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Opportunities for global financial institutions in India

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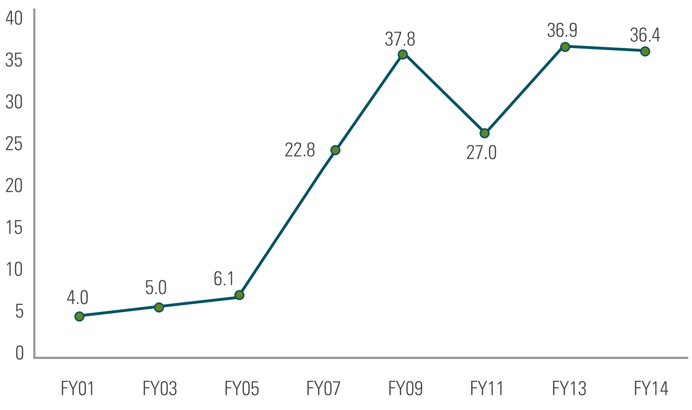
The India growth story

The Indian economy witnessed a high decadal growth of 7.6 per cent[1] during the previous decade (2001 to 2010), rising domestic and foreign investments along with a booming services sector. However, the global economic slowdown in 2008 impacted growth momentum.

Despite an initial recovery from the global recession, India faced a domestic slowdown in FY13 and FY14. The uncertain global business environment coupled with limited policy initiatives and a stressed balance sheet on account of high interest rates have impacted growth in the short-term, with growth rates falling from 9.3 per cent[2] in FY11 to 4.7 per cent in FY14. This in turn has had an impact on FDI in the short-term with the FY14 levels of USD36.4 billion[3] yet to achieve FY09 figures of USD37.8 billion.

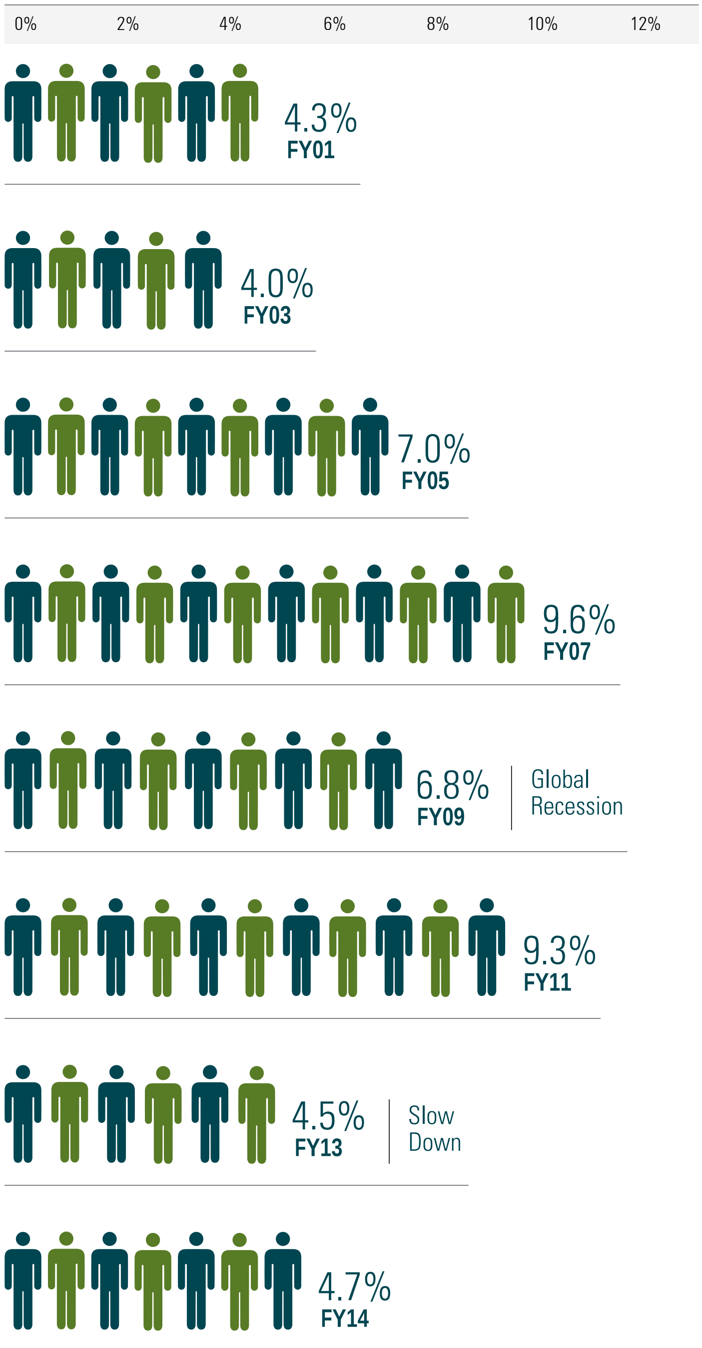
However, some of the fundamental factors driving growth in the Indian economy still stay intact such as the burgeoning consumer and urban class, growing working age population, and high domestic demand amongst others. With a stable government at the centre, there are hopes that the economy would get back on the growth trajectory. The Indian economy is expected to exhibit one of the highest growth rates amongst the larger economies, reaching a GDP of over USD7,700 billion[4] by Purchasing Power Parity (PPP) in FY18.

