



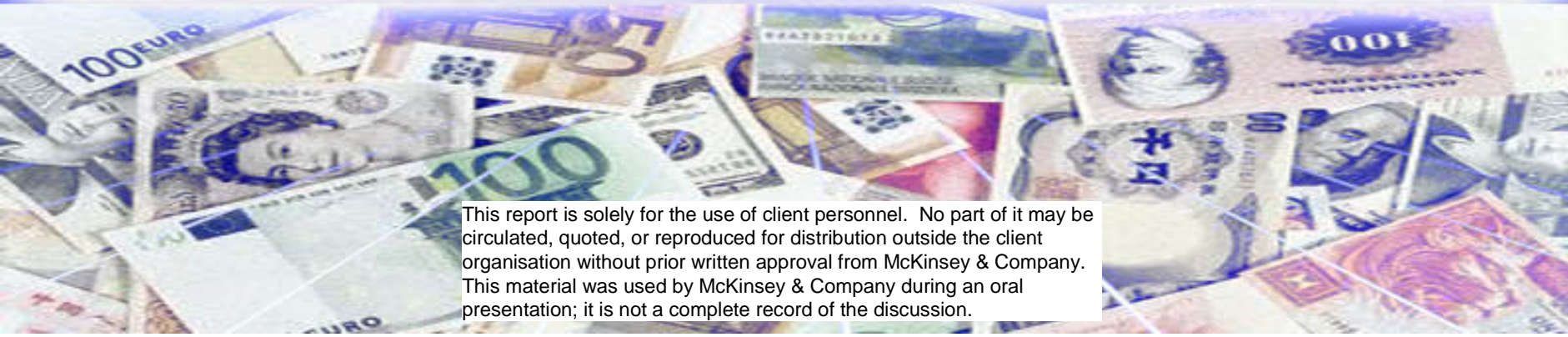
CONFIDENTIAL

Global Banking: Paradigm Shift

FICCI IBA conference

Mumbai - October, 2005

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McKinsey & Company**



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AGENDA

- **Trends in North American and European Banking**

- Trends in Asian Banking

- Indian Banking 2010?

THE PAST 20 YEARS

Common “myths”

“The essential
is invisible to
the eyes”



*Antoine
De Saint Exupery*

- Banking is a maturing industry
- US banks are growing faster than European ones
- Profitability is under pressure as a result of margin squeeze more than offsetting productivity growth (negative operating leverage)
- Banking is a local game, concentration is limited

WHAT ARE THE REALITIES OF THE PAST 20 YEARS

Myths

- Banking is a maturing industry
- US banks are growing faster
- Profitability under pressure as a result of low productivity and high margin pressure
- Banking is a local game, concentration is limited

