



10000 Start-ups

Presents

In Conversation with Uday Kotak

Introduction by Rajan: Good evening everyone! First of all, a warm welcome to all of you from NASSCOM 10000 Start Ups initiative and most importantly I thank you Uday for taking the time to join us this evening. I want to start by thanking Uday and the entire team at Kotak Mahindra Bank for being one of the anchor partners in the 10000 Start Ups initiative. I think it is great that we have a company that is in the banking space as one of the co-partners. I think it is a testament to the passion that Uday and his team have for entrepreneurship.

Rajan: We are talking about 10000 start-ups, you were 26 years old, it was 1985 and you created this company with a much focussed mission at that point and in the year 2014 as we just start, you've got a 50000Cr company that you built. I think we should first give Uday a huge round of applause. And i think it is fair to say Uday ideally we will create more than 10000 tech start-ups in India over the next decade but if we can create a hundred companies or even 50 companies like the one you have created we have more than achieved our mission.

So let us start off Uday with the early days of your journey. In 1985 you created this company around bill discounting and every few years you have changed the business you have added, expanded. You were 26 years old and you

started a company in India, what was the vision, what made you start this company, what was the original vision and goal?

Uday: Thank you Rajan and I am delighted to be with all of you here. Let me first start by saying that I have always loved being a start-up which is what I was and I wish I can keep the spirit of the start-up even now at this stage because there is such a great need for every firm to be on the edge in today's world. I must also admit to something else, that if I had started my company today I had no future because I was able to grow in my early days because of a huge gap in the information society that existed then therefore I would have to think more creatively how I would survive today. Therefore friends, I just wanted to share with you that the starting point for me in terms of what went in my mind was, I had done my MBA from Bajaj and was almost joining Hindustan Lever, a consumer products company when thanks to a nudge from my father, I started this company. I had a friend from my Jamnalal Bajaj MBA class and that highlights the importance of network and this friend of mine had joined a Tata company called Nalco. In those days it was quite strange that banks used to lend money to companies at 17% which is significantly higher than what they paid on deposits. They would pay individual depositors 6%. That meant borrowing money from depositors at 6% and lending at 17%. For me after passing out of MBA and learning about discounted cash flows and all these much higher level hierarchy things, this sounded very strange. How could you take money at 6% and lend to Tatas at 17%? What is the reason for the 11% spread? But that was the opportunity and it was the early seeds of what you call as a banking business in a way. I went to a lot of my family friends who used to give keep money in bank deposits at 6% and said listen instead of 6 what if you got 12% on a Tata company risk? You are not taking risk on me but on a Tata company. I will give you 12%. They would look at me strangely and say does this guy know what he is talking but maybe we will put in a lakh or two into bill discounting. So I got money at 12%. I went to Nalco and said ok 17 is what you are getting from banks but there was a scarcity and banks did not give unlimited money, I will give you at 16%. So a spread that was 11% between 6% and 17%, I narrowed it to 4%. That is how business happened. I worry about it that in today's world if there was a 400 basis point spread social media or any such technology would wipe it out in minutes but that is how it remained and that is how we grew in the early days. It is quite amazing that

the Indian banking system is what it is and even today there are lots of areas where banking is very much behind the curve. I see a huge opportunity and for a number of entrepreneurs to leverage the banking industry and inefficiencies for building business models.

Rajan: That's great. So we will come to the whitespace opportunities Uday. It is interesting what you said that there was this glaring opportunity around arbitrage and I think with start-ups one of the things we talk a lot about is are you going after an unmet real opportunity. Because we do see a lot of companies which are trying to build a feature but you were going after this massive thing. Now let's go to the initial years. Entrepreneurs as you know usually struggle with their first few years and if they get over that, it becomes easier. Tell us what were the 3 or 4 most important things in the first 3-4 years of your journey as an entrepreneur.