Figure 1: FDI



Source: Department of Industrial Policy and Promotion, http://dipp.nic.in/English/Publications/FDI_Statistics/2014/india_FDI_March2014.pdf

Figure 2: GDP growth rate (%)



Source: Central Statistical Office Economist Intelligence Unit Data

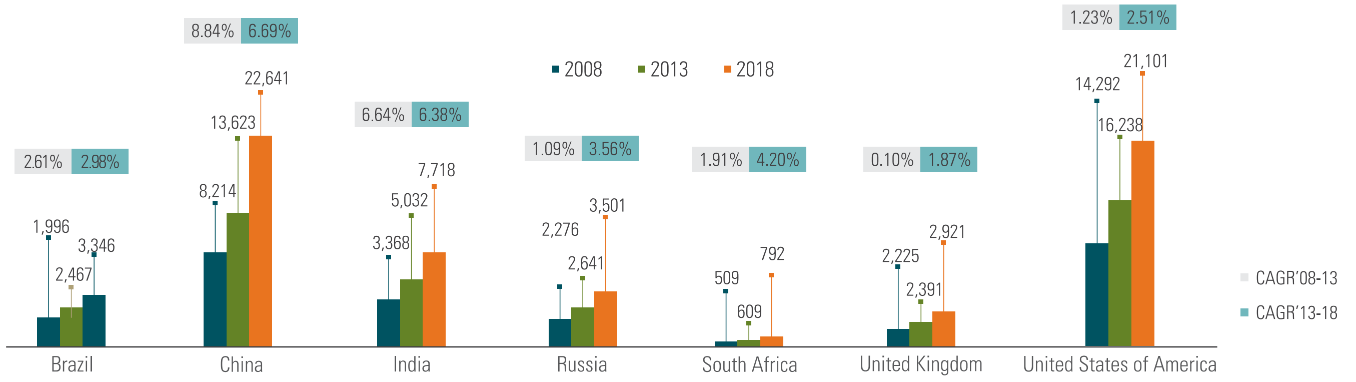
[1] Central Statistics Office http://mospi.nic.in/Mospi_New/upload/SYB2014/ch3.html (3.4)

[2] Central Statistics Office (for 9.3 per cent) http://mospi.nic.in/Mospi_New/upload/nad_pr_30may14.pdf - for 4.7 per cent (refer to page 2, point 6 or page 7 for FY 13 and FY 14)

