Obtaining New Banking Licenses in India: Challenges and Opportunities

New banks in India will not have an easy time securing licenses, given the Reserve Bank of India's guidelines and expectations for promoting financial inclusion, rural banking and technology innovations.

Executive Summary

On July 1, 2013 the list of 26 applicants for new banking licenses to be issued by the Reserve Bank of India (RBI) was announced - marking the end of the first phase of a process that played out in the 2010-2011 time frame. During that period, RBI posted a discussion paper on its Web site - inviting comments and feedback on the proposal to offer new banking licenses to private sector players. Among other things, RBI sought views/comments on the minimum capital required for new banks; the promoter’s contribution; foreign shareholding in the new banks, and the business model for the new banks. Based on responses - from banks, the general public and non-banking financial companies (NBFCs), as well as microfinance institutions (MFIs), analyses opinion pieces in the media and discussions with relevant stakeholders - the RBI issued specific guidelines, “Licensing of New Banks in the Private Sector,” in February, 2013.

The guidelines take into account the existing economic environment, RBI’s objective regarding banking sector reforms, and its past experience with banking licenses issued in 1993 and 2003.

Apart from stringent entry-level guidelines, RBI expects new banks to take the lead in achieving greater financial inclusion, enhancing rural banking facilities, reaching priority-sector lending targets, and ushering in technology innovations in the banking industry. Applicants that were issued licenses in the earlier two stages have reached a certain degree of success in some, but not all, of the above. It will be a tough task for the beneficiaries of the new banking licenses to meet RBI’s expectations while ensuring they establish and run a financially strong entity.

This paper looks at why applicants find it desirable to apply for a banking license, and what they can expect from its allotment. Among other benefits, the new banks will have access to a vast unbanked/underbanked populace, low-cost funds, as well as opportunities in credit and investment products. We will analyze the current position of banks that were issued licenses earlier, and attempt to interpret RBI’s guidelines. This paper will also cover the challenges that new banks are likely to face, such as compliance with RBI guidelines on financial inclusion, rural banking and priority-sector lending, plus the
significant capital expenditures and competition from existing banks. Inherent advantages that some applicants possess, such as an infrastructure for a Public Sector Undertaking (PSU), or a client base from an NBFC/MFI (Non Banking Financial Company/Microfinance Company), will be analyzed as well. Finally, we will examine business opportunities for consulting firms in areas like business process modeling, core banking product selection, core banking implementation, governance, risk and compliance.

Background
Following the nationalization of banks in the 1960s and 1980s, the Reserve Bank of India began issuing banking licenses to 10 private sector banks between 1993 and 1994, and to another two between 2003 and 2004. The first set of licenses led to the emergence of private banks such as ICICI Bank Ltd., HDFC Bank Ltd., and Axis Bank Ltd. Promoted by various financial institutions, these went on to become the biggest private sector banks in India. A few other banks that had come into existence at the same time as these “Big Three” either collapsed or were merged with one of the three. Times Bank merged with HDFC Bank, while Bank of Punjab was acquired by Centurion Bank to form Centurion Bank of Punjab, which in turn was acquired by HDFC Bank. Global Trust Bank failed – subsequently merging with the Oriental Bank of Commerce. Only two licenses were issued between 2003 and 2004, creating Kotak Mahindra Bank and Yes Bank.

The issuing of banking licenses between 1993 and 1994 (and to a lesser extent during 2003 and 2004) was probably the outcome of economic liberalization initiated by the then-government. The current licensing cycle seems to be prompted by RBI’s objectives of financial inclusion and taking banking to the unbanked and underbanked areas.

New Banking Licenses – Why Now?
Economic conditions during 1993 and 1994 demanded new banking licenses. Economic liberalization was underway, and the role of banks and other financial sector intermediaries was becoming prominent. PSU banks held 91% of the total bank branches in India, and collectively accounted for 85% of the total banking business in the country. New banking licenses were issued to move financial sector reforms forward, upgrade technology in the financial services sector, and avoid placing economic power in the hands of a few.

Those objectives were probably met to a large extent by newer entrants, since RBI proceeded with issuing another round of banking licenses during 2003 and 2004.