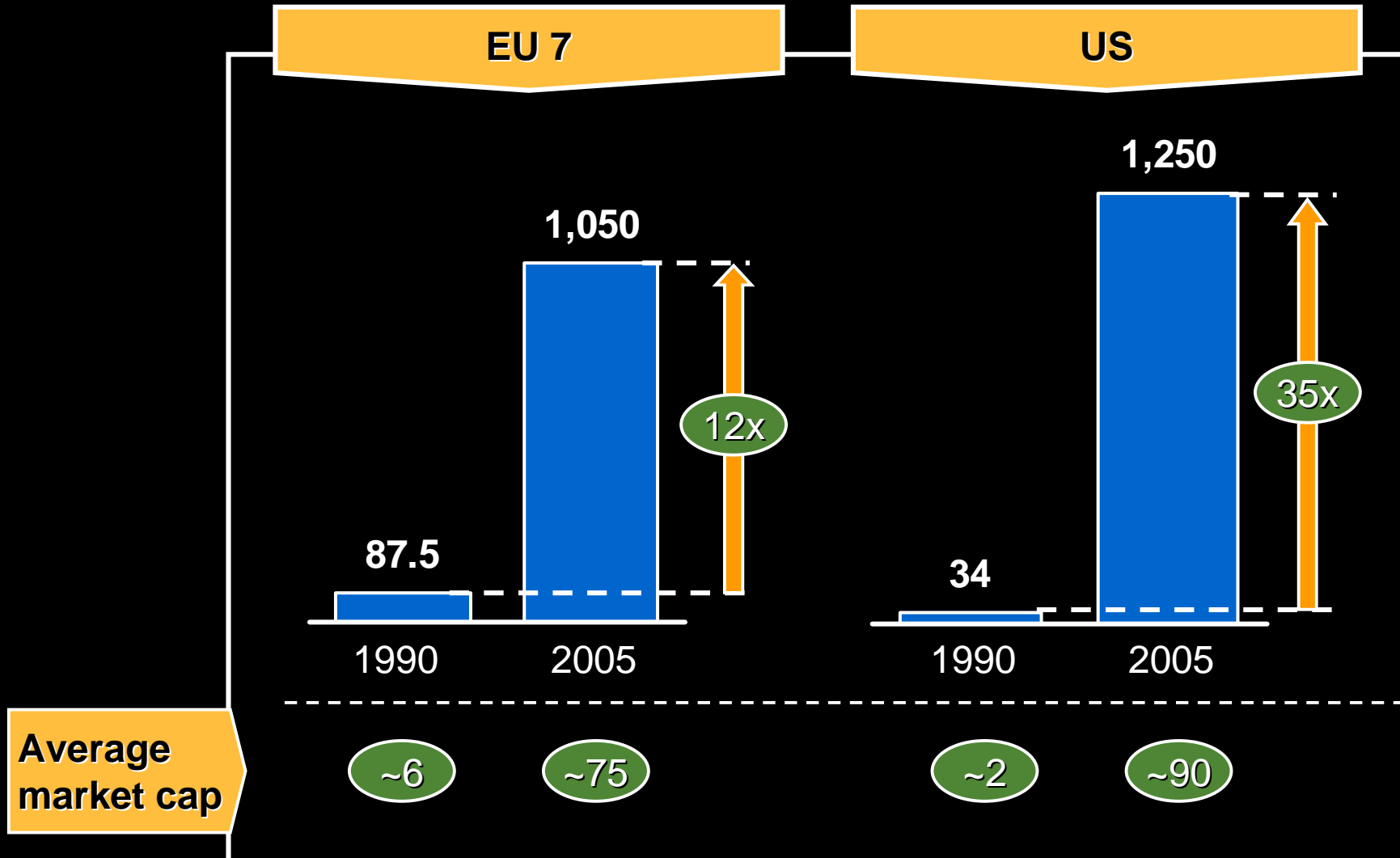
Realities

- Banking was not a maturing industry as revenues were growing much faster than GDP. This has been true in Europe in the U.S., despite increasing disintermediation of banks, and to a more limited extent in Asia
- US and European banks grew revenues at exactly the same pace over a 20 years period
- Cost to income improved by 3 per cent both in US and Europe, but increased equity usage pushed Europe ROE down
- Top 25 European bank have almost half of their assets abroad
- Concentration of top 30 players in US and Europe on a global scale increased 4 fold to almost 30 per cent
- Market cap grew 10 fold in Europe and 25 fold in US

MEGABANKS HAVE EMERGED – PARTICULARLY IN THE U.S.

Top 15 banks, combined market cap

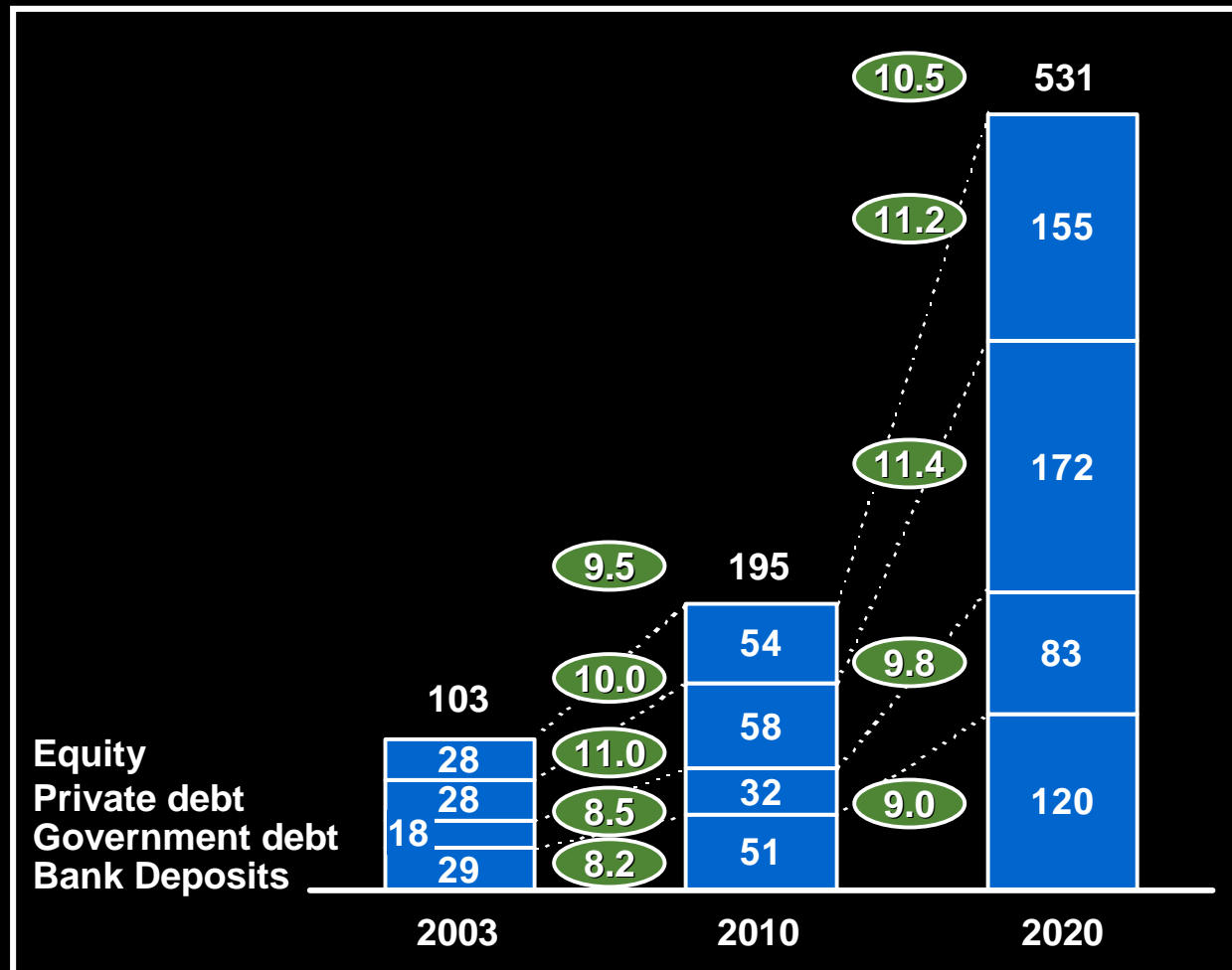
US\$ billions



CURRENT GLOBAL FINANCIAL ASSETS ARE EXPECTED TO DOUBLE BY 2010 AND NEAR TRIPLE AGAIN BY 2020 ESTIMATES

US\$ trillions

○ CAGR vs. previous period (Per cent)