[3] Department of Industrial Policy and Promotion

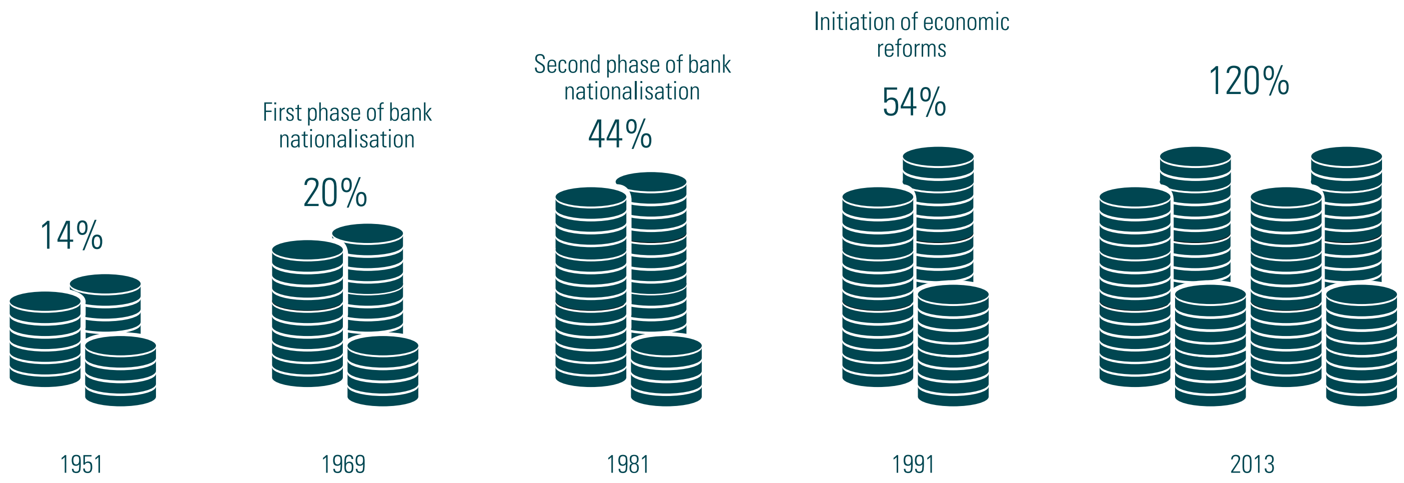
[4] Central Statistics Office., Economist Intelligence Unit Data. 1USD = 54.3 INR
Not a single report or Publication