Uday: I think the thing which you really have to focus is what is the need for business, you should be able to spend money for that and whatever is outside just don't waste money. I could not afford a fancy office so in Flora Fountain my family gave me a 300 sq ft of office space which was compound tiles and old furniture. I actually remember we had Godrej tables which we cut into smaller sizes so that we had more space and more people to accommodate. So anything that is wasteful overhead and is not adding to your business or your topline, don't waste money. But when it comes to anything which is critical for your business don't save money. I used to do business in Chennai with a leasing company which meant I had to travel to Chennai. The cost of air travel plus hotel stay at Hotel Connemara in those days was a lot of money. But I could not afford to stay in a lower level hotel because the guy I was meeting should feel that this guy is okay to do business with, so I had to stay in a hotel like Connemara. It was a pressure for me on overhead but you did it because that was needed for your business. Don't cringe on anything which helps you build your business; everything else is a waste of money. Just be very tight and ruthless about it and don't be ashamed about what people will say. "Arre aap godown jaisi jagah se kaam kar rahe ho", doesn't matter as long as you have a business model.

Rajan: Perfect. In the early days of a start-up, funding is very scarce, some startups don't spend on what they need to spend and your example is terrific. What about team building Uday, you were 26 years old how did you build a team? Who did you hire, how did you get them to join you?

Uday: One of the first person I got to join me was a person who was in the Finance department at Nalco. They guy was very smart in terms of squeezing me on rates and everything else and i just found him to be an outstanding negotiator. I started with myself and two junior people but when i found this guy to be so good, i wooed him, I went after him. He was also a start-up kind of guy. His name was Shivaji Dam, a chartered accountant and he joined me from Nalco. So that was my first break. Thereafter I found that you had to make sure that you are getting people with high integrity but smart on the other side of the counterparty fence and if you spotted one go after that person and that is how I built the team.

Rajan: How do you get that absolute best talent to take the risk and join the start-up?

Uday: I think it is a little bit of passion, little bit of purpose, little bit of something different, something challenging and a lot of it is the personal charisma in the early stages. You have to be able to convince the other side with your passion and purpose that 'Hey! We will create something!' It has to be believable and that is absolutely important.

Rajan: Startups in the entrepreneurial land have this word called pivot, you got to change the business, you got to adjust to market landscapes etc. If you look at the company you have built Kotak , you have pretty much not just survived but thrived through every crisis, whether it is the 91 crisis or Harshad Mehta scam, the Asian crisis, the dot com bust, the recent global meltdown, your firm not only went through those but became stronger at each stage. It will be helpful for you to share some lessons as to how you are able to do that. Most of your contemporaries may have disappeared, logos keep going away through each of these scams but you got stronger you added more businesses, tell us something about that.

Uday: I think every crisis in a sector is a huge opportunity and we have found post every single crisis we have benefitted and the reasons for them are two.

One is your ability to spot a problem before others do and number two is to make sure that in general you make fewer mistakes than everybody else. 1991-92 was a Harshad Mehta security scam it was waiting to happen. I have seen huge death of my competition. We have lived through what we call Agni Pariksha. There are a few home truths that we have internalised in the firm. One of them is when something is too good to be true it is too good to be true. Don't try and challenge it. Very often people get sucked in by some lure of something that is too good to be true. There will always be a catch there, watch out for that. Number two, you need to be able to think little beyond. For example, in 97-98 when you saw the ASEAN crisis, a lot of NBFCs in the sector which I was in, died. There were some 4000 odd NBFCs and 3980 died. The mortality rate was huge it took away a lot of competition. We said that unlike the big banks in those days, the state owned banks and private sector banks, we will not get any bail out from anybody to give capital to us, and we got to survive on our own. We actually pruned our lending books by 50%. Our stocks collapsed but we knew we were on the right track and that saved us. So in that period 97-98-2003 when the whole industry got wiped out and we actually came out of it much stronger. But markets too did not see it till 2 or 3 years later. The other interesting aspect is, be very clear about what you know and what you don't. In the mid 90s, we felt that in the financial sector we did not know enough of what was happening. We were a bit like frogs in the well. We did joint venture tie-ups with two global majors, Goldman Sachs and Ford Credit. One was in investment banking and securities and other was car finance and we learnt from them. We imbibed the best practices. So more than financial capital, knowledge capital that came from them was very wide and 10 years later we bought back our stake whatever we had given them in both those joint ventures and in a very happy manner. So we have great relationships with all our partners but we think knowledge and knowing how best global practices are is critical for scaling up.