RBI’s intent can be broadly attributed to three objectives:

Financial inclusion – Providing affordable banking services to the lowest strata of the population is one of the primary goals. RBI has mandated that commercial banks achieve financial inclusion by offering “no-frills” savings-bank accounts and easy access to credit facilities through general-purpose credit cards (GCCs). KYC (Know Your Customer) norms have also been relaxed to achieve greater financial inclusion. Additionally, CRISIL Inclusix provides a comprehensive index for measuring financial inclusion in the country (see Figure 1).

CRISIL Inclusix Score

CRISIL Inclusix measures financial inclusion on three parameters: branch penetration, deposit penetration and credit penetration.

As seen in Figure 1, financial inclusion has improved from 2009 (score of 35.4) to 2011 (score of 40.1) but is still low, and reflects under-penetration of banking services in the country. Other findings from the index also indicate significant room for improving this score (see Figure 2, next page).
Significant Room for Improvement

<table>
<thead>
<tr>
<th>Findings from the Index</th>
<th>Interpretation</th>
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</table>
| Number of savings bank accounts is close to four times the number of loan accounts. | 1 Access to credit facilities is restricted to a small section of the population, possibly due to the stringent regulations that are in place.  
2 There is significant opportunity for banks/other financial intermediaries.  
3 Banks are looking to mobilize low-cost funds and focus less on extending credit to every category of depositors. |
| India's six largest cities have 11% of the total bank branches. | 1 Banks have largely ignored smaller cities and rural areas.  
2 Indian cities may be overbanked. |
| There are four districts in the Northeast with only one bank branch among them. | 1 Some regions in the country are highly underbanked, in spite of RBI-mandated financial inclusion measures. |

Source: [www.crisil.com](http://www.crisil.com)

Figure 2

To rectify this situation, RBI has mandated that new banks would have to open at least 25% of their branches in unbanked rural areas. This would result in:

**A wider reach of financial services** – For banking to be truly inclusive, banking and financial services must reach a large section of the general population. Consumers can then benefit from access to a wide variety of banking products and services; banks win by bringing more people into the banking fold, which reduces the cost of offering such services. Penetration of banking services also achieves the greater good of financial inclusion.

The percentage of growth in rural and urban households availing themselves of banking services (see Figure 3) can be attributed to the increasing reach of such services in rural centers.

**Rural banking** – Penetration of banking services in rural areas is RBI’s third objective regarding issuing new banking licenses. During 1993 and 1994, new banks were obligated to open branches in rural areas; between 2003 and 2004 they were required to have 25% of their branches in rural and semi-urban centers. This time around, RBI has specified that new banks must set up 25% of their branches in unbanked rural centers (having a population of up to 9,999). This guideline emphasizes RBI’s focus on rural banking.

“Average Population per Bank Branch” (APBB) for rural and semi-urban areas (see Figure 4, next page) fell from 17,200 in 2005 to 12,100 in 2013. The APBB is likely to continue to decline as the number of branches increases.

Out of a total of 102,343 branches of scheduled commercial banks in India (as of March 31, 2013), 37,953 (37%) are located in rural areas. Of these, private sector banks account for just 1,937 (only 5.1%).

As Figure 5 (next page) indicates, private sector banks and foreign banks have the least number of rural branches.

Clearly, private sector banks have lagged behind in terms of providing banking services to rural

**A Wider Reach of Financial Services**

Source: [financialservices.gov.in](http://financialservices.gov.in)

Figure 3
areas. By issuing guidelines for setting up branches in those parts of the country, the RBI hopes to correct this situation.

What is in it for Applicants?
The number of applicants for new banking licenses has come down - from 113 in the 1993-1994 time frame to 100 between 2003 and 2004, to just 26 in the current cycle. This can be attributed to the stringent guidelines issued by RBI and an uncertain operating environment. However, the fact that 26 applicants across NBFCs, PSUs and large business houses have applied for a banking license indicates that these entities see business and other opportunities in this sector.