Figure 3: GDP at PPP

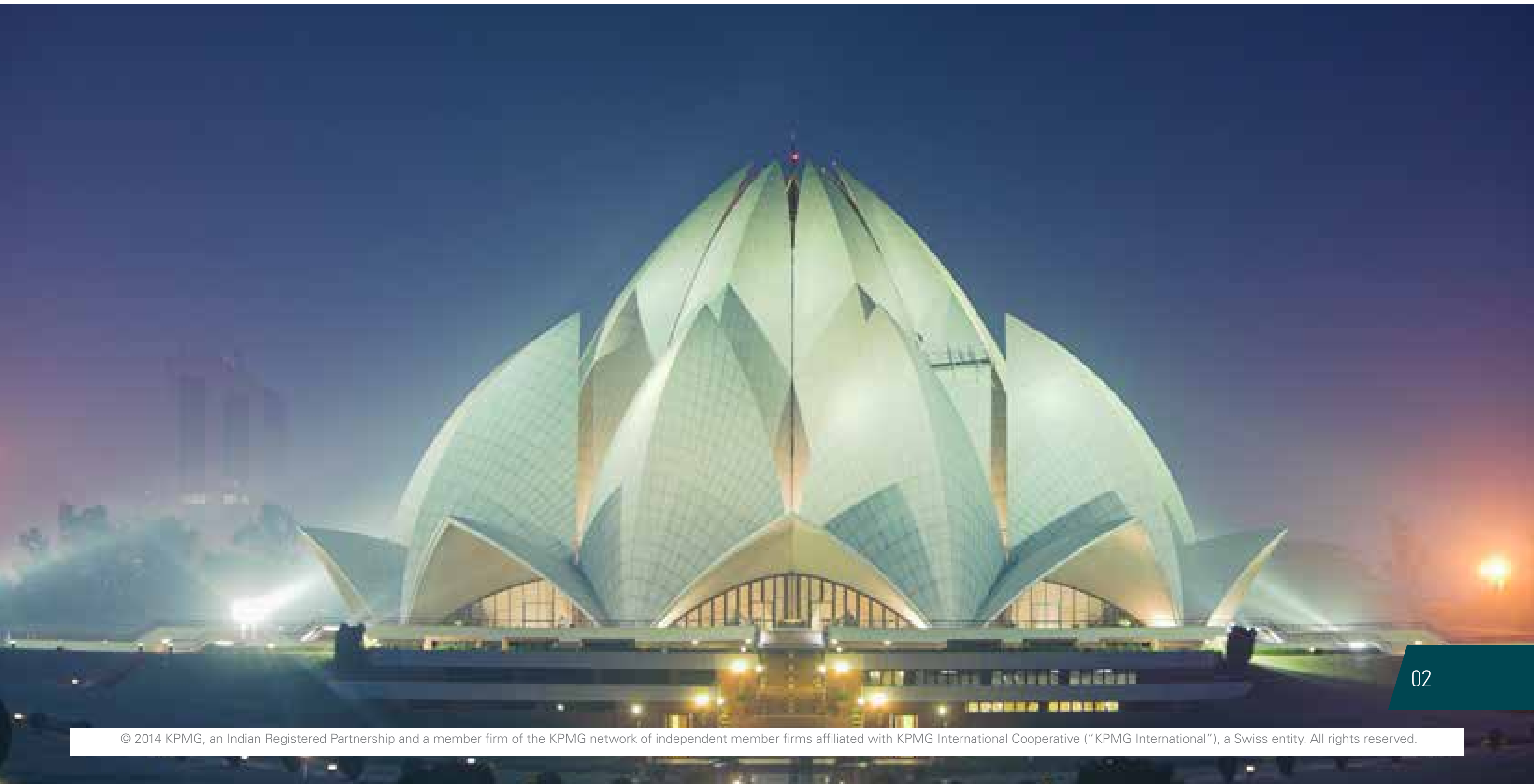


Source: Central Statistics Office (not statistical)

Figure 4: Banking Business: GDP ratio



Source: Reserve Bank of India



Financial services sector in India

The financial services sector in India has also grown significantly in tandem with the overall growth in the economy. The sector has also seen increasing maturity across segments, with evolving regulatory frameworks and the entry of several new players. A brief snapshot of the growth in two key segments: banking and insurance is captured below.

Banking in India

The banking sector was estimated at USD1.8 trillion in terms of banking assets in FY13[5] and has evolved significantly over the years, acting as an engine to India's growth story. The banking business (Credit plus Deposits) to GDP ratio has more than doubled to 120 per cent in 2013 from 54 per cent in 1991 when India's major economic reforms were initiated.

There are 89 scheduled commercial banks in India, including 43 foreign banks.[6] Many of these foreign banks are niche players in the market who focus on the investment and trade flows through the bilateral corridors, while a select few like HSBC, Standard Chartered etc. have established a large presence that focusses on the domestic market as well.

Key focus areas for the players in the banking sector include:

- Managing impact on asset quality given the economic slowdown
- Identifying niches for driving future growth with increasing competition in existing segments
- Building a commercially sustainable model for financial inclusion
- Implementing Basel III framework and mobilisation additional capital.

[5] IBEF - http://www.ibef.org/industry/banking-india.aspx

[6] http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP21112013_F.pdf (Pages 168-170)

Insurance in India

India is among the top insurance markets in the world; it is ranked tenth among 147 countries in the life insurance business, with a share of 2.03 per cent during FY13, and nineteenth in the non-life insurance business, with a share of 0.66 per cent.