Growth components of financial deepening*

- For equities
 - Privatisations
 - New stock issues
 - Earnings growth
 - P/E growth
- For debt
 - Increased government debt
 - Increased private debt
 - Securitisation
- Bank deposits
 - Increase in savings by business or households
 - Intermediation growth

AGEING WILL CAUSE ASSET ACCUMULATION TO SLOW DOWN

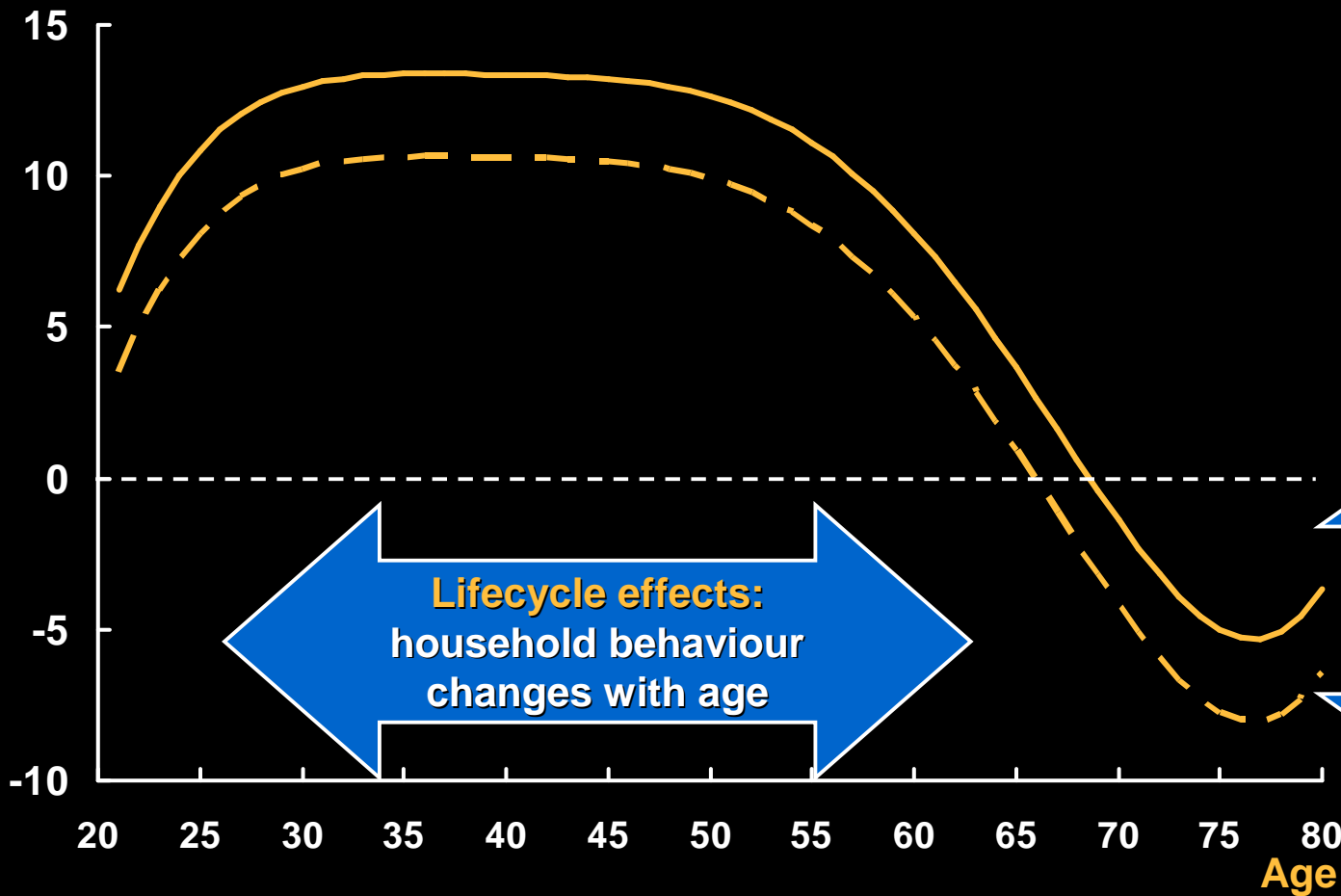
Example of U.S. life cycle savings curve

