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Foreign Banks operating in India with specific business practices models and their Scenario Post RBI Road Map 2005

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Abstract: -During the last two decades, India has seen an unprecedented degree of globalization especially in financial services. At present the cross border financial flows have increased dramatically. Many foreign banks from both developed and developing countries have ventured abroad and established their presence in other countries with specific business practices models. Foreign trade, financial system, technological advances, deregulation impact, industry and its major players' growth were identified as industry shaping milestones that gradually formed the present business practices models of foreign banks. As of March 2013, there are 43 foreign banks from 26 countries operating as branches and 43 foreign banks from 22 countries operating as representative offices in India. In addition, a number of foreign banks have also entered India via the Non-Banking Financial Company (NBFC) route, while a considerable number have set up captive centers in the country. Foreign banks present in India as representative offices often have correspondent banking relationships with domestic banks and provide a useful platform for foreign banks to access opportunities for foreign currency lending to Indian corporate and financial institutions with the application of specific business practices models. Foreign banks have less than 1% of the total branch network but about 7% of the total financial sector assets and a sizeable 11% of profits. With 334 branches in all, the share of FFIs branches is less than 1%.
Keywords: Foreign Banks, RBI Road MAP 2005, Business Practices Models, Finance.

I. INTRODUCTION

A. Most Profitable Market

After 2008-09 world over, Indian financial market became a place of profit making opportunities in spite of loss of some profits on account of prevailing Indian income tax system , tax rates and tax slabs. Indian financial market resulted in more surplus creation place compared to other countries and this resulted in providing more growth opportunities to foreign banks. After the financial meltdown, India emerged as the hottest destination for foreign banks. In 2006, the difference in marginal returns offered by Indian financial market and US market was 0.3% whereas this figure rose to 11.4% in 2009. Indian financial market was less volatile with a characteristic of stable growth. This peculiarity of Indian financial market was equally supported by RBI's proven regulatory guidelines and framework. These factors have increased its attractiveness. For Hong Kong and Shanghai Banking Corporation (HSBC), financial year 2010 in India was record making year from the point of view of profits. Standard Chartered Bank (SCB) also earned huge profits in Indian market during above year. Gross profits of lenders in Indian financial market was nearly $ 1 billion in 2009.Today foreign banks have become important in domestic financial intermediation and foreign trade. Given the importance of foreign banks in our country India, studying business practices models of foreign banks, especially with respect to domestic and foreign trade (FT) and lending financial stability has become essential.

B. History

Foreign banks are operating in India since last 150 years and well known to Indian financial system. In the year 1858 Standard Chartered Bank (SCB) started its working and Citi Bank in 1902 in India. Hong Kong and Shanghai Bank (HSBC) started operating in India from 1953 for providing financial services to Indian customers. 1980's policies related to Indian financial system provided more and more growth opportunities to foreign banks operating in India. The recent guidelines and initiations of the Reserve Bank of India (RBI) for foreign banks have encouraged in opening their operations. The role of foreign banks is extremely important in Indian financial system and it helps to increase the operational efficiency of the local financial system by introducing sophisticated

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financial services with specific business practices models. Within the past decade, the financial system, in India, undertook a substantial transformation from the initial heavily regulated RBI environment where competition was nearly non-existent, to an open and competition-driven financing. It would be an interesting study to understand as to why the Reserve Bank of India and the government of India were slow and cautious in issuing licenses to the foreign banks to operate in India and what economic benefits the country derived from the presence of foreign banks.

Primary objectives of the establishment of foreign banks in India with specific business practices models. were as follows:-

2.1 Developing economic relations with the home country of foreign banks.

2.2 To provide them an opportunity in domestic and foreign trade considering the size of home country and its economy.

For maximization of profits, with the least risk element, foreign banks operating in India utilized prevailing less restrictive regulatory practices and high interest rate as compared with what was prevailing in their home country.