The industry consists of

53 players

24 life insurance players (1 public and 23 private)

Source: IRDA https://www.irda.gov.in/ADMINCMS/cms/NormalData_Layout.aspx?page=PageNo129&mid=3.1.9

28 non-life insurance players (6 public, 22 private), including standalone health insurance players

Source: IRDA https://www.irda.gov.in/ADMINCMS/cms/NormalData_Layout.aspx?page=PageNo264&mid=3.2.10

01 public re-insurance player

Source: IRDA https://www.irda.gov.in/ADMINCMS/cms/NormalData_Layout.aspx?page=PageNo1687&mid=3.3.6

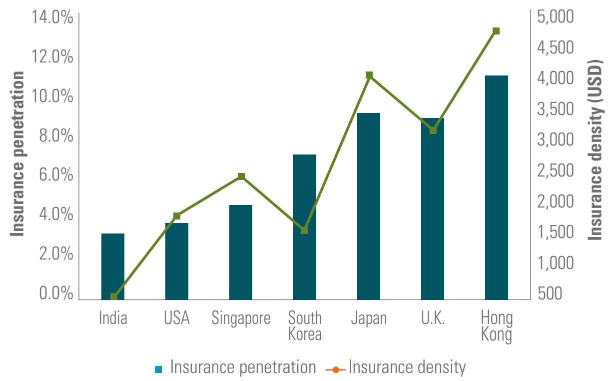
Life insurance

After a healthy pace of growth between 2000 and 2010, the Indian Life insurance industry has seen significant slowdown leading to a de-growth in the retail (Annualised Premium Equivalent) APE over the last four years. A key reason for the de-growth was changes in the regulatory framework which impacted the product structures and distribution channel viability for the companies. Existing players are focussing on enhancing distribution channel effectiveness, improving retention and operational efficiency. The segment has also seen an investor churn with several shareholders exiting in the last few years given the long gestation period and high capital requirement. An impending policy change on increasing the FDI limit to 49 per cent from the current 26 per cent has been expected for a few years now.

Despite the falling new business sales, the overall insurance cover has still risen over the years. The total in-force retail policies have increased from 258 million in FY08 to 337 million in FY13 [7]. The focus of the companies seems to be on increasing persistency and this trend is likely to continue.

Going forward, the industry is expected to grow at ~5 per cent[8] in the near term. However, given the low current density and penetration of life insurance in India, USD43 and 3.2[9] per cent respectively, there is significant headroom for growth both in terms of penetration and density.

Figure 5: Life Insurance penetration and density (FY2013)



Source: RBI, Swiss RE 'World Insurance in 2013', 2013

[7] IRDA Annual Report and KPMG in India Analysis (2013)

[8] KPMG in India Analysis (2013)