A few reasons why new applicants could succeed can be attributed to:

An underbanked population – For the financial year ending March 31, 2012, there were 26 nationalized banks, 40 foreign banks and 21 private sector banks (including both old and new-generation private sector banks). In addition to these, there were 86 regional rural banks, 1,721 urban cooperatives, 31 state cooperatives and 371 district central cooperative banks. However, as Figure 6 (next page) indicates, India has a lot of ground to cover compared to other emerging economies and developed economies. This represents a significant opportunity for newer entrants, since they have access to this vast and probably underbanked population.

Access to low-cost funds – Most of the 26 applicants already have a presence in the financial services sector, with a significant portion of their existing business coming from rural areas (see Figure 5). Therefore, they are likely to have better access to low-cost funds in the form of current and savings deposits. Deposit holders in the rural and semi-urban areas are not as financially literate as their urban counterparts; hence, they are largely unaware of alternative financial and investment products. They are more apt to keep surplus funds in the bank rather than invest in other instruments.

Low credit penetration – As we mentioned earlier, the number of deposit accounts in India is almost four times the number of loan accounts. The reasons could range from stringent credit checks to the Indian mindset of not turning to loans. However, this also indicates that credit penetration still has ample room to grow, and that newer and more aggressive entrants can take advantage of this opportunity.

Low penetration of financial products and services – Nowadays, distribution of third-party products (TPPs) such as mutual funds and insurance, and services such as portfolio management, form a sizable portion of a bank’s income. However, in spite of aggressive marketing by banks, mutual fund penetration in India stands at 4.7%, while insurance penetration is at 5.1%. The new banking license applicants will be looking to tap into this market.

Dissatisfaction with existing banks – Newer entrants will seek to leverage customer dissatisfaction with existing banks due to

**Data on Average Population Per Bank Branch (APBB)**

Source: financialservices.gov.in

![Data on Average Population Per Bank Branch (APBB)](image)

**Percentage Distribution of Rural and Other Branches**

Source: financialservices.gov.in

![Percentage Distribution of Rural and Other Branches](image)
declining standards in customer service, lack of technological innovations and limitations in geographical reach, for example.

**Use of existing infrastructure and experience** – The list of 26 applicants for banking licenses comprises entities such as Bajaj Finserv Ltd., JM Financial Ltd., LIC Housing Finance Ltd. and Reliance Capital Ltd., which have ample experience in dealing in financial products and services. Apart from experience, these entities also possess the infrastructure and client base necessary to support their foray into banking.

**Success stories of earlier entrants** – Licenses issued in the earlier phases resulted in the formation of banks such as ICICI Bank Ltd., HDFC Bank Ltd., Axis Bank Ltd., Kotak Mahindra Bank Ltd. and Yes Bank Ltd. These institutions have grown in size, income and geographical reach, and now wield considerable influence in the Indian financial markets. Along the way, these entities also got listed on major stock exchanges in India, such as the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE), as well as overseas (The New York Stock Exchange [NYSE] and the London Stock Exchange [LSE]) - creating more value for shareholders. New applicants will be looking to emulate the business model of such banks.

**Licenses Issued Earlier – Successes and Failures**

Banks that came into existence post the 1993-1994 time period are referred to as New Generation Private Sector Banks (as opposed to the Old Generation Private Sector Banks, such as South Indian Bank, Federal Bank and Karnataka Bank, for example). Most of the banks that came into existence as a result of banking licenses issued in the 1990s and early 2000s have done well.

**Performance of Banks**

Source: KPMG-Indian Banks:Performance Benchmarking Report FY12 Results.

Figure 6

![Graph showing Bank Branches per 100,000 Adults](source: worldbank.org)

Figure 7

![Graph showing Performance of Banks](source: KPMG-Indian Banks:Performance Benchmarking Report FY12 Results.)
The new private sector banks, such as ICICI Bank, HDFC Bank and Axis Bank, which were set up post-1991, compare favorably (see Figure 7, previous page) to the PSU Banks such as PNB (founded in 1895), Bank of Baroda (founded in 1908), Canara Bank (founded in 1906) and Bank of India (founded in 1906) (See Figure 8, below).

These banks have also been able to create and enhance value for their shareholders in the comparatively short period of time they have been listed.