During the year2003-04 to 2012-13 (ten years observation period) the number of foreign bank operating in India along with business, advances, investment year wise are as under:-(Figures for Business, Advances, Investment and Foreign Trade are in INR million)

Table 2.1 indicates that during the period 2003-04 to 2012-13, with increase in business, advances and investment of foreign banks, there is an increase in foreign trade of India.

Table 2.1 Year wise Performance of foreign banks. (FBs)

Year	No. of FFIs	Business	Advances	Investment	Foreign Trade
2003-04	29	126490	713120	406850	6524750
2004-05	29	128530	852010	422450	8764050
2005-06	29	166630	936520	504140	11168270
2006-07	32	249680	1263390	714710	14122850
2007-08	32	350370	1619590	990920	16681760
2008-09	32	452110	1654150	1303530	22151910
2009-10	40	363430	1632600	1592910	22092700
2010-11	40	395160	1955110	1654990	28263890
2011-12	40	468930	2298490	2004880	38114220
2012-13	43	534600	2636800	2280630	43034810

Source:https://www.rbi.org.in/Scripts/Publications.aspx?publication=Annual

C. Rbi, Government Of India (Goi) And Foreign Banks

Reserve Bank of India and the Government of India (GOI) were initially very cautious in allowing foreign banks an unrestrictive access to their set up in India as the Indian financial institutions were in infant stage of their growth and the unmatched competition was sure to destroy the domestic institutions. Besides, it was observed that the foreign banks were interested in niche market by providing services to the high end customers, foreigners and non-residents and corporate sector. Foreign banks had disproportionate high share in credits and deposits when compared with the domestic institutions. Foreign banks also came under a lot of criticism as they were given concessions in lending of priority sector. Besides, net profit percentage to the working funds of foreign banks in India was much higher when compared to the domestic institutions and it appeared as unhealthy competition. With the

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establishment of foreign banks with specific business practices models, the host nations are primarily driven by twin objective of having greater access to the international financial market and introduction of latest financial technology to increase efficiency and productivity i.e. debit and credit cards, ATM's, swaps, internet and phone banking. Invariably these techniques are followed by the domestic institutions also while leading, to increase in efficiency and productivity. In India foreign banks started many new products which provided growth to the industry, banking and infrastructure i.e. mortgage of houses and cars, reverse mortgage, leasing and consultancy. Foreign banks with specific business practices models, played an important role in boosting economy of India by providing flow of foreign exchange to the individuals, corporate sector and conglomerate. Foreign banks in India enjoy considerable freedom in their operations which goes beyond the commitment given to World Trade Organization (WTO). India's approach towards liberalization had been appreciated by the International Monetary Fund (IMF) and the World Bank (WB) and the emerging market economies advised to follow it as prototype. Under WTO norms, the Reserve Bank of India had committed to provide twelve new branch licenses every year but actually RBI provides more than twelve licenses as the foreign banks were keen on branch expansion programs with specific business practices models. Foreign banks are interested in parking their financial resources in an environment which is stable, profitable and minimal risk. In India there was a strong argument in favor of foreign banks to fulfil the objectives such as financial inclusion, development of small scale industries, and encouragement to the agricultural sector, increased foreign exchange inflow and integration with international financial market. Foreign banks gained an ability to develop both in size and scope of operations through the implementation of partially deregulations after the year 2005 which is generally recognized as being one of the first steps towards the present day partially deregulated environment. In turn, traditional finance business shifted towards lesser or totally non-traditional activities by leveraging their core competitive advantages: well-developed distribution networks, and experience in risk assessment gained through servicing retail and corporate customers involving active participation in India's foreign trade.