[9] RBI, Swiss RE 'World Insurance in 2013', 2013

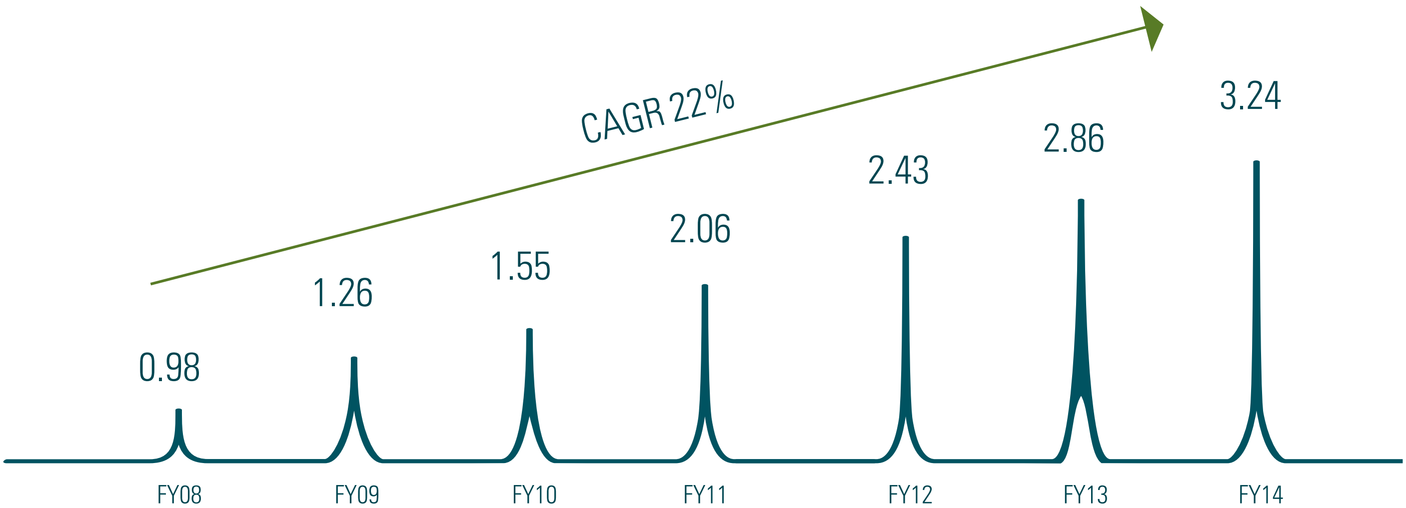
Health insurance

The Indian health insurance industry has grown rapidly since the deregulation in 2000 and the establishment of the insurance regulator IRDA. The market is estimated at USD3.2 billion in FY14, and grew at a CAGR of 22 per cent from FY06 to FY14.[10] The industry is expected to reach over USD8 billion in FY20 and close to USD20 billion in FY25.[11] The industry has 27 players (including both non-life and standalone health insurance players) with the four public sector insurers enjoying a market share of 58 per cent.

The current density and penetration of non-life insurance (including health insurance) in India is amongst the lowest in the world. In FY13 non-life density was USD11, ranked eighty-fifth in the world, while penetration (premium as a per cent of GDP) was a mere 0.8 per cent.[12]

[10] Insurance Regulatory Development Authority. 1USD = 60 INR
[11] KPMG in India Analysis (2014)
[12] Swiss RE 'World Insurance in 2013', 2013

Figure 6: Health insurance premium market (USD billion)



Source: Insurance Regulatory Development Authority.
1USD = 60 INR

India-U.K. collaboration in financial services

India and the U.K. share a strong relationship in the financial services sector. As of 31 January 2014, there were five Indian banks with 30 branches in the U.K., while there were four British banks with 168 branches in India.[13]

In the Insurance sector, there are five British life insurers, one health insurer and two U.K. general insurers operating through joint ventures with Indian partners. Many of these companies have been successfully running their operations for about a decade and have witnessed significant growth in their Indian operations. Private insurance companies, on account of their small size and significant demand in domestic markets, have been largely confined to India only.[14]

Opportunities for U.K. based banks in India

The total bilateral trade of goods and services between the U.K. and India stood at USD15.8 billion in 2013-14 an increase of 6.16 per cent, as compared to the previous year. Trade between the two countries has been resilient, despite a global economic downturn. India was the U.K.'s elevnth largest trade destination by value in 2012, while the U.K. ranks seventeenth in the list of India's top 25 trading partners, with its share in India's global trade improving from 1.88 per cent in 2012-13 to 2.07 per cent in 2013-14.[15]

With a large and growing business relationship between U.K. and India, which has been furthered strengthened by growing bilateral ties between the two countries, a point of presence in India has become a key imperative for leading financial institutions.

This presents a significant opportunity for U.K. banks to can leverage their strong relationships with multinational companies and large corporates and their strong infrastructure and global banking relationships to provide cross border trade and corporate banking services. In addition, U.K. is home to the second largest proportion of NRI millionaires[16] and a banking presence in India can be used to build a wealth management offering.

Many foreign banks have traditionally established a presence in India as a branch of the global parent bank. The RBI has also come out with guidelines on setting up of Wholly Owned Subisdiaries in India, and new entrants need to examine the applicability and impact of the same.

