



FINANCIAL SERVICES PRACTICE

New directions for Asia's wholesale banks: A discussion with two investment bankers

Uday Kotak of Kotak Mahindra Group and Dato' Sri Nazir Razak of CIMB Group offer their perspectives on the changing landscape in Asia.

Recently, McKinsey sat down with two Asian banking leaders: Uday Kotak, executive vice chairman and managing director of Kotak Mahindra Group, and Dato' Sri Nazir Razak, CEO of CIMB Group. These are two of the leading institutions in corporate and investment banking in Southeast Asia and India. Joydeep Sengupta, a director in McKinsey's Singapore office, led the discussion.

The Quarterly: *I would like to start by asking about your views on the discontinuities in Asian corporate and investment banking and the opportunities they present, especially as the financial crisis fades.*

Dato' Sri Nazir Razak: As far as the bigger picture is concerned, the growth story is a very good one. If you talk about capital markets, they are still nascent in many countries. Even in Malaysia, despite all of the development, I think there is still much growth potential, as many companies are still funding directly from the banking system. We also see opportunities on the buy side, for instance, where funds are still concentrated in government investment companies. In the smaller markets like Cambodia and Vietnam, capital markets will grow exponentially when they do take off.

There's also the Islamic segment, which is still growing very quickly, even in Malaysia, the most

Uday Kotak



Vital statistics

Born March 15, 1959, in Mumbai, India

Married, with 2 children

Education

Graduated with a bachelor of commerce from Sydenham College, Mumbai, and a master of management studies from Jamnalal Bajaj Institute of Management Studies, Mumbai

Career highlights

Kotak Mahindra Group, 1985–present

Executive vice chairman and managing director

Founder and promoter

Fast facts

Government roles

Member of the Technical Advisory Committee on Money, Foreign Exchange, and Government Securities Markets of Reserve Bank of India, member of the Committee on Review of Eligibility Norms of Securities and Exchange Board of India (SEBI), member of the board of governors of the Indian Institute of Corporate Affairs, member of the Primary Market Advisory Committee of SEBI, member of the Committee on Review of Ownership and Governance of Market

Infrastructure Institutions, member of the board of governors of ICRIER, former member of the Committee on Financial Sector Reforms

Honors and awards

Ernst & Young Entrepreneur of the Year, 2003

CNBC TV18 Innovator of the Year, 2006

CNBC Asia's Business Leader of the Year, 2008

advanced Islamic capital market. Finally, the macro picture relating to ASEAN (the Association of Southeast Asian Nations) integration will likely fuel more business transformations, cross-border transformations, cross-border M&As, and so on, which will bring good capital market opportunities. I am firmly of the view that to compete effectively in this space, in this region, you need to be a universal bank.

Uday Kotak: In India, the corporate and investment-banking business has been bank-centric, especially centered on the commercial banking business. Stand-alone investment banks continue to find it challenging to operate in India. I believe the right business model has to include a commercial bank and an investment

bank. While both are important, my view is that the stronger the investment bank's skills and agency capabilities, the better the model would be; weaker models are those that depend disproportionately on balance sheets.

The Quarterly: *One of the changes we're seeing is a lot of investment going into areas like infrastructure, which spurs the growth of specialized finance, commodities, and so on. Historically, these businesses have been dominated by global players. Do you see opportunities there for Asian banks?*

Uday Kotak: Actually, you would be surprised at the way infrastructure financing has evolved in India. If you look at the numbers, very

Dato' Sri Nazir Razak



Vital statistics

Born November 19, 1966,
in Kuala Lumpur, Malaysia

Married, with 2 children

Education

Graduated with a bachelor
of science from the
University of Bristol and a
master of philosophy
from the University of
Cambridge

Career highlights

CIMB Group, 2006–present

Group chief executive

CIMB Group Holdings Berhad, 2006–present

Chief executive and
managing director

CIMB Investment Bank Berhad, 1996–2006

Chief executive and
managing director

Deputy chief executive

Fast facts

Board directorships

CIMB Group Holdings
Berhad, CIMB Group Sdn
Bhd, CIMB Investment
Bank Berhad, CIMB Bank
Berhad, CIMB Islamic
Bank Berhad, CIMB
Securities International Pte
Ltd, Malaysian Electronic
Payment System Sdn Bhd,
Pride Foundation (trustee),
Rahah Foundation (trustee)

Government roles

Member, Securities
Commission Malaysia
Capital Markets
Advisory Council

Member, Employees
Provident Fund Malaysia
Investment Panel

Member, Malaysia
International Islamic
Financial Centre executive
committee

Honors and awards

Dato' Sri (Darjah
Kebesaran Sultan Ahmad
Shah Pahang Yang Amat
Di Mulia–Peringkat
Pertama, Sri Sultan Ahmad
Shah Pahang)

Ranked second in
Institutional Investor's
2008 Asia Best CEO
(Bank) Survey

Youngest recipient of
FinanceAsia's 2009 lifetime
achievement award

Named Malaysia's
best executive
by *Asiamoney*, 2009

little financing has come from Europe or the United States. There are pockets in Asia or even regions that generate a disproportionate amount of this financing—places like Malaysia, for example. Therefore my view on infrastructure in India is that we face less a challenge of financing and more a challenge of execution. If the execution is there, the financing will follow.

