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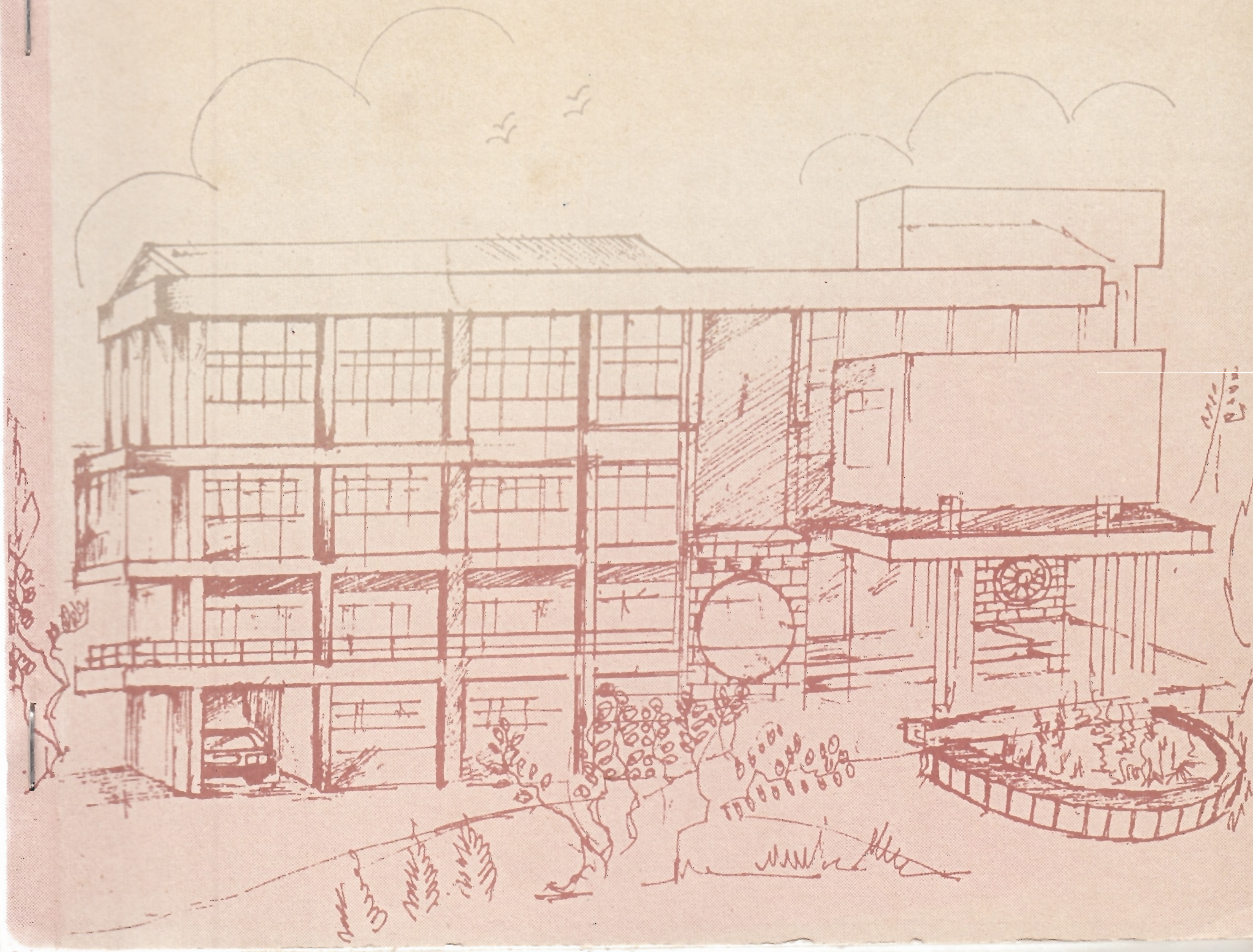
Sustainbility Of Foreign Banks In India - A Statistical Analysis