D. RBI's Road Map for Foreign Banks

Before 2005, that is partially the deregulation wave pushed by RBI, foreign banks operating in India were highly dependent on the specific region they were operating in and clients as approved by RBI. Only high local demand for domestic and foreign trade financial services could fuel the limited growth of local financial institutions. Adding to that, strict RBI regulations largely prevented profiting through economies of scale. Only when, after 2005 RBI's Road Map for foreign banks, which allowed fair competition and geographical expansion, were implemented, to some extent, foreign banks became aware of new strategic possibilities. Now, foreign banks were free to enter new markets either by acquiring existing competitor bank franchises or by opening one of their own set up Wholly-Owned Subsidiary (WOS) model proposed by RBI. Furthermore, foreign banks holding companies were finally able to create a system of branch offices by consolidating previously independent affiliates. Waves of acquisitions and takeovers followed radically, which changed the structure of foreign banks. Newly grown foreign banks learned to exploit their size and, as a result, decrease marginal costs, having the ability to reduce service prices offered them a substantial competitive advantage with specific business practices models. Additionally, to expansion in scale, foreign banks holding companies heavily invested in non-traditional financial services. Insurance and merchant financing company and acquisitions were another logical step towards expanding the scope of foreign banks' business. Foreign banks holding institutions combined experience and knowledge gained in manufacturing, domestic trade financing and foreign trade financing and by using it quickly adapted to insurance and merchant financing businesses. For foreign banks risk assessments became more accurate and available for affiliates, decreasing service costs in newly acquired lines of financing business with specific business practices models.

E. Effects of Competition

Following competition encouraged by RBI's partially deregulation, growth in scale and scope a new accelerant joined the mixture. Technological advancement was met with growing application throughout the financing system. The foreign banks were no exception. By achieving economies of scale, which is necessary in order to apply technology efficiently, foreign banks were able to swiftly adapt and adopt new technology with specific business practices models. Technological solutions such as computers, internet, credit cards, and digital information storage radically changed many core processes in Indian financial system. Information accessibility increased rapidly, which, if combined with automated and optimized information processing, offered faster and more precise decision–making. These decreases in costs, information processing and customer servicing time summed up in substantial growth of profits. The Online service, electronic payments, credit cards, and online brokerage are just a few of among hundreds of products and their versions that became available with advancements in technology used. Most importantly, the very core of

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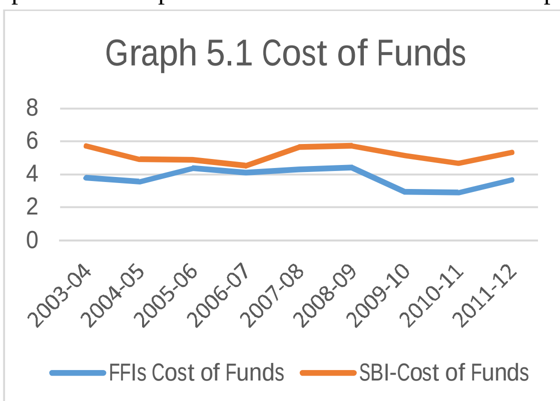
traditional financing – intermediation - undertook a major update with this technological wave. By representing a link between parties with excess of liquidity (depositors) and those that are in need of liquidity (borrowers), foreign banks earn a major share of their earnings. With newly-widened horizons of expansion and innovation, foreign banks in India quickly recognized that only the front runners will be running the future financial markets and profiting from them; meanwhile, institutions that lagged behind will fail or be consumed by competition. Fueled by obsessive optimization and innovation, and barely restricted by optimistic regulators world over, foreign banks entered the modern financing system having core features as rapid and aggressive financing tendencies. An increase in interconnectedness and integration among foreign banks and other domestic local financial institutions became evident. Foreign banks operating in India with specific business practices models, provide liquidity, transform maturities, manages risk and develops financial innovations. In India, while RBI's partially deregulation and technological advances inflicted foreign banks expansion, the competition was its main driving force. A tendency for excess leverage and under-capitalization became noticeable among many foreign banks as a means for increased competitiveness. Foreign banks are developing their Indian business along with increasing their client base and implementing potential opportunities for massive entry into the market. Most of the foreign banks have the greatest experience in working with private depositors, and also lending actively to the real and various business sectors .Foreign banks desire to enter the Indian banking market with specific business practices models, is understandable. The general consensus is that the benefits of foreign banks greatly outweigh costs in many dimensions. It is presumed in general that foreign banks add to domestic competition with more easy availability of services which are related to financial operations, more help to customers to improve their business performance and help in stabilizing financial system with specific business practices models. Generally, lower costs of financial intermediation (measured by margins, spreads, overheads) and profitability are documented with greater foreign banks' presence. Graph 5.1 indicates cost of Funds- Comparison with State Bank of India (SBI)