Having said that, I think you point to a very interesting comparison between India and China. There is one major difference in terms of the way

they finance themselves. A lot of infrastructure in India is financed by entrepreneurs, and we have seen some very significant public-private partnerships. But as private entrepreneurs come in, they in turn depend on public markets for equity financing. That presents an issue, as public-market horizons are much shorter than the time frame on which infrastructure projects operate; there is a long period before they produce returns.

China, on the other hand, has relied much more on state-sponsored funds. These investors

take a longer-term view on infrastructure, and that is why, compared with China, Indian infrastructure is lagging. Capital in India has shorter horizons. I think that is going to take some time to change, and therefore as a country India will always have demand for infrastructure ahead of supply.

Dato' Sri Nazir Razak: We at CIMB are positioning ourselves for infrastructure opportunities as well. For example, we recently won private-equity mandates from the Islamic Development Bank and the Asian Development Bank. Those mandates made a huge statement, as traditionally they would have gone to a global player. It was transformative for us, as we believe we can leverage this and truly “Asianize,” or even globalize, our fund-management unit. We are also strengthening our capabilities in specialized or structured finance and in commodities so that we can provide tailor-made solutions for our business customers. I don't think that you need much beyond regional scale to be able to do that. In fact, I would say that some of the departments in specialized finance from global banks are one-man shows anyway.

However, there continues to be an issue with brand perception. The global financial crisis helped to change some of these perceptions held by customers about what we can do. But I think the window is closing quite fast, as some global firms have regrouped and those that want in are expanding rapidly again. So now it's up to the Asian banks to ramp up quickly.

The Quarterly: *Another way that Asian banks may need to ramp up is to serve the many Asian companies in all sectors that are expanding internationally. How do you*

see your institution positioning itself to take advantage?

Dato' Sri Nazir Razak: I think the rise of regional investment banks is inevitable. Companies stick with global banks at their own risk. The big global banks are geared for a particular kind of service, which isn't adequate for many customers. In fact, on many deals, banks want to partner with us because of our strong local brand and the institutionalized ability of our local franchises to understand the markets in ASEAN. Banks that have their management team based outside the region will always be less able to connect with the local clientele.

Uday Kotak: I think there are clearly two models in use. One is a global model, which tends at times to be a generalist model. It carries the risk of being a little superficial, not going deep enough into specific countries and customer requirements. Then there's a purely local model, which suffers from an inability to do cross-border transactions.

Our view—and this is something that we are implementing—is that the best model is a third kind, a network model, which connects us with banks and customers in different markets. To use an analogy from a troubled industry, it is like an airline alliance. We believe this model is far more sustainable than a global model in which decision making happens in New York or London. The axis is shifting. Further, Asia is a very diverse region; the one-size-fits-all model is, I think, doomed to failure.

The Quarterly: *That's an interesting perspective. Let's shift gears a little bit and come back to India. In the next ten years, most*

people expect dramatic growth in China and India. In that context, how do you see competition evolving, especially from foreign banks?

Uday Kotak: I think foreign players will definitely move deeper into markets like India. The good news in India—and the bad—is that every major bank on the planet is now in India. If we were having this discussion five years ago, we would have said that global competition coming in was a worry for domestic institutional players. But now that it is here and we are living in a much more competitive space, we feel reasonably fine.

The world is changing much more dramatically than people's mind-sets are. If I look back 20 or so years ago, when I started my career, I see an outstanding example of this. At that time, the biggest worry was the export of Indian capital markets to global destinations like London or New York—that is, GDRs (global depositary receipts) and ADRs (American depositary receipts). Recently, and for the first time, we did an IDR—an Indian depositary receipt—of a global company that is listed in India. We were the lead managers for that global company's Indian issuance. So rather than exporting Indian markets, we're delighted to welcome the import of global markets to India.

The Quarterly: *Another topic of debate among Asian bankers is about margins: how quickly margins will be compressed, how to secure good sources of float, and so on. How do you see that?*

Dato' Sri Nazir Razak: We do see declining margins in high-growth markets of Asia. So for all the opportunities I mentioned earlier, you do have to factor in the negative effects of declining margins, and more clients negotiating for interest in the float, asking for cash solutions, and so on. Falling margins in the lending segment are also inevitable. However, we do see a strange dynamic sometimes, such as bigger spreads on mortgages in Singapore than in Malaysia, or foreign banks helping to increase margins by being more rational on product pricing.

The Quarterly: *How do you decide the regional configuration of your bank?*

Dato' Sri Nazir Razak: I think we get enough scale from Southeast Asia. Does that mean that we get even more scale with Asia? Probably, but it comes with costs and challenges, and I'm not sure what differentiation I can bring to Hong Kong or Shanghai. We had an operation in Hong Kong, and we struggled to find a differentiated proposition for the market. It was just a "me too," right from the start. In essence, our regional

Banks that have their management team based outside the region will always be less able to connect with the local clientele.

footprint is driven by our ability to create and capture value, not mere presence.