Rajan: I think those are very good lessons. I think making sure you are always trying to look at the future and understand the risk making sure you surround yourself with partners and team members who bring new capabilities. One of the interesting things you mentioned Uday is you took a hard call and you cut your portfolio into half and stock markets reacted. So being able to make those

calls at the right time without worrying what otherwise would have gone under.

Uday: Yes, without worrying about quarter to quarter.

Rajan: Let us now move to adoption of technology in the banking sector and in your firm. In many ways what has happened in India Uday is we have gone from having no internet users to 200 million internet users. 70 million of them access the internet through smartphones and so on and so forth. The banking sector has rolled out ATM technology very well and a few banks like yours are beginning to adopt websites and mobile strategies. Talk to us a little bit about where do you think the internet, the mobile internet, technology broadly, whether it is Aadhar or other platforms; what can it really do to the banking industry over the next 5-10 years.

Uday: Frankly Rajan, I think banking industry is light years behind what is happening in the broader technology. We had you come over and spend half a day with us a few months ago and it was just shocking how much behind the curve banks are. But in that lies the opportunity for every one of you because we are behind the curve we are forced to adopt new things which can be fitted in like a plug with what we are doing. There is a huge opportunity for efficiency in banking. The problem I think, some of which is genuine and some of which is in our minds is the perception about risk and trust. I think Central banks are slow for the same reason. How risky and trustworthy is the basis of new technology from the point of view of robustness. We spend enormous amount of time trying to save ourselves from numerous frauds hitting our industry that are coming out of technology. One big area which I think banking industry would love to grab is around security. If we can get lot of technology and application around security to make you more secure and which we are very very nervous about. What is it that keeps me awake every night? Will I have a bank next morning? Will the bank be cleaned out, that is one. That is the security aspect. On the other hand what keeps me awake is why do you need this so called animal called a bank? Tomorrow, a Google or a Vodafone or an AT&T can do everything we do. Will we have a business 5-10 years from now? So it is these two extreme things which is actually the whole canvas of opportunity. From the point of view of where banking is to where it can be but what are the risks.

Rajan: That is very interesting Uday. You mentioned areas like security are huge areas of concern and opportunity for start-ups but what you hear from entrepreneurs is when you are a technology start up and you make your list of vertical markets to go after banking is not on the top 10. Because it is very difficult to convince banks and CIOs, they would much rather work with IBMs and TCS. What counsel do you have for entrepreneurs who are building technology companies trying to make BFSI segment its customers?

Uday: I think in banks we have faced the other side of the problem. When you have dealt with some relatively young companies and have got them on board and actually entrusted them with some areas of our applications, we have found some of them have problems. People leave, the stability of the counterparty is a big concern for us. Maybe in the early stages of a start-up, you need to reach a certain level of stability before banks get comfortable to deal directly. If it comes along with a more stable name, it is easier for us. For us we are hungry, we were pretty keen on finding new ways of keeping our edge as a product and I think the problem in banking is that most banks have become me too. We really need to think about how we need to differentiate ourselves. I think differentiation is through smarter, better, efficient service and what can we do for that.

Rajan: You mentioned about security. Another area where there is lot of excitement among start-ups is payments. Would love to hear your thoughts on what are the 2 or 3 big opportunities that you see in payments in India where let us say a set of entrepreneurs could go and build a billion dollar business.