Graph 5.1 points out that the cost of funds of foreign banks is lower than SBI's Cost of Funds during the observation period. Hence these banks can finance at a very competitive interest rate. SBI's base rate is 9.3% and it is the prime major bank in India.

F. Foreign banks' Presence

Participation foreign banks has increased steadily across various developing sectors in India since the mid-1990s. It is essential to study this trend to find out the leading factors and effects of this phenomenon of foreign banks' participation. Possibility of creation of surplus in local financial market, presence of positive environment for entering in local business, availability of effective system for the solution of issues related business information have been the principal leading factors for pushing foreign banks' entry across various business sectors in India. It is observed that foreign banks' presence does not endanger but rather enhances financial sector stability. Along with the basic target of profitability, foreign banks' presence in India has helped the host and home country to increase Foreign Trade volume by availing the necessary financial services. It is highly significant to relate foreign banks' presence in India with application of specific models and steady rise in India's Foreign Trade during last decade. Over the last 20 years, economic and political power has been shifting towards emerging economies. A number of developing countries have become centers of strong growth, raising their shares of global income significantly, which has made them major players in regional and global affairs. Furthermore, flows of trade, aid and investment between emerging and developing countries have all intensified. India is no exception to the aforesaid phenomenon with increasing presence of foreign banks with specific business practices models in various financial sectors.

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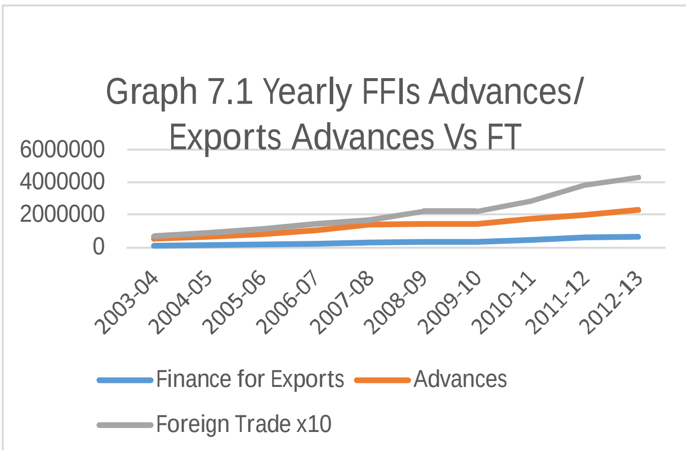
G. FBs and Foreign Trade (FT)

Foreign Trade (FT) in the modern economy is a complex system of value creation and transformation, wherein Foreign Trade policies of various countries, Foreign Trade players and foreign banks play significant role. The financial markets of various countries and foreign banks project it to new heights of efficiency and funding accessibility for further value creation. Foreign Trade is to benefit from foreign banks financial system implications, however, at the same time; it became dependent on it on account of foreign banks' market oriented credit policies. Over the past decade, foreign banks have become much more important in domestic financial intermediation, heightening the need to understand their models. Foreign banks have helped in bettering the technology used in the financing sector. The first Automated Teller Machine (ATM) in India was brought up by Hong Kong and Shanghai Banking Corporation Ltd (HSBC) and from then on foreign banks have contributed to the latest financing practices. Foreign banks have become more & more efficient today and their Return on Assets has clearly shown a positive trend bringing into forefront the improvements brought across by the operational improvements through better practices (Gaurav Shard and Namratha Swamy 2014). Graph 7.1indicates that with an increase in advances given by foreign banks there is an increase in foreign trade (FT). There is a liner relationship between the independent variable-advances and the dependent variable- foreign trade.