### Market Capitalization of Banks Currently Under Review

<table>
<thead>
<tr>
<th>Name of Bank</th>
<th>Year of Listing</th>
<th>Market Cap (INR crores)*</th>
<th>Name of Bank</th>
<th>Year of Listing</th>
<th>Market Cap (INR billion)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI</td>
<td>1993</td>
<td>107643</td>
<td>ICICI Bank</td>
<td>1997</td>
<td>97661</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>2002</td>
<td>17242</td>
<td>HDFC Bank</td>
<td>1995</td>
<td>147982</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>1996</td>
<td>19985</td>
<td>Axis Bank</td>
<td>1998</td>
<td>45957</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>2002</td>
<td>9482</td>
<td>Kotak Mahindra Bank</td>
<td>2003</td>
<td>49649</td>
</tr>
<tr>
<td>Bank of India</td>
<td>1996</td>
<td>8878</td>
<td>IndusInd Bank</td>
<td>1997</td>
<td>19648</td>
</tr>
</tbody>
</table>

* as of 08/26/2013 (rounded off)

Source: moneycontrol.com

Note: Market cap on a particular day has been used for illustrative purposes.

Figure 8

However, not all banks that came into existence post-1991 have managed to survive and prosper. Global Trust Bank had to be merged with the Oriental Bank of Commerce; Centurion Bank and Bank of Punjab merged with HDFC Bank, largely due to lack of financial strength. Times Bank voluntarily merged with HDFC Bank.

The banks that did well were those promoted by financial institutions. They had adequate experience in the financial services field, financial resources, and a sound business model, and were well equipped in every way to run a bank. Banks that were promoted by individuals with banking experience either collapsed or merged with other banks; for example, Global Trust Bank and Centurion Bank. Development Credit Bank, which was earlier a cooperative bank, and IndusInd Bank, which was promoted by an individual, continue to function.10

### Guidelines for Licensing New Banks in the Private Sector – An Analysis

Guidelines for licensing new banks are formulated by the Reserve Bank of India, based on the experience gained from functioning banks that were issued licenses earlier, and the existing macroeconomic and banking sector scenario (see Figure 9, next page).

### Challenges for New Applicants

#### Top Business Challenges

- **Regulatory requirements** – New banks will have to meet CRR (cash reserve ratio) and SLR (service level requirements) mandates from day one. They will have to raise enough low-cost deposits to park funds with RBI and also invest in government securities.

- **Financial inclusion and priority sector lending** – RBI’s two primary objectives in issuing new licenses could prove costly and difficult for most applicants. Taking banking services to unbanked areas and lending to priority sectors could significantly pressure banks’ balance sheets.

- **Consolidation of existing financial services operations** – Most applicants for the licenses are predominantly lenders, and would need to merge their lending business with that of the newly formed bank. This might impact the balance sheet of the new bank, due to the quality of assets (loans) and RBI’s provisioning requirements for banks. On the other hand, the nature of loans given out may help the new banks meet their PSL requirements.

Similarly, entities running other financial services such as insurance, broking and the like would need to bring such businesses under the NOFHC.
### Guidelines for Licensing of New Banks in the Private Sector – An Analysis