ILLUSTRATIVE

- Depression cohort: 1915-24
- - - Baby boom cohort: 1945-54

Annual savings per household

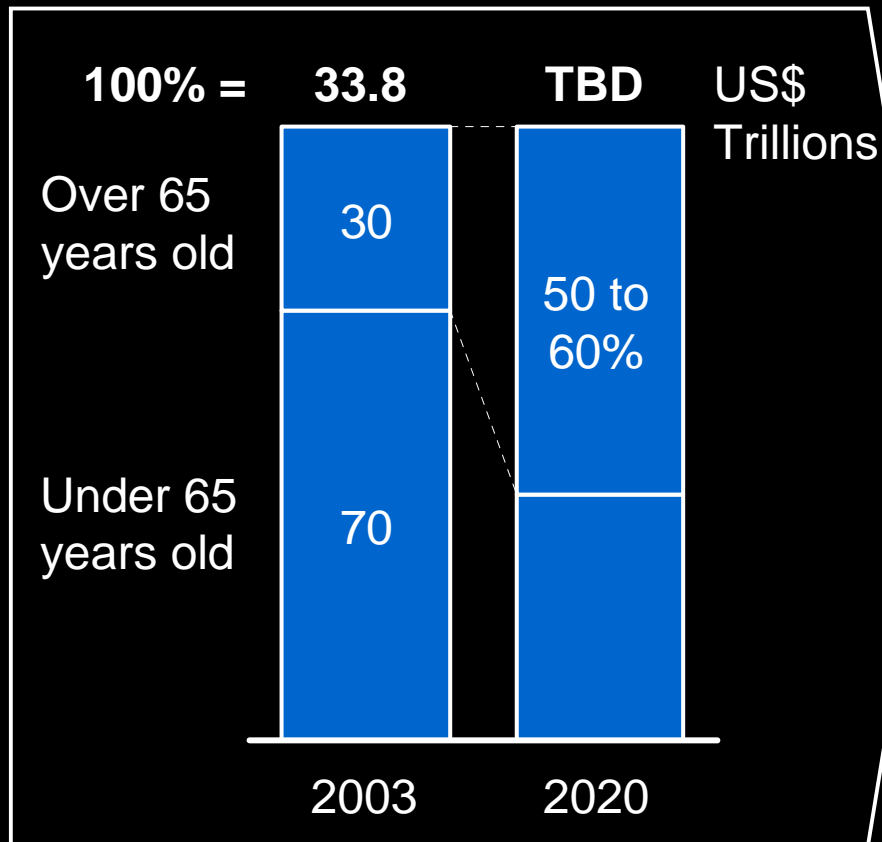
\$ Thousands, 2000



OLDER PEOPLE WILL END UP OWNING MORE OF THE FINANCIAL ASSETS

ROUGH ESTIMATES

Per cent



Future world?

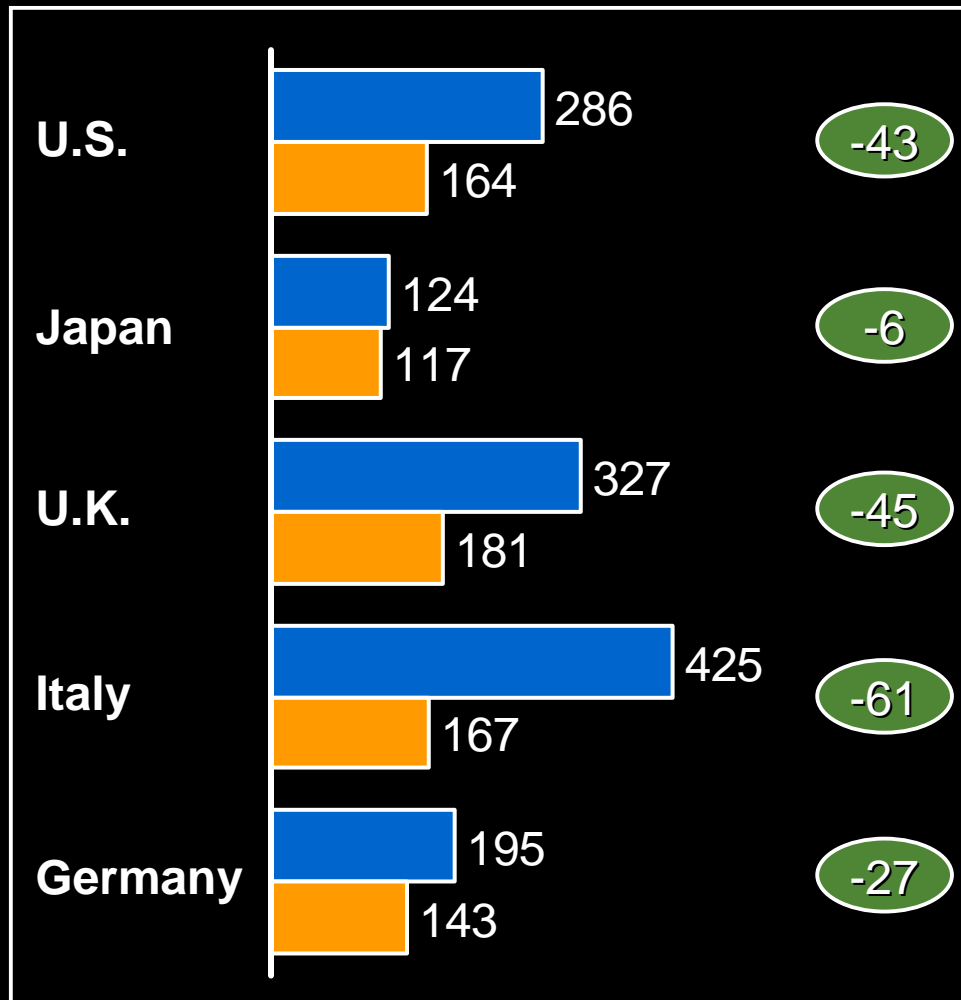
- Assets owned by older people, with different needs
- Reduced net flow of saving could reduce performance and put fees under pressure
- Traditional “buy and hold” investment strategies not performing so well

Needs for new “transformation products” give an upper hand to “insurer” and “structure”?