H. Criticism against FFIs

At present, in India, the current foreign banks are criticized in general of being too volatile, too interdependent, inflexible and operating under highly competitive models. It is observed that foreign banks operating in various developing countries are focused on a section of credit worthy customers and are involved in taking out cream of credit market. While carrying out financing operations these institutions in general neglect small or marginal customers (Mandira Sarma and Anjali Prashad 2014). It has become hard to forecast, monitor or even follow how foreign banks conduct their business. In the light of India's Foreign Trade and domestic trade these issues and many others, though complex, can be addressed through a proper approach. Knowing under what models foreign banks operate for financing India's Foreign Trade or domestic trade and how models change in perspective to time or a foreign banks' operative approach can provide valuable insight into the whole financial system. Foreign banks are to develop commercially viable relationships with a target set of externally business oriented companies in India and their host countries by offering them comprehensive range of products and services, aimed at enhancing their internationalization efforts with the application of specific models.

I. Foreign banks' Principal Focus

While financing trade, with specific business practices models, foreign banks' principal focus is on promoting bilateral trade by offering finance at various stages of trade cycle like product development, production, and marketing, import-export credit at pre-shipment and post-shipment stages, investment abroad and import of technology. Foreign banks operate a wide range of lending programs. Financial packages offered by the foreign banks are competitive and multi-currency. During the financial year 2003-04 to 2012-13 most of the foreign banks have met target for lending to export sector set by RBI under priority sector lending (12 per cent of Adjusted Net Bank Credit (ANBC) or Credit Equivalent Amount Off-Balance Sheet Exposure (CEOBSE). Over the time foreign banks have operated in India, they have built a good team and created business processes adjusted to India's practices. While developing their niche market, slowly but steadily foreign banks are increasing their presence in India. Foreign banks are, in general

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focusing on companies holding foreign capital with registration under Indian Companies Act-1956 as well as pure Indian companies which are engaged with bilateral trade with home and host country. Foreign banks in India continue efforts to attract new clients, especially among

to a large extent subsided as over the years the Indian institutions have gained in experience, became financially strong and stable and introduced innovative techniques to remain in competition with the foreign banks. This experience had been mutually beneficial to both the foreign and Indian financial institutions resulting in assimilation and diffusion of sound financial practices making Indian financial foreign companies newly registered in India. The host and home country currency-denominated operations could become an important area for foreign banks in India in the near future. The first step on the way to expanding the use of the national currency as an international payment medium has already been made, many foreign banks are now allowed to work with home country currency and make payments from India in favor of companies from the home country. With the application of user friendly models foreign banks with specific business practices models, are highly competitive so far as quality of customer service and quick decision making are considered. Thus, it is significant to study the role of foreign banks in India's foreign trade and their application of models leading to their survival in India with grace.

II. CONCLUSION

Foreign banks are developing their Indian business along with increasing their client base with specific business practices models and implementing potential opportunities for massive entry into the market. Most of the foreign banks have the greatest experience in working with private depositors, and also lending actively to the real and various business sectors .foreign banks desire to enter the Indian market is understandable. Bilateral trade with various countries has been growing rapidly as economies are recovering from the global financial crisis. It is highly significant to relate foreign banks' presence in India with application of specific business practices models and steady rise in India's domestic and foreign trade during the last decade. In conclusion it can be said that the initial suspicion, opposition and restrictive approach towards foreign banks has system healthy, transparent, and financially viable and integrated with the international financial system

