrancy of the organization, adoption of progressive policies and demonstration of “out of the pack” financial performance.

14. Getting started:

Each of the above initiatives takes 9-12 months to design, pilot, and rollout. While there is a need to get all of the above accomplished, in our experience no more than 3-4 initiatives should be undertaken by a bank at any given point of time. This ensures that the new initiatives can settle down before the next ones are taken. Banks need to:

- 14.1. Get the top team aligned on strategic direction during the first 3 months of the journey, before the initiatives are launched.
- 14.2. Take the Chief managers and AGMs on board for strategic direction because they have a long stake in the bank and they are crucial to any implementation of new ideas.
- 14.3. Set up a core transformation team of a senior executive supported by 5 mid-level staff that is mandated to run a full-time change program. Highlight it as one of the most important roles in the bank and thus enlist the best in the bank to take up this role.
- 14.4. In our experience, the success of transformation is crucially linked to the quality of people you will pick to lead the initiatives. Those Chairmen who commit themselves to change and release their smartest and most dependable staff for transformation initiatives, eventually derive rich dividends from the process.
- 14.5. Take the officer association and union into confidence at the start of the program. They can be very constructive if taken along well. They can be a major distraction otherwise.

15. Making change happen:

A job well begun is only half done but half done is not enough in the case of transformation. We have observed that employees change themselves only if they believe that the transformation processes will not be jettisoned half way. The Chairmen of banks need to articulate the rationale for change in terms of (1) Why change, (2) Change to what, (3) What will happen to individual employees, (4) Who is behind the change, and (5) Will the change really happen fully. Thereafter, verbal and written communication and updates are required. But they are hardly enough in making real change happen. We have found that people change only when they see new initiatives succeed. People who are a part of the successful initiatives become very articulate change champions

or change agents. These change agents become the catalyst for change. They are very credible when they communicate the need for change to their peers. The transformation journey has to be orchestrated meticulously to ensure change agents are nurtured and placed carefully.

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