RISK OF DECLINE OF CONSUMER LENDING

2024 (Index: 2003 =100)

- Extrapolation of historic growth
- 2003-2024 projection based on demographic trends
- Projected shortfall (Per cent)



- Growth in consumer credit in key European countries with strong current consumer credit businesses could be 30-50% points less than historic trend*
- Growth in consumer credit in emerging countries expected, coming more from increase in income (GDP/capita) than from demographic evolution

TECHNOLOGY: HOW WILL IT IMPACT?

What we can expect

- High internet penetration
 - RFID technology for micro payments
-
- Higher processing capacity/ lower Telco costs
-
- Digital signature widespread
 - Ever increasing information availability causes transparency

Impact

- Cashless society/ reduction of physical transaction
-
- Full maturity of “white collar” offshoring industry in India
-
- Customers may unbundle banking relationships

Potential outcome

- Branches as pure point of sale
-
- Back-offices fully outsourced/ offshored
-
- Margin pressure/ loss of (relative) weight of distribution

REGULATION IS GETTING SUPRANATIONAL

“ ... for the banking sector the bulk of **regulatory changes** in the foreseeable future will continue to be **driven mainly by EU legislation**, and in particular by the implementation of the Financial Services Action Plan ...”

“ ... the FSAP provides the legislative framework to **achieve the objective of developing a single market in financial services**, one of the key elements of EU Member States commitment to economic reforms in Europe”

Kary Hale – FSA

HOW COULD BANKS LOOK LIKE IN 2020?



1. **Much bigger** – As combined market cap of top 30 institutions may grow from 2 trillion up to 15 trillion creating at least five 1 trillion banks



2. **More international** – As cross border consolidation will make them country less organisation much like industrial corporation



3. **More complex** – As they will employ directly or indirectly various hundreds thousands people, operating multi country with global platforms

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TODAY, THE LARGEST ASIAN PLAYERS (EX-JAPAN) HAVE US\$10 BILLION OR MORE IN MARKET CAPITALISATION