Opportunities for U.K. based insurance players in India

A major reform initiative by the new Indian government is to increase the FDI limit in the Indian insurance sector from 26 per cent to 49 per cent.[17] This is expected to be a welcome move for many companies wishing to enter the market or expand the ownership of their current operation. The legislation, once approved, is expected to trigger an inflow of capital as insurers can take up the option to increase their stake to 49 per cent. It is believed that life insurers will benefit the most from the increase in the FDI limit as many of the new life insurance companies have not raised fresh capital in the last few years.[18]

With one of the lowest FDI limits globally for insurance, we feel that the increased FDI cap is necessary for the cash starved insurance sector. It is estimated that around USD3-4 billion can flow into the sector following an increase in the FDI limit. 70-75 per cent of this is expected in the life insurance sector.[19]

In addition to this, with the increase of the FDI cap there is a possibility of certain insurance companies looking to IPO. Given the recent poor performance, many insurers maybe reluctant to consider an IPO at this stage. However, with the help of foreign players, profitability can improve as the foreign partner can help:

- Deliver product innovation
- Leverage technology (particularly in relation to distribution)
- Implement client servicing tools
- Protect consumers against insolvency.

There is also the potential for consolidation, with a number of smaller players exiting. The proposed increase in the FDI limit is also expected to have a follow on impact on other sectors, including the pension industry, where an upturn of activity is expected.

[13] Reserve Bank of India

[14] IRDA, KPMG in India Analysis (2014)

[15] High Commission of India, London, https://www.hcilondon.in/economic_brief.html

[16] India Investment Journal by India Incorporated http://www.indiaincorporated.com/publications/print-edition/itemlist/category/87-india-investment-journal-v2-i-1.html

[17] http://timesofindia.indiatimes.com/business/india-business/Cabinet-clears-49-FDI-in-insurance-through-FIPB-route/articleshow/38969455.cms

[18] Industry Discussions

[19] http://www.deccanchronicle.com/140727/commentary-dc-comment/article/best-practices-cash-flow-ensured

Opportunities in financial services outsourcing including offshoring

Overview of the India IT-BPM industry

India continues to maintain a leadership position in the global sourcing arena, and reinforce its position as the only country in the world where you can do everything.[20] The Indian technology sector is on track to achieve a revenue of USD118 billion in 2014, up from a mere USD8 billion at the turn of the century. The domestic market touched USD32 billion in 2014. Exports are expected to cross USD86 billion in 2014, growing at 13 per cent YoY. India also continues to be the preferred choice from a Shared Services and BPO destination standpoint for global operations.[20] Several leading banks and financial services organisations have large scale shared services organisations that perform multi-geography/ multi-function processing. These centres have over time evolved from being traditional 'back office' functions to full fledged global business services hubs that provide a gamut of judgment intensive/analytics heavy services. Among the key enablers that have made the India story an enduring one is the availability of talent and sustained cost arbitrage.

India has emerged as a hub of the global technology industry, contributing to 50 per cent of the total headcount of global MNCs as well as 80 per cent of the headcount of Indian IT-BPO firms. India also continues to lead in cost competitiveness in the technology sector. Flat entry-level salaries, Tier II and III service delivery and alternate talent pool hiring are some of the factors helping India stay seven to eight times cheaper than developed countries, and at least 30 per cent cheaper than the next nearest low-cost destination. The sector is is expected to achieve its 2020 target of USD175 billion in export revenues, and USD50 billion in domestic revenues. Large Indian IT-BPM service providers continue to do well (revenue of top the five players crossed USD40 billion in FY14), and are looking at acquisitions abroad to expand beyond their traditional markets.[20]

Overview of financial services outsourcing/ shared services in India

BFSI as a sector spends the maximum on technology, after the Defence sector and the government. However, the sector leads in outsourcing services (IT-BPM) across borders to low cost destinations like India, China, Eastern Europe, Mexico and South America. Many large investment banks have a YoY technology spend to the extent of USD1 billion which is more than the GDP of about 90 per cent of the countries in the world. A lot of the outsourcing originates from the US and Europe (including U.K.), and many of the top 1000 Fortune BFSI institutions are outsourcing to India and several of them have captives setup in India providing both IT and BPM services. The growth in outsourcing through BFSI has been steady within a range of 3 to 5 per cent CAGR over the last 10 years and is expected to continue to grow similarly in the next five years, with significant changes to their operating model (covered in trends below).[20]