The Quarterly: *Can you talk a bit about the operating model? For a long time, there has been a debate about whether to separate or integrate corporate and investment banking. Where do you stand?*

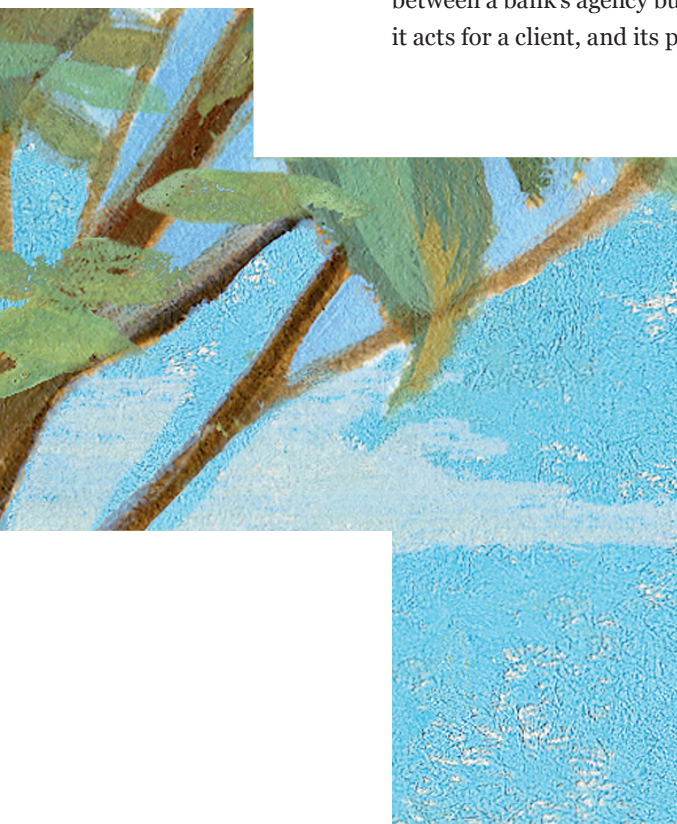
Uday Kotak: I think the entire field of corporate and investment banking is up for redefinition. Former practices, particularly in the developed markets, have exposed the challenges of managing corporate and investment-banking businesses. At the heart of both the corporate and the investment bank is the corporate customer. The ability to serve this customer effectively should be the basis of building a corporate and investment bank. However, what has happened is that in serving this customer, many business models have run into areas with significant conflicts of interest, primarily those between a bank's agency businesses, in which it acts for a client, and its principal businesses, in

which it acts for itself. The most obvious example is providing credit for a client that is also an investment-banking client.

The ability to handle that information and manage those conflicts is a serious challenge for the two banks. For the investment bank, the ability to place securities for clients presents this classic conflict between the issuer and the investor. Each firm must strike the balance to make things work, and that decision is critical for building an appropriate corporate and investment bank. I do believe that many financial institutions in developed markets have struggled with this decision. In lots of businesses, the global financial crisis exposed the mistakes that people made in drawing the line between being a principal and being a fiduciary.

Dato' Sri Nazir Razak: We are big believers in the universal-banking (UB) model, which has come under fire during the crisis. I don't disagree that regulation could be tightened. I actually think that the US regulators would do well to come to Asia and do some research here. However, we think that the crisis was not caused by the model, but rather by the arbitrage in the model. If you throw away the UB model, you're throwing out the baby with the bathwater.

We are convinced that the UB model has brought a lot of value to a lot of people, but it's very difficult to prove it. I feel very strongly about this because we come from a history of investment banking, and the kind of value creation that comes with combined leadership, cost-savings products, and so on is tremendous. And with UB you get full intermediation. I'm not sure that the risk that the UB model presents to the economy is all that different from the risk of a single investment-



banking or corporate banking model. And I think that the risk of the UB model can be mitigated by regulatory guidelines.

The Quarterly: *What are the main challenges you face? Talent? Scale? Competition?*

Dato' Sri Nazir Razak: I think it is the war for talent. We have come a long way, in the sense that people are now happy to have CIMB on their CVs. But I don't think we have crossed that threshold where they are happy to have only CIMB and no Wall Street bank on the CV. That is still something we have to get to. Our other challenge is that we have to go through a period of bedding down, because we have grown very rapidly over five years. You've got to have an organization that can stand the test of time, and from time to time you have to slow down and focus on ensuring sustainability.

Uday Kotak: I think the return-on-equity question is going to be critical. At this stage, I believe that Indian financial institutions are keeping in mind that the demand for financing is growing significantly stronger. Up to now, we have had reasonable pricing power to be able

to get a fair spread and return on risk. But we are aware of what has happened in the developed markets, where banks have started doing business at lower and lower spreads for higher and higher risk. I think that is a very significant challenge for us in the future.

And talent is always an issue. If there is anything that keeps us awake at night, it's the challenges of managing talent. I believe that the talent pool in India is getting deeper, and it is fresher. New talent is able to look at things differently, rather than in the mind-set of how things were done over the last ten years, and that is probably a good thing. ○