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Sustainbility Of Foreign Banks In India - A Statistical Analysis

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SUSTAINBILITY OF FOREIGN BANKS IN INDIA – A STATISTICAL ANALYSIS

Abstract

It is interesting that foreign banks have been operating in India for over a century and a half (since 1842). But, greater awareness about them has come only after economic reforms in India (1991). They were allowed to operate only through branches till 2000-01 subject to reciprocity and other considerations. Foreign banks had only 5% of total deposits and 7% of total loans as market share in India. Larger foreign banks like Citibank, HSBC, Standard Chartered Bank, ABN AMRO Bank, etc., are increasingly expected to garner greater market share.

With a view to reducing disparity between domestic and foreign banks as regards priority sector lending obligations, their minimum lending was fixed at 32% (as against 40% for domestic banks) of their total advances. Customers dealing with foreign banks derive higher satisfaction for sophisticated services rendered and products offered. Being global players, foreign banks may not have any obligation to extend finance to priority sector like Agriculture and SSI segment because they are not present in rural and semi-urban centres. After over a decade since formation of ***World Trade Organisation*** *(in January, 1995) and* ***Financial Services Agreement*** *of 1997, Indian banks are able to overcome competition from foreign banks by improving their products and services, professionalism, ambience of offices, technology usage, change in employee attitude, etc., after downsizing their staff strength and unviable branches. In the Union Budget 2003-04, Government of India permitted foreign banks to either operate as branches of their overseas parent bank or corporatise as domestic companies.*

*In February 2005, Reserve Bank of India announced a "****Road Map for Presence of Foreign Banks****" to be implemented in two Phases – I between 2005 and 2009 and II from April 2009. But it was observed that number of foreign banks in India increased from 21 in 1988 to a peak of 44 in 1998 and is on the decline to 31 by March 2005. This made the authors to work on foreign banks to study their functioning in India by using '****Closed Model****' for those foreign banks which existed and data is available throughout the study period and an '****Open Model****' of studying all such foreign banks that operated but data is missing in some cases during the period of study. The period of study is for five years (1997-1999 and 2000-2003), and the authors made an effort to analyze each of the foreign banks and its development on various parameters under CRAMEL (Capital Adequacy, Resources Deployed, Asset Quality, Management, Earnings Quality and Liquidity) model of ranking the banks.*

INTRODUCTION

Indian banking system is transforming very fast in recent years in tune with changes taking place world over. Legal, technical, organisational and market changes are occurring in India that is facilitating to evolvution of a highly competitive banking field. Liberalisation, Privatisation and Globalisation principles adopted by Government of India in the early nineties with Financial Sector Reforms are having direct bearing on all the types of banks in India since the year 1993. Indian banking industry comprises of a good blend of 27 Public Sector Banks (including 8 of State Bank Group), 30 Private Banks (21 Old and 9 New), 31 Foreign banks, a large number of Cooperative banks, 196 Regional Rural Banks and 4 Local Area Banks (LABs). There are also other players like (a) Development Finance Institutions (DFIs), (b) Non-Banking Financial Companies (NBFCs) and (c) Post Office / Small Savings Schemes in the four-pillared Financial System.

Commercial Banking in India has undergone dramatic changes in the last three decades. Some experts divide the working of the banks into three phases – viz., (1) pre-Nationalisation period up to July 1969 (2) post-Nationalisation and up to Financial Sector Reforms in June 1991 and (3) post Reforms era. Opening of new Private Sector Banks and inviting more Foreign Banks (FBs) did impact the working of the entire banking industry. Several remedial steps like deregulation of interest rates were taken to bring back profitability and productivity in the system. Balance Sheets of Banks are more transparent now. Introduction of new products and services including Credit Cards, ATMs, Electronic Clearing System, Electronic Funds Transfers, Bancassurance, Mutual Funds, Dematerialisation, Retail Banking, Venture Capital Funding, Securitisation, Asset Reconstruction Companies, Portfolio Management Services, Private Banking, Internet Banking, etc., by FBs is adopted simultaneously by Public and Private Sector Banks too in a highly competitive environment.