Key trends in financial services outsourcing

- Vertical maturity: BFSI continues to be the largest vertical segment[20]; however, healthcare, utilities and retail sector is expected to drive demand and growth in the next few years.
- Operating model: Many mature captives (operating since the last 5 years with a workforce of 1000 employees) are looking at hybrid operating models by outsourcing transactional BPM services such as accounts payable and receivables and Application Development and Maintenance (ADM) IT to third party vendors with experience and abundant skilled workforce which can enable them to reduce their operating costs. Third party provider operating models are more global in nature with the follow-the-sun approach now being supported by centres in similar time zones thereby supporting more critical services in real time.
- Ownership: More and more captives are developing and nurturing leadership roles which are able to hone business unit heads for regional operations. This enables the captive in showcasing its capabilities, thereby bringing on more work to the centre as well as enabling the region to appreciate the work being received from the captive, and furthering robust change management as and when it happens.

[20] Nasscom Strategic review 2014, Published by - NASSCOM in February 2014

- Organisation structure: Extended teams seem to be a thing of the past. Many captives and service providers have advanced-decision making capabilities allowing them to staff the right number of skilled resources, thereby benefitting the client and reducing costs.
- Capabilities: ADM, and transactional BPM and call centre are now a given for the capabilities of captives and 3rd party service providers. Since the last seven years, higher end work like testing, infrastructure management, data centre monitoring on the IT side and analytics (predictive and inductive), management reporting, budgeting and planning, middle management investment banking on the BPM side are on the rise. Due to the economic downturn of 2008 a lot of emphasis was put on quality and cost reduction, probably due to which internal capability teams (internal consulting) were been cropping up.[21] This is fairly nascent as the skills required for this are niche, however it is expected to become a main stage capability in the mature captives soon and many service providers now already provide this as a free add-on in large IT-BPM bundled deals.

The India value proposition

The outsourcing industry in India has been around for more than two decades and has witnessed two major economic downturns, but seems to have enabled the Indian outsourcing providers/captives of large global MNCs to be a partner to the parent organisation, with expertise in designing leading practises across services helping clients effect significant topline growth, business and operational improvements. India's dominance in the global sourcing arena shows that we can execute services from here, from call centre and ADM to analytics and IT architecture design. One of the main reasons for this dominance is a continually changing and improving industry enhancing and expanding its service offerings, adding capabilities, evolving business models, enforcing a tight control over operations and focussing on high standards of customer satisfaction that tend to result in high return on investments.

Cost leadership: IT-BPM services are ~8-10x cheaper than source countries and 30 – 50 per cent better than other low cost outsourcing destinations. The cost advantage is achieved through controlling wage inflation, sourcing talent from Tier II and Tier III cities, flattening the organisation pyramid, evolving pricing models and setting up base in Indian Tier II/Tier III cities.

Industry employment: The outsourcing industry in 2014 has provided for over 16 million people (more than 3.1 million through direct employment and over 13 million through indirect employment) grow ing at a CAGR of approx imately seven per cent per annum over the last five years. In the largest global employable talent pool there are over 5.5 million graduates.[21]

Global presence: Indian IT-BPM firms have presence in 78 countries across the world, providing a vast array of operating models and delivery centres. Even in India there are 50 delivery locations across Tier I/II/III cities. [21]

Service provider landscape: There are approximately 16,000 companies in India providing outsourcing services. These firms cover third party providers, start-ups, global in-house centres (captives), etc. [21]

Full gamut of services: Services range from call centre to basic transaction processing and analytics on the BPM side, and from traditional ADM to virtualisation and cloud computing and product development. Interestingly the Engineering, Research and Development side also is involved in creating a large number of patents from the centres in India. [21]

Vertical portfolio: More than 25 industry verticals are serviced, however BFSI is by far the largest serviced vertical with approximately 40 per cent of the exports. [21]

India therefore continues to be one of the preferred choice from a Shared Services and BPO destination standpoint for global organisations. Whilst locations such in eastern Europe, latin America and South East Asia have emerged as outsourcing/ shared services destinations of scale, for the sheer breadth and depth of services, the India story continues to be an enduring one.

[21] Nasscom Strategic review 2014, Published by - NASSCOM in February 2014

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