US\$ billion

ILLUSTRATIVE

Market capitalisation, July 2005

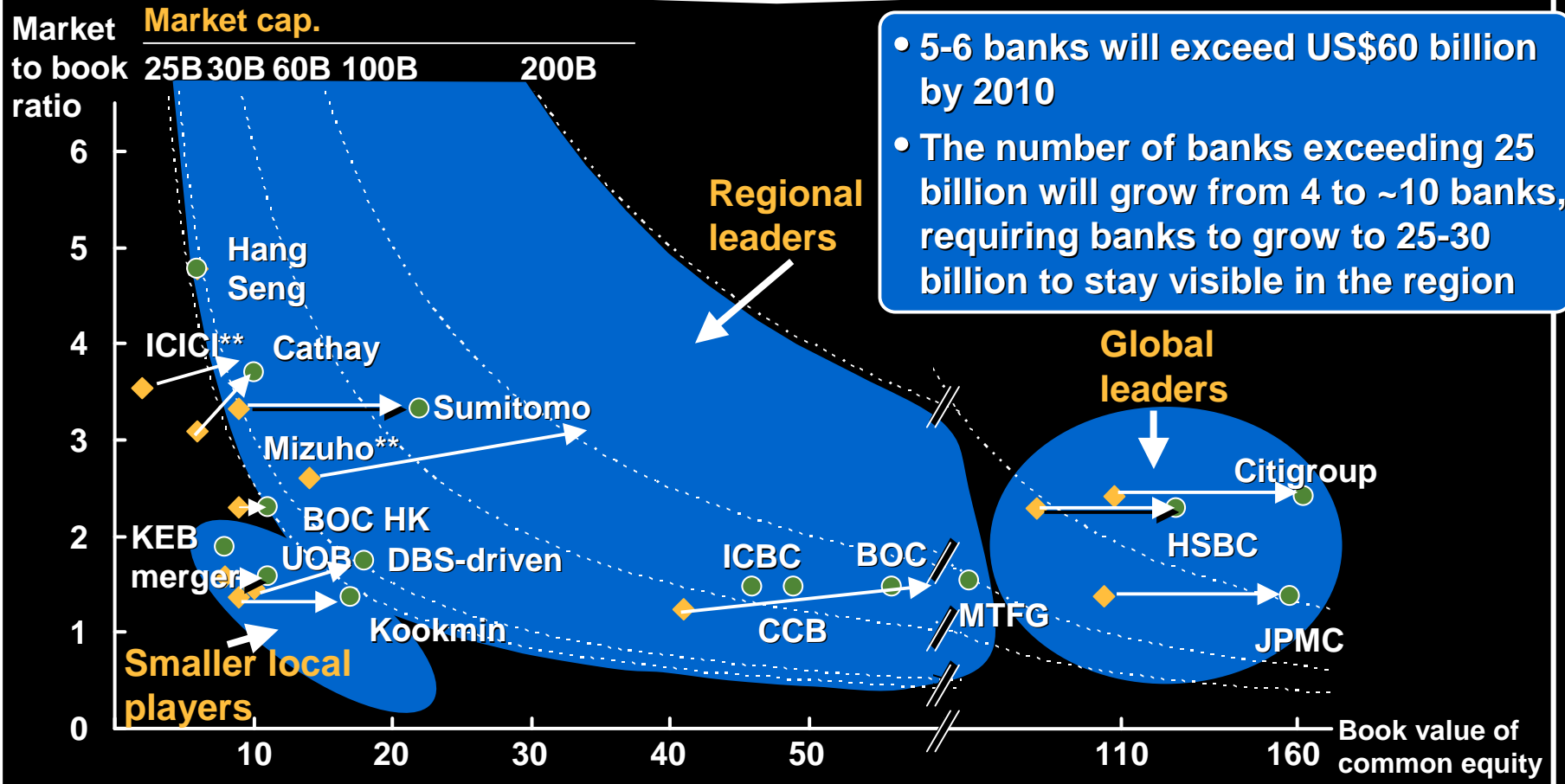


BY 2010, A FEW ASIAN BANKS WILL EXCEED US\$ 60 BILLION IN MARKET CAPITALISATION

◆ 2004 ● 2010

US\$ billion

Hypothetical strategic control map, 2010*



THE KEY EXPECTED CHANGES IN THE ASIAN FINANCIAL MARKETS CAN BE SUMMARISED INTO SIX Trends

Key drivers of change

1 Domestic consolidation

- Need for scale will drive further consolidation in local markets
- In more mature markets, expansion into non-bank sectors as well

2 Regionalisation

- As local markets mature, banks seek growth opportunities through regional expansion
- Europe has experienced this trend in sub-regions, which is now expanding even further
- Some Asian players have already highlighted this trend

3 Global banks playing to win

- Asia is amongst the top three management agenda items for many leading US and European banks and financial institutions
- Some players (Citibank, HSBC) have already built multi-billion dollar businesses in Asia
- Strong sector experience will intensify competition in local markets

4 Wholesale banking as a major source of profit

- Current market is highly fragmented and volatile, but will trend upward over the longer term
- Key drivers of growth will be deepening of capital markets, increasing cross-border capital and trade flows, and increasing sophistication of Asian corporates (driving need for more complex products and services)

5 Rise of consumer finance and retirement services

- Rapid growth of bankable population, driven by India and China
- Younger generation will lead growth of consumer finance, especially in less developed markets
- In more mature markets, like Japan and Korea, retirement products and services will be the next growth area

