NEW BANKS: LICENSE TO SKILL

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For the majority of 2012 and 2013, the Reserve Bank of India (RBI) has seemed reluctant to take decisive action on policy issues and monetary mechanisms. It finally managed to rouse the banking industry in India, by giving the go-ahead for corporates and non-banking finance companies (NBFCs) to apply for new banking licenses. This decision has been long debated and even longer awaited, coming after a hiatus of 10 years. The RBI had issued only two licenses in the early 2000s and prior to that its last activity was in 1993-94.

The main reason the RBI has pushed ahead for new banking licenses is to bring a large section of the unbanked and under-banked population of the country into the folds of the organized banking financial system. For the first time, it is also going to allow big industrial houses to apply for licenses.

Presently, 26 companies have thrown their hats into the ring. Plenty of thought has been given to the business strategy in light of the stringent guidelines laid down by the RBI (see below for the salient features). However one of the most critical challenges that the licensees (and even the larger FI segment) will face is regarding human capital. The purpose of this alert is to discuss the potential HR issues for both the licensees and the broader financial services industry.

THE RBI GUIDLINES

The RBI requirements for companies applying for a banking license are[1]:

1. *The minimum paid-up capital for setting up a bank pegged at INR 500 Cr (USD 83 Mio). Cap on foreign investment (including Foreign Direct Investment/Foreign Institutional Investors and Non-Resident Indians) set at 49%.*
2. *Licensees must begin operations within 18 months, and must list the bank within the following three years after commencement.*
3. *New banks must open at least 25% of their branches in rural (unbanked) centers.*
4. *Following the grant of license, the promoter group must set up a wholly-owned, Non-Operative Financial Holding Company (NOFHC) which will initially hold a minimum of 40% of the paid-up voting equity of the bank for five years, and which shall be reduced to 15% within 12 years.*

[1] Source – RBI website, Business India & Economic Times

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5. *The bank is required to maintain a capital adequacy ratio of 12% for the first three years – starting from day 1 of commencement.*
6. *Any individual (including relatives) belonging to the promoter's group can only hold 10% voting equity shares of the NOFHC.*
7. *The company being issued a license, publicly listed or not, must have 51% of its shares owned by the public.*
8. *Re-organization of promoter entities will have to be completed within a period of 18 months from date of in principle approval or before commencement of banking business.*

WHO'S AT RISK FOR THE LOSS OF TALENT?

The Indian banking industry will hire (0.9 to 1.1 Mio) people in the next five years[2], largely led by the Public Sector Banks (PSBs). This will rise in relation to the number of licenses granted by the RBI, and will, in the short to medium term, create a scramble for talent.

Top management positions are already being filled and actively budgeted for, as are the slots for people who will need to build or bring in teams. Most of the hiring for junior and mid-level positions will begin once the licenses are announced. The following analysis highlights where we see the maximum talent exposure:

- In the past, **international banks** have been targeted by new private sector banks and this time around, we anticipate specific functions are likely to be at risk. Control functions like compliance, risk, audit and finance have traditionally been strong for international banks. As a result these roles are likely to be targeted by the new banks, given the regulatory regime in the country. Additionally, retail banking will also be at risk given the marginal growth (or decline, in some cases) that international banks have seen in this segment, whereas the opportunity for new banks in retail will be substantial.
- **Private sector banks** will be targeted at the mid to senior levels given the sizeable experience of the larger banks in building branch networks and successful fee-based businesses. Their culture of frugality, productivity and experience building scale are also attractive to the new players.
- **Public sector banks and local cooperative banks** could bear the brunt of exodus at lower and middle levels as these staff tend to value bigger, performance-friendly pay packages and faster career growth more than the stability and security of a public sector job.
- **Other FI sectors like insurance or broking** may also see a talent threat given their low salaries and a slowdown in their respective segments. Life insurance

[2] Source: BCG Report

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(LI) in particular is likely to be a hunting ground for the new banks. This sector has seen a challenging business environment for the past year, and presents affordable talent given the compensation gap between LI and banking. Skill sets are also comparable as the insurance industry thrives on building an extensive distribution reach and has significant experience in operating in tier 3 and tier 4 cities. That experience will be in high demand given the RBI's guideline for new banks to have at least 25% of their branches in rural / unbanked areas.