While there was a conscious RBI policy of branch expansion for Public and Private Sector banks, FBs enlarged their operations in a moderate way up to mid nineties. FBs in India have their origin from countries like USA, UK, France, Belgium, Germany, Netherland, Scotland, UAE, Bangladesh, Ceylon, Japan, Malaysia, Indonesia, Singapore, Hong Kong, Bahrain, Muscat, Oman, Mauritius, etc. World Trade Organisation (WTO) came into existence on January 01, 1995. WTO regime opened up business opportunities among member countries moving towards competition. With certain relaxations to the member countries, after the Financial Services Agreement in 1997, the share of FBs in All Scheduled Commercial Banks (ASCBs) in India has increased substantially under all the parameters.

The year 2005 is witnessing celebration of bi-centenary year (200 years) by SBI with its long history while two other Public Sector Banks viz., Corporation Bank and Canara Bank have declared one hundred years of their service. Others like Punjab National Bank, Allahabad Bank, Central Bank, etc in public sector as well as Federal Bank, Vysya Bank and others in private sector have also been in existence for long years. More and equally interesting is the functioning of FBs in India for over one hundred sixty years (since the year 1842) conforming to rigid business standards and complying with various regulations. In February 2005, RBI announced a '*Roadmap for presence of Foreign Banks in India and Guidelines on Ownership and Governance in Private Banks*'. FBs can now enter India via a branch or set up a wholly owned subsidiary (WOS). The minimum start-up capital requirement for a WOS would be Rs. 3 billion (US$ 68 million). The WOS would also be required to maintain a Capital Adequacy Ratio of 10 per cent or as may be prescribed from time to time on a continuous basis, from the commencement of its operations. FBs applying to RBI for license of WOS must satisfy the RBI that they are subject to adequate prudential supervision in their home country. Other factors that will be taken into account while considering such application include economic and political relations between India and country of the FB as well as its ownership pattern. Looking at the above developments and the moderate market shares in deposits and advances the FBs had in India as well as their varying numbers due to entry and exit in the last decade (post WTO era), a question arises about their sustainability in changed Indian banking scenario.

OBJECTIVES OF STUDY

During late sixties and the next two decades, banking system in India underwent stressful and testing times. In fact sustainability of some of the PSBs was at stake in mid-nineties. It was only during the post reforms era that with several changes and with the competition emerging in the banking scene. In the mean time, Public and Private Sector Banks faced stringent treatment through reforms to stand on their own amidst favourable circumstances for FBs. In the process, almost all categories of banks were overhauled due to the reforms undertaken by GOI and RBI. The recent guidelines in February 2005 to FBs from RBI gave rise to this study because even after Financial Services Agreement with WTO in 1997 for increasing their presence in India, FBs have been freely moving in and out of the Indian banking scene. There have been defaults in their compliance to Capital Adequacy requirement, priority sector lending, branch expansion, etc. In contrast, barring a few, domestic banks (in public and private sector) have been proving themselves successful and accepting challenges in the new environment.

The authors have taken up the study to find out the ‘Sustainability of Foreign Banks in India’, in view of long history of some of them in the Indian scene – before and after Independence, and some others before and after the economic reforms / WTO era. The total number of FBs had risen to 43 by the year 1997-1998 but came down to 31 by 2005. Accordingly, the paper attempts to examine the following aspects in which FBs in India were functioning during the five years period viz., 1997-98 to 2002-03 (except 1999-2000) and the aspects as under:-

1. To study the sustainability of FBs that are existing in India throughout the study period
2. To study and identify the FBs which are vulnerable and the reasons therefor
3. To study the working of FBs that entered during the study period and
4. To forecast the levels of various parameters the FBs for the year 2005-06.