<table>
<thead>
<tr>
<th>Key Features of Guidelines</th>
<th>Eligibility Criteria</th>
<th>Comments/Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eligible promoters</strong></td>
<td>NBFCs and entities in the public and private sectors are eligible to set up a bank through an NOFHC.*</td>
<td>The earlier restriction on large industrial houses has been removed. The financial resources and management expertise that such applicants bring has been recognised. This is relevant in light of the failure of banks promoted by individuals and banking professionals.</td>
</tr>
<tr>
<td><strong>“Fit and proper” criteria</strong></td>
<td>Applicants should have sound credentials and a 10-year track record of running their business successfully.</td>
<td>RBI has given due importance to the credentials and integrity of applicants. The 10-year track record criteria should ensure that only those applicants with a sound business model and those that have demonstrated the ability to run a successful business are given entry into this sector. This too seems to be largely driven by the experience from licenses given earlier, as well as by recent media reports on some banks flouting AML guidelines.</td>
</tr>
<tr>
<td><strong>Corporate structure of the NOFHC</strong></td>
<td>The NOFHC should be wholly owned by applicants.</td>
<td>As a holding company, the NOFHC will hold the bank and any other financial service entities of the bank, e.g., it will be the holding company for activities conducted through a subsidiary/JV – such as insurance, broking and also the holding company - and for activities conducted internally or through subsidiaries/JV such as credit cards. The objective of the holding company is to separate the regulated financial service entities of the promoter groups from its other activities. Through such an arrangement, the RBI would be able to regulate the financial service activities of the holding company on a consolidated basis. The NOFHC is to be registered as an NBFC with the RBI.</td>
</tr>
<tr>
<td><strong>Minimum equity capital</strong></td>
<td>INR 500 crores to be put up by applicants. Bank to list itself within three years from start of operations.</td>
<td>The minimum capital to be brought in by promoters was capped at Rs 500 crores, considering the capital outlay that would be required for setting up a new banking business. It has been raised from Rs 200 crores from the earlier cycle, taking into consideration the changed economic conditions. Additional capital may be approved if the promoters’ business plans make a compelling case.</td>
</tr>
<tr>
<td><strong>Foreign shareholding</strong></td>
<td>Not to exceed 49% for the first five years.</td>
<td>The current FDI policy notwithstanding, non-resident shareholding is to be kept under 49% for the first five years from the date of issuance of the license. This guideline seeks to ensure that the new bank does not become a takeover target in the initial years of its existence – a period when financials may not be very strong and valuations are likely to be cheap. This guideline may also ensure that the new bank remains classified as an “Indian” bank and is regulated accordingly.</td>
</tr>
<tr>
<td><strong>Corporate governance of the NOFHC</strong></td>
<td>At least 50% of directors should be independent directors.</td>
<td>Independent directors bring with them objectivity, and are generally not susceptible to internal pressures. They also bring a different perspective to any issue, compared to the bank’s own directors. They are in a better position to protect shareholders’ interests and also ensure that the entity is being run effectively and ethically. The RBI has mandated that independent directors should have experience/knowledge of one or more of the following subject areas: accounting, finance, banking, insurance, law, MSME, agriculture and rural economy, for example.</td>
</tr>
<tr>
<td><strong>Exposure norms of the NOFHC</strong></td>
<td>NOFHC and the bank will have no exposure to the promoter group. The bank cannot invest in capital instruments of financial entities held by the NOFHC.</td>
<td>This should ensure that the promoter group’s banking business functions separately, and is regulated apart from its other businesses.</td>
</tr>
<tr>
<td><strong>Rural bank branches and priority sector lending</strong></td>
<td>Bank to open at least 25% of its branches in unbanked rural centers, and also comply with PSL targets and sub-targets.</td>
<td>This will ensure that the new banks get serious about the RBI’s agenda of financial inclusion and rural banking. Unlike earlier, when the mandate was to open branches in rural and semi-urban areas, this time around the focus is on rural banking.</td>
</tr>
</tbody>
</table>

*Non-Operative Financial Holding Company (NOFHC)*

Source: Guidelines-rbi.org

Figure 9
**Capital investment** – Following issuance of licenses, the new banks will need to set up an operational branch within 18 months. This will require investments in land, premises, IT and other infrastructure; recruitment and training of personnel; and advertising and publicity, for example. New banks will also need to bear the cost of setting up branches in rural areas without the possibility of immediate returns.

**Human resources** – The new banks will need staff that is trained for work in a banking set-up. Apart from technical skills, staff will need to be proficient in “soft skills” as well, since banking today is also about relationship management. Additionally, banks will need to spend time and funds on training and recruitment.

**IT infrastructure** – Applicants that are given licenses will need to considerably enhance their IT infrastructure. Tasks like core banking implementation and multi-channel banking are likely to pose major challenges for a new bank.

**Regulatory reporting and compliance automation** – The regulatory reporting environment for a bank is very different than that of other financial entities. Apart from setting up a regulatory reporting process, new banks will also have to be ADF (automated data flow) compliant – automating regulatory reports per RBI guidelines.