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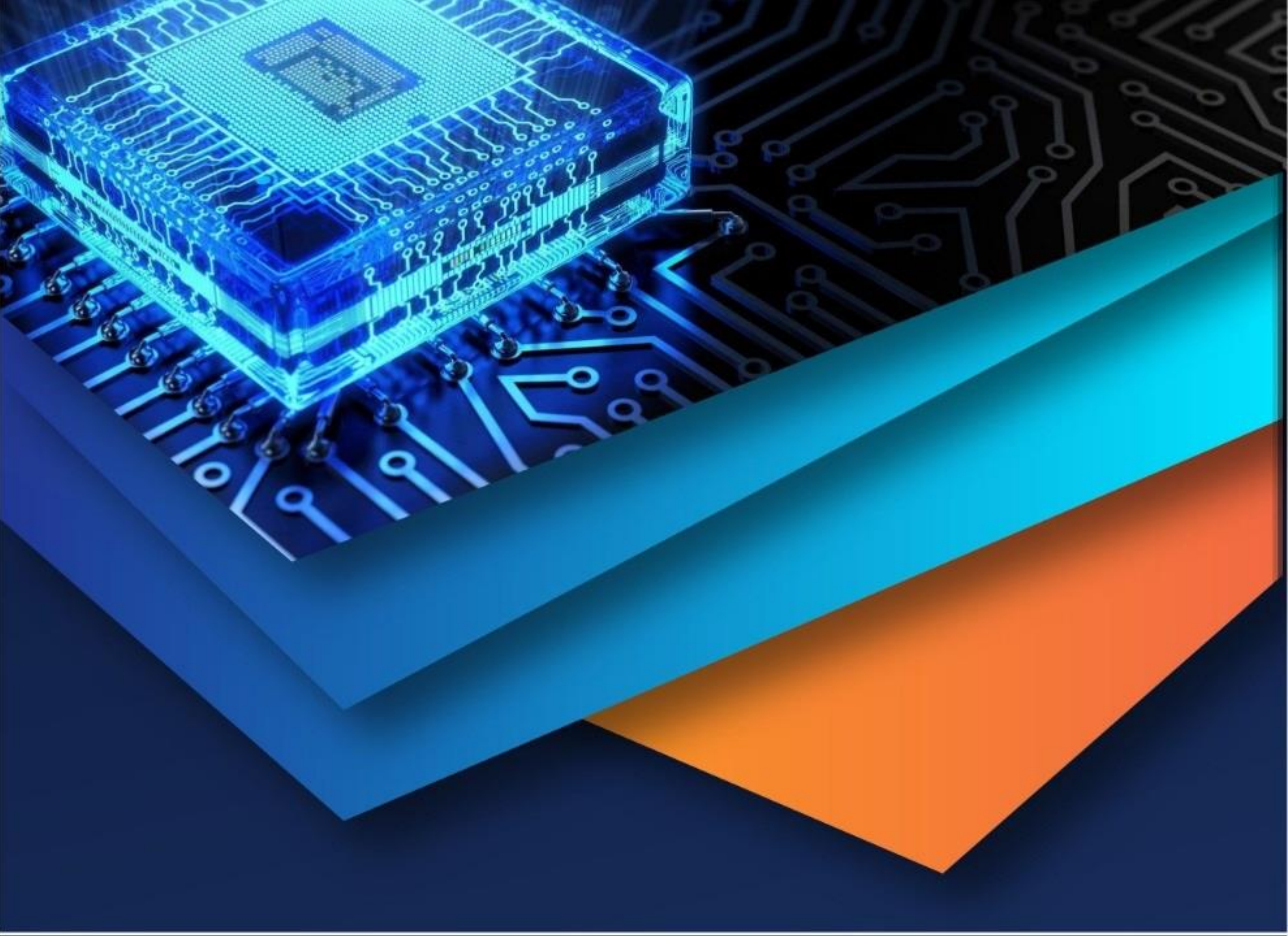

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