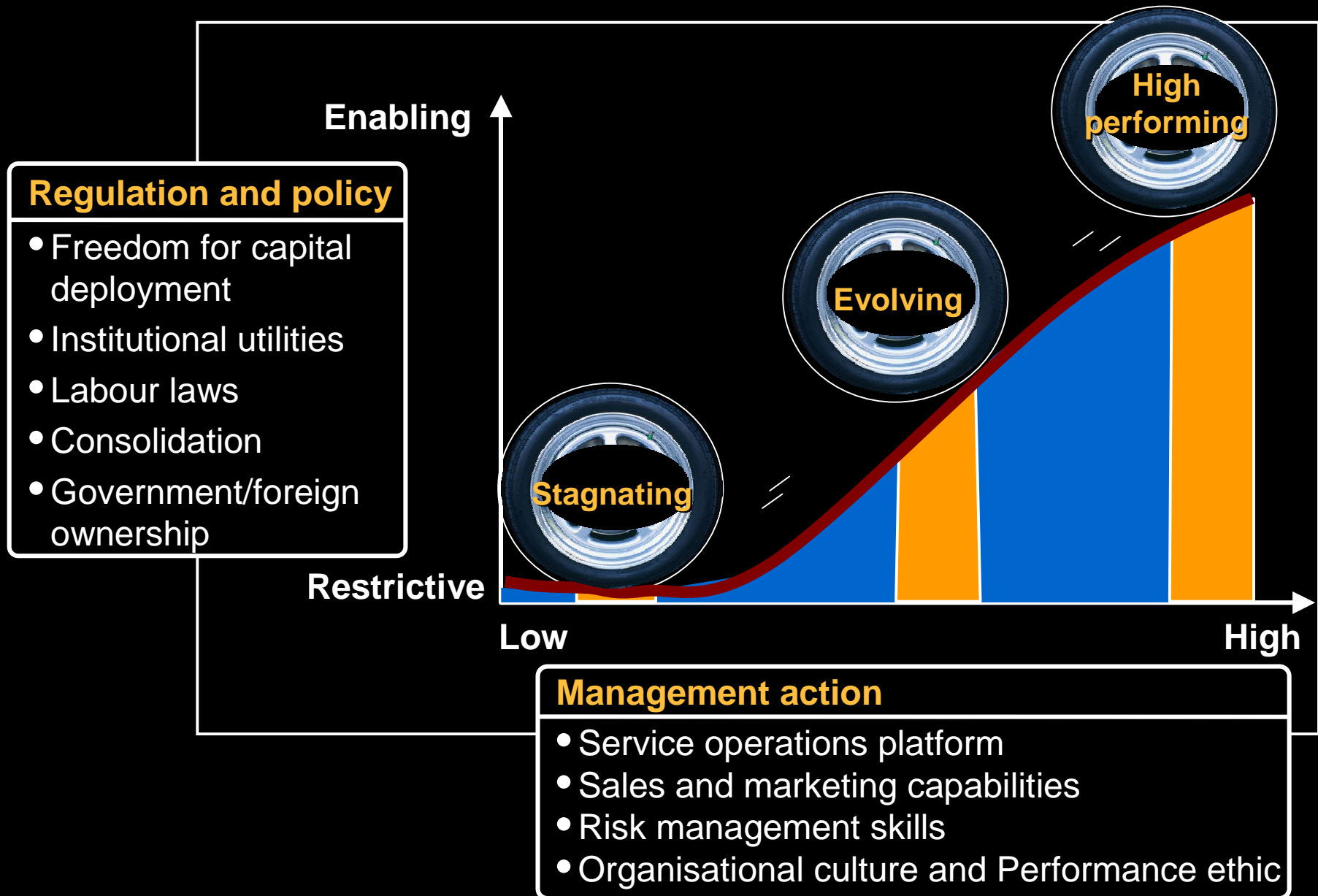
6 Board governance reform

- Driven by institutional investors, many banks have undertaken significant initiatives to revamp board composition and more clearly define roles and responsibilities

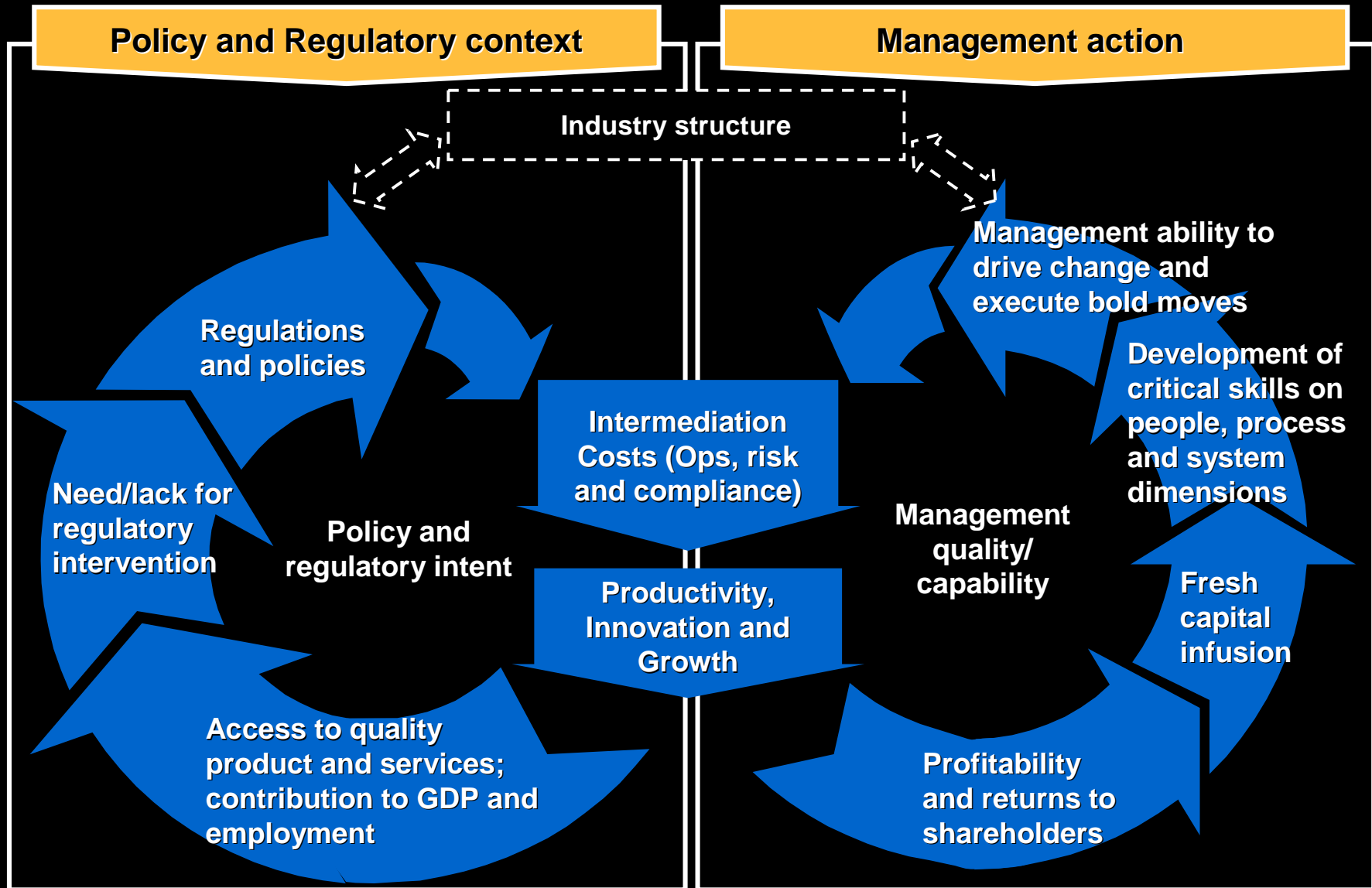
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THREE POTENTIAL SCENARIOS FOR INDIAN BANKING IN 2010