**A highly competitive marketplace** – Even though new banks are expected to tap unbanked areas, this may not happen immediately. As and when it does happen, new customers may provide volumes but not profitability. New banks will have to look at metropolitan and urban areas to increase their customer base and also maintain operational profitability. Thus, they would be competing with entrenched public and private sector banks, as well as cooperatives and other financial intermediaries.

**Customer loyalty** – Not all customers are dissatisfied with their existing banks, and not all dissatisfied customers are likely to switch banks. New banks need to consider this when they start looking for customers.

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### Specific Challenges and Inherent Advantages

The applicants for new banking licenses can be broadly categorized as follows:

#### Applicant Categories

<table>
<thead>
<tr>
<th>Category</th>
<th>Applicants (e.g.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Undertakings</td>
<td>Department of Posts, TFCI, IFCI</td>
</tr>
<tr>
<td>Corporate</td>
<td>Aditya Birla Nuvo, L&amp;T, Reliance Capital</td>
</tr>
<tr>
<td>Broking Houses/Capital Market Entities</td>
<td>JM Financial, India Infoline, Edelweiss</td>
</tr>
<tr>
<td>Microfinance Institutions</td>
<td>Bandhan, Janalakshmi</td>
</tr>
<tr>
<td>Other NBFCs</td>
<td>Muthoot Finance, Shriram Capital</td>
</tr>
<tr>
<td>Others</td>
<td>INMACS, UAE Exchange</td>
</tr>
</tbody>
</table>

*Source: rbi.org*

By applying for licenses, applicants will be looking to leverage advantages intrinsic to them and to their category. However, they are also likely to be hampered by the challenges facing the sector (category) to which they belong. This is explored in greater detail below:

- **Public sector undertakings:** Government support is the biggest advantage that a PSU has. The Department of Posts has a network of approximately 1.55 lakh post offices across the country, of which around 1.39 lakh offices are in rural areas. In comparison, SBI has around 13,000 branches across the country. Thus, a PSU is better placed than most other applicants to satisfy the RBI’s guidelines on financial inclusion and rural banking. The IT modernization project, undertaken by the Department of Posts, can be enhanced to include the implementation of core banking solutions (CBS) and other IT requirements. Its large workforce, including “feet-on-the-street,” can be an advantage in reaching out to potential customers. However, it can also be a liability, since most of the project’s workforce is untrained in the specific skills required for banking and selling financial products. Also, a bank promoted by the postal department may not find many takers in the urban areas, where usage and dependency on the post has been on the decline. The other PSU applicant, TFCI, has no experience in the financial services domain.
• **Corporate houses:** Corporate houses benefit from prior experience in financial services, availability of capital, experienced and trained manpower, updated IT and other infrastructure assets, and acceptability in urban areas (which is vital in the initial stages of setting up a bank). However, RBI norms on financial inclusion, rural banking and priority sector lending may involve substantial expenditures, which in turn would put pressure on the parent entities’ balance sheet. For a corporate, this may not be an ideal situation, as there are too many stakeholders to answer to. Corporate houses can also suffer from adverse corporate governance issues, including ongoing investigations from regulatory agencies and unflattering media reports.

• **Broking houses/capital market entities:** Most of the advantages - as well as the challenges - that a corporate entity is likely to face are also applicable to broking houses. Such institutions are at an additional disadvantage due to the RBI guideline, which states that “promoter/promoter groups should not potentially put the bank and the banking system at risk on account of group activities such as those which are speculative in nature or subject to high asset price volatility.”

• **Microfinance institutions and other NBFCs:** The business model of MFIs in India makes them ideal vehicles for achieving the RBI’s objective of financial inclusion. Such entities are concentrated in rural areas, and provide loans where banks are unable or unwilling to do so. Their network in unbanked areas and their customer base can help them reach the targets of opening rural branches and financial inclusion. The kind of loans they offer can also go a long way in meeting PSL requirements. On the flip side, such entities can be hampered by low profitability and inferior asset quality (most of their loan portfolio is unsecured). NBFCs such as Muthoot Finance (4,200 outlets, of which 60% are in tier II, II and IV cities) and Shriram Capital can benefit from their rural reach and lending, as well as from a client base that can be tapped for banking services. However, applicants whose other group activities are “subject to high asset price volatility” (e.g., gold loans in the case of Muthoot Finance) may not be encouraged by RBI.

