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# Eight degrees of separation

## The retail banking challenge going forward

**T**he banking sector has had turbulent changes after the economic downturn. While India escaped a lot of the ills, it was still affected. In spite of the fact that India's retail asset/GDP ratio is 14 per cent, compared to 40 per cent in the US and 65 per cent in Malaysia, its retail asset growth dropped last year to 4 per cent compared to 40 per cent per year for the previous three years.

I believe that successful Indian retail banks will have to find the eight degrees of separation from their competition to sustain their competitiveness. Here's a discussion around a few:

**Real cost reduction:** Low personnel cost is a double-edged sword. For years we thought it gave India the edge. Instead we watched our compensation levels climb with little regard to revenue/employee and we underleveraged the ability of technology to optimise cost. This number tells the story. The operating cost/income ratio is 44 per cent for India compared to a similar number for many UK banks and around 38 per cent for Malaysia. So our cost structure is no better than others. This needs to drop at least 10 points. Automation in processes and reducing branch utilisation from 70 per cent to 60 per cent should do it.

**Improved fee income:** This is sometimes hard to do. The regulator often comes in the way of banks generating their share of fee income. However, it is in every bank's interest to manage their risk better by not being over-dependent on interest income. Again here the fee income/total income ratio is an anaemic 18 per cent. The US operates at about a 40 per cent average. Too many customers (not just banking) get away by not paying enough for service in this country, then demand the moon.

**New liability products:** There was much discussion last year about whether the challenge was too much liquidity or too little. The considered view was that there was liquidity, but banks were not willing to lend. Even if that were true, low cost retail liquidity is always welcome, and that means doing more than the vanilla deposit products that the country has had for a long time. Some recent examples of innovations include retail trust accounts, sweep in accounts, small savings and value remittances, individual

retirement accounts, etc.

**Best-in-class collections & recovery:** Last year, banks with a large unsecured retail asset book got seriously concerned about collections as default rates rose. The whole collections model got stress tested. What to outsource? Or insource? As collections became difficult, many banks pulled in some of the functions they had outsourced, and started to deal with customers directly. The government also got testy about how customers were handled. In my view, this whole area is going to go through a paradigm shift, going forward. It may be better to have a higher cost of collections if you can ensure a lower default rate.

**'Wow' customer experience:** Global data indicates that a bank loses 20 per cent of its clients in the first five years of their relationship. In India, low value customers seem to hog all the channels meant for high value customers. Call centres are all clogged up. On top of that, one will get the 50th call to open up an account, even though you have had an account there for 15 years. We either overdo it with a relationship manager calling us all the time, or we under-do it – can't find a person when we need help the most. The one who gets it right will be the winner in the long run.

**Enhanced loyalty programmes:** This takes me back to my AMP class at Harvard; a simple question from the professor. When you have five credit cards per wallet, what makes you pull out a certain card? Nine out of 10 times it's the frequent flyer programme on the card. It's as simple as that. Of course, there are other areas such as cash bank, discount vouchers, multi-partner cards, etc. In my view, keep it simple so that both you and the customer understand it. And remember it's not only about designing a loyalty programme for the credit card – it's for the full relationship.

The other two are product innovation and credit scoring.

With a large, young population and with GDP growth based on national consumption rather than exports, India's retail banking opportunity is amazing. 'Eight degrees of separation' will ensure that you win with the right set of customers, not the address verification variety! ♦