2 CYCLES LINK INPUT VARIABLES WITH OUTPUT METRICS



INTERPLAY OF POLICY MAKERS AND MANAGERMENTS WILL DRIVE OUTCOMES IN THE SCENARIOS

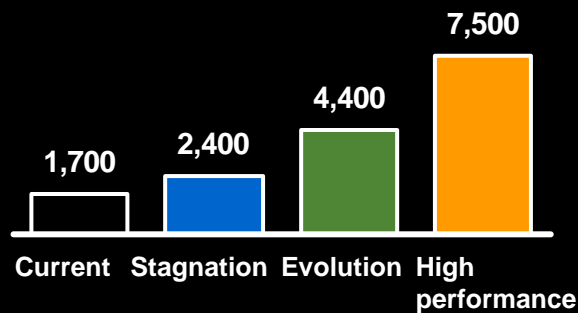
Outcome	High performance	Evolution	Stagnation
Growth	<ul style="list-style-type: none"> • New private and foreign banks grow at over 50 per cent • PSBs grow at over 15 per cent 	<ul style="list-style-type: none"> • Private sector and foreign banks grow at over 30 per cent • PSBs grow at 13 per cent 	<ul style="list-style-type: none"> • Private sector banks grow at 25 per cent • Growth of PSBs and old private sector banks declines to less than 10 per cent
Consolidation	<ul style="list-style-type: none"> • Large-scale mergers within PSBs and within some private sector banks • Some mergers between PSB and private sector banks • Foreign banks take over some private sector banks 	<ul style="list-style-type: none"> • M&A activity driven by new private sector banks, which take over some old private banks and also merge amongst themselves • Some PSBs begin to merge 	<ul style="list-style-type: none"> • Limited M&A in sector
Share of sector assets	<ul style="list-style-type: none"> • Share of private sector banks increases to ~35 per cent from the current 18 per cent • Share of foreign banks in is ~20 per cent 	<ul style="list-style-type: none"> • Share of private sector banks is ~30 per cent • Share of foreign banks is ~12 per cent 	<ul style="list-style-type: none"> • Share of private sector banks is ~ 25 per cent • Share of foreign banks remain at 7 per cent

BANKING SECTOR WILL LOOK DRAMATICALLY DIFFERENT UNDER EACH SCENARIO

ILLUSTRATIVE

Market capitalisation

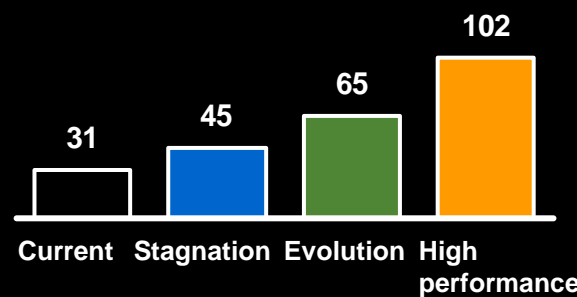
(Rs billion)



Access to quality products and service

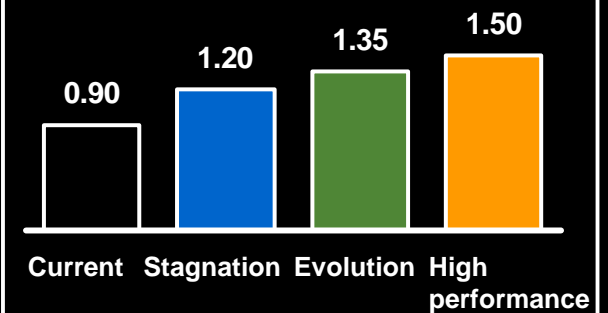
Banking intermediation level

(Loans to GDP, Per cent)



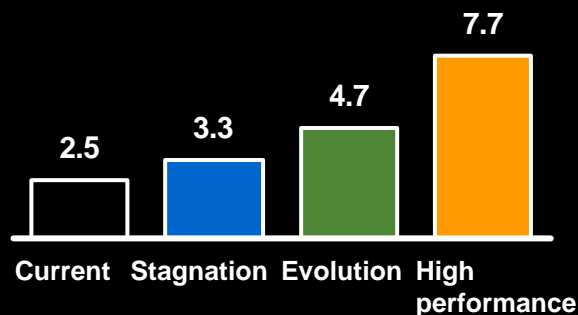
Employment

Million people



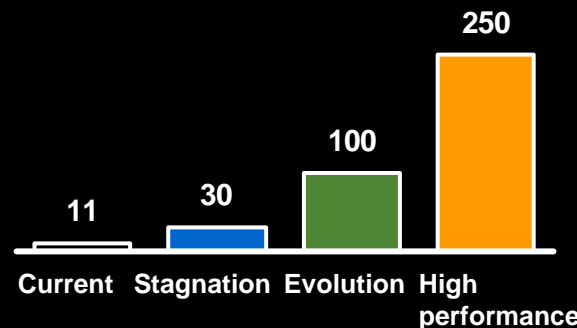
Value-add to GDP

Per cent



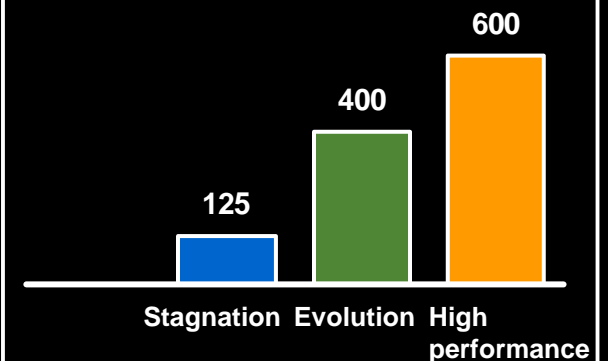
ATMs penetration

Number per '000 people



Total capital required

Rs billion



A PHASED APPROACH HAS TO BE ADOPTED FOR A TRANSFORMATION OF THE INDIAN BANKING SECTOR