**IT and Related Infrastructure Challenges**

Banking nowadays is associated with terms like “Anywhere Banking,” “24x7 Banking,” “multi-channel banking” and “Internet/mobile banking.” These terms reflect the minimum that customers have come to expect from their banks. In many cases, the availability of such facilities helps a customer decide on the bank they should do business with. Likewise, the automation of banking processes and services has resulted in a prodigious increase in the number of bank branches, customers and products offered. This has caused an increase in the volume of financial and non-financial transactions that are carried out. Such transactions need to be captured, verified, recorded and reported.

For all these activities, a robust and adaptable IT environment is extremely important. The development and maintenance of the IT infrastructure and related components (e.g. ATM services, card management) should be among the top priorities for any new bank. RBI expects new banks to take the lead in bringing technology innovations to banking, and wants new banks to operate on a CBS platform from the beginning. Following are some of the IT and related challenges that new banks will encounter:

**CBS implementation** – As stated above, RBI expects every new bank to run on a CBS platform from the start. New banks need to look at a CBS that is comprehensive, integrated, scalable and configurable, and can provide support for internal and regulatory reporting
functions. A CBS platform should also enable smooth migration from legacy systems, when needed.

**Maintenance and enhancement** – New banks need to look for CBS vendors that have a good track record of implementation, support and maintenance. At the same time, the institution’s SOA (service oriented architecture) should offer the capability to adapt to a changing business environment, with minimal vendor dependency.

**ADF and other implementations** – New banks will also have to be ADF-compliant. These institutions may have an advantage over existing banks in this case, given that they can have their CBS incorporate automated data flow. The other option would be to automate reports using ADF products available on the market. However, this involves another product implementation, and is not an ideal situation for a new bank, which would still have to deal with issues relating to CBS implementation/migration from existing systems.

**ATM network and card management** – In accordance with RBI’s expectation that new banks provide modern IT and infrastructure facilities, these banks will need to set up and maintain an ATM network and card management system. These activities can be “in-house” or diverted to a separate subsidiary. Banks can also look at “white label” ATMs if their existing business models do not permit them to set up their own ATM network. This is challenging, given that ATM networks would be required to cover rural and unbanked areas, where ATM servicing and availability of power and connectivity may be an issue.

**Multi-channel banking** – In the initial stages, new banks may not have a strong branch network or a presence in all geographical locations. To compensate for this, banks would need to offer access to banking services through multiple channels, such as online banking, phone banking and mobile banking.

**Opportunities for Consulting Firms**

New bank licensing promises several opportunities for consulting firms in areas like business process modeling and RBI regulatory reporting.

**Opportunities in Business Process Consulting**

Business Process consulting firms can apply their experience and expertise in industry best practices, and help new banks develop business processes that are well suited to the business model of the bank. For example, a bank that intends to
offer only retail or only corporate banking services can make use of process flows designed specifically for those services. These processes can then be documented for future use and referenced for updating when required.

**Opportunities in Core Banking Product Selection**

With so many core banking solutions on the market, and given banks' unique requirements, selecting a core banking product becomes a critical task for banks and a key standalone opportunity for consulting firms (see Figure 11, previous page). Consultants with expertise in core banking product selection will have to analyze certain aspects while evaluating and suggesting a core banking product:

- Target operating model.
- Size and scope of operations.
- Expected transaction volumes.
- Viability of using an “off-the-shelf” product.
- Customizations required and costs involved.
- Implementation, maintenance and upgrade costs.

The success of this activity can lead to core banking implementation opportunities as well.

**Opportunities in Core Banking Implementation**

Considering that new banks will need to set up a branch within 18 months of getting a license, any core banking implementation will need to “go live” in approximately two years (if one includes the six-month lead time in applying for and obtaining a license). Considering the time frame, the multiple tasks and the interdependence and involvement of various stakeholders in any CBS implementation, there is significant scope for consulting firms acting as Systems Integrators (SIs). Through an SI, the new banks will be able to maintain a single point of contact and communication for multiple vendors and different groups within the bank. An experienced SI also brings the domain and process expertise required to understand the functions of various dependent and independent banking processes.