Uday: I think one big area which I think is relatively underserved is the whole area of cheque truncation. The RBI has allowed the banks to not present the physical cheques through clearing but move through the cheque truncation system is dramatically changing the world of physical cheques. Look at the US, today customer can directly take a photograph of a cheque and it gets cleared. I think India is still not there. The whole area of CTS is a very significant opportunity for people to be thinking about. There has been some discussion about mobile wallets; I don't think they have so far reached the potential they can. One of the issues in India I think we got to keep in mind that it is a very large cash economy, lot of people continue to want to settle in cash which has also limited the use of credit cards. But I think the whole area of cards and

what can be done through it either through cards or other payment forms could be a big opportunity for the future and there again I think this 2 stage verification which has now been introduced is again a pretty burdensome thing for the customers but that is a tradeoff between convenience and security. So I do believe while payments is going to be a very important thing Rajan as we discussed a little while ago that increased cash economy is a problem for smooth payments growth and I would strongly encourage NASSCOM to see how you can take up and this is a much broader political social civil society economic issue- why does economy keep on having such a large portion in cash.

Rajan: You mentioned this earlier. One of the things which might be interesting for the entrepreneurs building payments start-ups is that compared to 1985, today the percentage of cash in the economy has increased, you might want to talk a little bit about that. I was surprised; I thought it was coming down.

Uday: You would have assumed that with liberalisation and reform the cash economy would have come down. The fact of the matter is the cash economy in India has not come down, it has grown significantly more. A cash economy distorts the formal transparent payments system. I keep on asking myself why we need so many branches, because ideally in the online world you would not need so many branches. One of the reasons is because small businesses across the country have disproportionate cash and we see it. The majority of transactions in our branches are handling cash so one of the things which is vital for speedier growth of the payments system is shrinkage of the distorted non transparent cash economy which has significantly grown in India in the last 20-25 year. Why it is that credit cards have not grown faster? It is because people want to use their informal money and pay in cash. If you look at the model of Flipkart, cash on delivery, the reason is lot of customers want to use cash rather than pay by card, so it's a complicated thing and therefore from the point of view of transparency, I think less cash in the economy is critical for the future and for some of you who know banking a little better, for the current accounts, banks pay zero interest. That's precisely because the cost of handling cash is high and therefore it is a way for compensating banks for inefficient handling of cash.

Rajan: So current account balance interest rate is zero, is there an opportunity there much like what you had in 85?

Uday: This is by law

Rajan: This is by law! But why is it zero?

Uday: I think one of the reasons is that there is a huge cash handling cost for banks, which is the branch cost, the rental of a branch, who pays for it?

Rajan: One of the primary reasons of a branch is actually all this cash, it is not the customer service, not the acquisition but those are part of it ...

Uday: Yes, a part of it, of course a customer likes to see a bank branch next to his home or office. There is a psychological need. All these factors are there and continue to be there but in addition to that the simple handling of the cash can be important.

Rajan: If you are 25 again today, 2014 India, the economy is 1.8 trillion, second largest internet market in the world, and you are going to start up, what would you do? What are the three kinds of companies you will build?

Uday: I think that is a real tough one but I would probably use technology for sure, I think most likely to be around mobile because I think that is extremely powerful and I would find a massive national distribution disintermediation business which is

Rajan: so say a little more about that because I don't know what that means

Uday: I think if you will really look at it, the gap in terms of the whole distribution system between the urban and rural India is huge and if I can find a way of efficiently being able to handle the ticket sizes which are smaller, it is something like what Hindustan lever did for sachets. Build a distribution model which is low cost so the cost to service is pretty low like what telecom companies have done in terms of mobile rates

Rajan: So you mean for financial service?

Uday: Yes, for financial services and find a technology driven solution to low cost national distribution and use that for disintermediating the banks. Frankly

the banking system has a significant counter opportunity from start-ups to disintermediate it.

Rajan: And to do that you would need a banking license?

Uday: In my view, you could do it through a NBFC platform. Ofcourse it's about regulation, it is about broadband, it's about how effective internet is but if somebody got that it can dramatically shrink intermediation costs.

Rajan: And you haven't seen anybody doing that yet in India?