THE NEW BANKS - EMPLOYEE PROPOSITION

Aspiring employees within India and in the region (APAC as well as Middle East) will consider the following advantages and pitfalls of joining the new banks:

- Many of the larger players will use their deep pockets to poach talent at a high premium. This has happened before; when banking licenses were last issued in the early 2000s.
- Given the directive to list the new bank within 3 years of inception, long-term incentives will form an important part of the compensation packages. Other private sector banks have made extensive use of them, pre-listing, and have created enormous amounts of wealth for staff.
- A lot of the growth is likely to happen in the retail segment, and the rural / semi-urban sectors for the new banks rather than wholesale banking, which will shape the bank's growth trajectory.
- Beyond compensation, the opportunity to be a part of new bank, the chance to craft a vision and to be part of an Indian-headquartered global bank is likely to exert a strong pull.

THE ASPIRANTS

Tata Sons	*LIC Housing Finance*	*Aditya Birla Nuvo*
Department of Posts	*Reliance Capital*	*Bajaj Finserv*
Bandhan Financial Services	*Edelweiss Financial Services*	*IDFC*
IFCI	*Indiabulls Housing Finance*	*India Infoline*
INMACS Management Services	*Janalakshmi Financial Services*	*J M Financial*
L&T Finance Holdings	*Magma Fincorp*	*Muthoot Finance*
Religare Enterprises	*Shriram Capital*	*Smart Global Ventures*
SREI Infrastructure Finance	*Suryamani Financing Company*	*Tourism Finance Corporation of India*
UAE Exchange & Financial Services	*Videocon's subsidiary Value Industries*	

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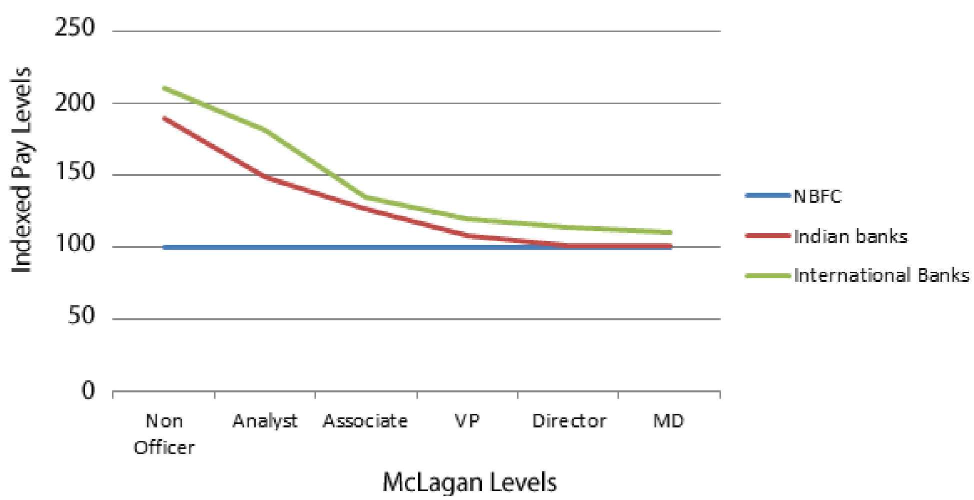
TO DOS FOR THE APPLICANTS

- Apart from large industrial houses and conglomerates, other players in the race for the licenses range from broking, microfinance, and NBFCs, to money remitters and infrastructure lenders. While the action is likely to heat up later in the year or early next year when the RBI is scheduled to award the licenses, there is a lot for the applicants to strategize and plan. Given the requirement to list after three years, the applicants will need to focus on **talent and reward strategy** early on as they strive to attract talent while controlling cost.
- The kind of talent to be hired will depend on the **current business and geographic spread** of the applicant. For those in the non-banking space (e.g., business houses, self-promoted companies, government departments, etc.) the organization will need to be built from the ground up. For existing NBFCs, liabilities, business skills and control function capabilities will be critical.
- Given the strength of internal teams and resources, most large NBFCs and conglomerates will look at **elevating and redeploying key talent from within** to take leadership roles in the newly formed entity as well as focus on **retraining existing talent** given the inherent nature of the banking business and its divergence from the NBFC world.