**Opportunities in Automated Data Flow (ADF): Consulting and Implementation**

**Background:** Banks operating in India are required to submit a set of returns (reports) to RBI at varying frequencies. These reports are used by the regulator to analyze a bank’s financial health and other requirements concerning regulatory compliance. RBI also uses some statistical reports for macroeconomic analysis.

**Four Stages to Achieve ADF**

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<thead>
<tr>
<th>Data Acquisition</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Data captured from source systems</td>
</tr>
<tr>
<td>• Manual Data migrated to some other system</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Data Integration &amp; Storage</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Data extracted and integrated as required in returns</td>
</tr>
<tr>
<td>• Data flows into CDR/Data Warehouse</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Data Conversion &amp; Validation</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Data converted into RBI prescribed format</td>
</tr>
<tr>
<td>• Data validation, variance analysis, reconciliation, etc.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Data Submission</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Secure file uploaded in STP mode</td>
</tr>
<tr>
<td>• Returns submitted automatically at pre-defined frequencies</td>
</tr>
</tbody>
</table>

Figure 12
The quality of the data being reported is therefore very important.

The Reserve Bank of India had observed that since most reports were being prepared manually by the banks – opening the potential for data manipulation and incorrect reporting. RBI therefore initiated its Automated Data Flow program to ensure the submission of clean data from banks’ systems to RBI, with no manual intervention.

Common end state: The Reserve Bank of India expects banks to use their CBS system capabilities for automated data flow. However, since different banks are at different stages of maturity regarding their IT systems and processes, this may not be possible for all existing banks. As a result, RBI has not defined any particular approach that banks need to follow for ADF implementation. However, it has defined the common end state, which is complete automation of report submission without any manual intervention. According to RBI, this can be achieved in four stages (see Figure 12, previous page).

For IT and consulting firms, standalone ADF consulting and implementation offers significant opportunities. A solution providing end-to-end ADF implementation can be promoted not only to the new banks, but also to existing banks that are yet to implement ADF.

Conclusion

The beneficiaries of this latest round of issuing new banking licenses are likely to be declared by March 2014. However, the stringent guidelines issued by RBI, including fulfillment of the “Fit and Proper” criteria, mean that eligible applicants will also find it difficult to obtain licenses. According to media reports, six to eight banking licenses are likely to be issued during this time period. Whatever the final number, new entrants will most likely find it an uphill task to set up and run a bank, considering the challenges they are likely to face, the market and regulatory environment in which they are expected to operate and the existing level of competition. However, these issues could also translate into opportunities for consulting firms and other service providers.

Consulting firms with experience and expertise in core banking implementation are likely to benefit the most. Firms acting as systems integrators can offer their domain and process expertise, which would be a value proposition for new banks. Not only would a qualified SI be able to define and target the required business processes at the beginning of an engagement; it would also be in compliance with the RBI guidelines for implementing core banking solutions from day one. These consulting firms can also offer ADF consulting and implementation services to these new banks – adding even more value.

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Footnotes
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About the Authors

Nikhil Mehta is a Senior Consultant with Cognizant Business Consulting, based in Pune. He has more than 10 years of experience in the banking and wealth management domain across retail and private banking. Nikhil has worked on core banking and wealth management products, and has expertise in Indian regulatory reporting, business requirements gathering and business process management. He can be reached at Nikhil.Mehta@cognizant.com.

Ajit Varshney is a Manager within Cognizant Business Consulting, based in Chennai. He has over 16 years of industry experience and over 12 years of experience in business consulting and banking product transformation programs in the Asia-Pacific region, Europe and North America. His expertise includes business process management, business requirement management, core banking product fitment and GAP analysis. Ajit holds a bachelor’s degree from BITS Pilani and is a management graduate from NITIE, Mumbai. He can be reached at Ajit.Varshney@cognizant.com

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