Uday: I think the part of the problem is also the broadband, the net, how good that service is and how sort of robust that is. If you get high class broadband across the country I think you will see that.

Rajan: Got it perfect. I think we have talked a lot about the things you have learnt, what's work, what's not work, your perspective on white space etc. Talk a little about some of the mistakes you have made in the early days not today and if you want to do it again building again, building a company, building teams, whatever the various things you have learned that might be helpful for the audience here.

Uday: I think I have made lot of mistakes along the way. Frankly I ask myself the question, especially after we became a bank in 2003 that should we have scaled up faster and should we have taken big bets on scaling up faster than we have. In retrospect if I had the opportunity, I would have scaled up in 2003 and 2008 even faster than we did and maybe I had the opportunity of being 2x or 3x of where we are. It was at that time you began to worry, if I spend so much and invest so much is it going to hurt my P&L. I am not sure about the outcomes, but the opportunity was extremely large and therefore little bolder steps than would have certainly helped. And hence for this New Year's, my message to my employees was we are going to build a bigger, better, bolder Kotak

Rajan: Terrific, that is great. One of the things we talked about outside was that despite being a 1.8 trillion dollar economy where the eco system is developed, we have a couple of angel investors, lot of VC's , but the reality is that raising 50 lakhs is still very difficult. I am sure there entrepreneurs in the room who run around for six months for all kind of investors to raise 50 lakhs.

You come here from the financial services, what advice you have for the eco system? It is a shame that we have so many great ideas, founders and raising 50 lakhs is really hard.

Uday: Rajan I think I have told you about it, two Rajans together can make a big difference - one is you and second is the Governor Rajan and maybe you should go and talk to the other Rajan about this. All banks have requirement of 40% priority sector and is it possible to consider angel funding or venture funding as a part of priority sector, as a part of the inclusion exercise where banks put an x amount of money in to some sort of a fund and see? There could be a pretty dramatic growth for putting capital for startups. The question in my mind is do we have investors who have the investment capability and those smart investment managers like you have in the Silicon valley who can really understand how to take the bets on startups. And if we really have good managers who can do this, I think money can come

Rajan: I think that's a great idea which is to say know how you make risk capital for startups out of the priority sector norm so that there is lot more money flowing in from the banks into the funds, investments so on and so forth.

Uday: I also think that the policy makers have to differentiate between private equity and angel investing and this is much more angel and even the early stage venture. You really need to figure out how that is given a special treatment as distinctive from core private equity

Rajan: One last question, have you had mentors as you built the company? If you are comfortable saying who they are that will be great otherwise we will love to talk. Just give us some talks around the importance of mentors, having a network and so on.

Uday: I think network is critical and being able to listen to people is extremely important. But for me lot of my early stage experience came from a professor at Jamnalal Bajaj and I have no hesitation in publically saying it was a professor called Professor Mankekar. He was our corporate finance professor and the first day at class he asked us what is the most important thing for a company? So people answered, and most of it was around profits but he said no. The answer was something that each of you will relate to, cash flow. Do you have

enough money in your bank or in your company to be able to do what you need to do? And around that ofcourse what was very fascinating for me was the fact that Professor Mankekar used to be a significant investor in the stock market. This was in 1981 and I would literally hold his little finger and go to the stock exchange and look at how the whole theory of finance was being implemented by him in investing. So that was great early stage learning for me and even today he is one of the most outstanding public market investor. Personally my view is rather than having one role model, look and learn from different people, get the best and try to create your own chemical mix out of that.

Rajan: Perfect, no I think that is fantastic and also I think also for the technology industry this notion that cash is king because we like to invest cash not generate cash , so I think that's one thing that we can learn from.....

Uday: And Rajan that's what I told you, I have grown up with the fundamental view that cash flow is extremely important. What I understand from your industry is that cash burn is extremely important. If you burn more cash you are more valuable, but I can't figure that out.

Rajan: Only eventually if you are going to generate lots of cash and that is the art story of telling in technology business building.

Let's give Uday a big round of applause everyone.

Thank you Uday for that!