COMPENSATION CONSIDERATIONS

We looked at the pay differentials between NBFCs, Indian banks and international banks to ascertain how the applicant companies, largely consisting of NBFCs, will need to arrive at a compensation strategy.

CHART 1.1 Comparison of Banks v/s NBFCs in 2012 on Total Cost to Company[3]



Includes both front office and infrastructure population.

[3] Source: Aon Hewitt Database for NBFC & Banking 2010-2012

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Firstly, at the junior level there is a considerable gap between compensation levels of banks and NBFCs. The latter will struggle to hire at junior and middle levels from both local and international banks. Secondly, the talent movement at the senior and top management positions is not likely to pose as much as of a challenge given the plateauing of salaries in the established private sector banks and international banks, and the hiring and positioning of critical levels within the NBFC sector.

However, the equation changes significantly when we include long term incentives. Local banks, led by the substantial value of stock options given out at their senior levels, have the highest paid staff on a total compensation basis. They are followed by the international banks and then the NBFCs. The gap between the NBFCs and local banks could be anywhere from 80-100%, thus still bringing about a lot of ground to cover for the former, when it comes to strategic and long-term hiring, especially at senior levels.

CONCLUSION – THE SHAPE OF THINGS TO COME

The new banking licenses are expected to be announced early next year, establishing a clear agenda for the new RBI governor who has taken over recently. His move has largely been seen as positive, given his economist pedigree and prior experience with the IMF. He was able to arrest the slide of the rupee against the dollar by announcing a slew of measures and reforms during his first week in office. Some of the measures on the currency and capital inflow front included offering a special window for swapping foreign currency non-resident (FCNR) deposits to encourage banks to attract more FCNR deposits from overseas residents; doubling the amount of money that Indian banks can raise through overseas bonds; and allowing greater flexibility to importers and exporters in dealing with currency-related forward exchange contracts[4].

There is positive momentum for the banking sector specifically, with the announcement of an external committee to screen the banking license applicants; a push to foreign banks to set up wholly-owned subsidiaries so as to enable them to participate more in the country’s growth; and a clear vision to eventually lower the entry barriers for more new banks.

The RBI has chosen to focus on inflation by hiking interest rates in the recent monetary policy announcement, a move which hasn’t made the industry and markets very happy. However the governor has partially rolled back short-term monetary tightening measures imposed in July to protect the rupee. In spite of the hard stance taken, the overall sentiment around the new governor and his focus on reforms is likely to make the country’s financial services sector gear up for action.

[4] Source: Wall Street Journal

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In the next 5 months leading up to the announcement of the new bank licenses, the following points will enable the FI sector in India prepare well for the scenario:

- The applicants will need to think about every element of their HR strategy, from identifying and drawing up an organization structure that will enable long term growth of the new bank, to planning redeployment and retraining of resources, manning the new bank and reshaping the new set of capabilities.
- Existing banks will need to ring fence their key talent across critical control functions and in retail, focus on long-term incentives for senior management and continue to build career development plans for top performers.
- Pay differentials across various sectors may not affect the bigger industrial houses applying for licenses given their deep pockets, and hence retention measures beyond compensation need to be strongly aligned to the talent strategies.

McLagan has deep expertise and broad experience in both the NBFC and the banking sector in India, and is uniquely positioned to help organizations in the FI sector with all aspects of this key planning process over the next few months.

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