LITERATURE SURVEY

Multilateral Banking originated in India in the second quarter of the Nineteenth century. In the year 1842, the Oriental Banking Corporation established the first Anglo-Indian Commercial Bank at Bombay through a Royal Charter. Within three years of its establishment, its Head Office was shifted to London in 1845 to provide a real multinational character. After some time, two other banks appeared on the Indian scene. They were (1) The Chartered Bank of India, Australia & China, and (2) The Chartered Bank of Asia, later known as Mercantile Bank of India, England & China, which were registered under Royal Charters in England. These banks commenced business in Calcutta in the year 1857. By 1870, only three Multinational Banks operated in India with their deposits of Rs.52.31 lakhs. The number of banks increased to 8 towards the close of the Nineteenth Century.

Then, FBs of real multinational character appeared on Indian scene in the first quarter of Twentieth Century. Four banks namely (1) The Mercantile Bank Ltd., (2) Grindlays Bank Ltd., (3) The Chartered Bank and (4) The Hong Kong and Shanghai Banking Corporation were established in 1914. The Mercantile Bank Ltd., and the Hong Kong and Shanghai Banking Corporation were registered in Hong Kong whereas Grindlays Bank Ltd., and the Chartered Bank were registered in London. Two more banks, namely the American Express International Banking Corporation and the Algemene Bank of Nederlands N.V. were established in 1920. The former was registered in United States of America and the latter in Netherlands.

The rate of increase of such multinational banks was quite stable. About 3 to 4 banks were added in each decade up to the beginning of the Second World War. The number of such banks rose to 19 in 1939 with an average deposit of Rs. 390 lakhs per bank which was much lower than the corresponding deposit of Rs. 500 lakhs in 1920. In 1961, though the number remained the same, the average deposits made further improvement to Rs. 1,362 lakhs. The years 1936, 1948, 1952, 1953, 1954, 1956, 1964 and 1966 made the addition of one bank each. Five more banks were established between 1979 and 1981. In 1979, a German Bank known as European Asian Bank was established at Bombay. In

1980, Bank of Oman Ltd., of United Emirates with Head Office at Dubai was established at Bombay. Similarly, another Gulf Bank from Abu Dhabi known as Emirates Commercial Bank Ltd., was allowed to function in 1981. The Government allowed a Srilankan Bank known as Bank of Ceylon and a French Bank known as Banque De L'Indochine Et De Suez (Indosuez), but both could not start their operations till 1981. (Dr R D Sharma)

There are 31 Foreign Banks (FBs) operating through 220 branches/offices in India as on March 31, 2005. The larger FBs enjoy strong franchises, both in corporate as well as in retail savings products, and among High Net-worth Individuals (HNIs). They have an increasing market share in retail lending like auto loans, credit cards and personal loans. Growing acceptance of FBs is partly as a result of the high 'aspirational value' attached by consumers to banking and associating with a foreign brand. Robust systems, well-defined processes of their global network and an attractive market have enabled these banks to move from a 'dipping the toe' strategy to establishing and cementing their foothold in the Indian market.

Whereas the state and private banks are locally incorporated, it is important to note that most of the FBs operate as branches of the parent bank which, due to regulatory consideration, puts a constraint on the number of branches they can open. Although the central bank is meeting and exceeding its WTO commitments with regard to allowing the branches of Foreign Banks to be set up, they would need to wait for some time before they have flexibility on their distribution network. This presents an interesting conundrum for the FBs that recognize the need to establish a distribution network but is limited due to their current structure and by the Government's ceiling on foreign ownership of private banks.

An alternative that FBs are increasingly pursuing is the creation of NBFCs. Although there are various restrictions on resource mobilization and certain restrictions on foreclosure rights otherwise available to banks, NBFCs are subject to relatively less stringent regulatory requirements than banking subsidiaries. For example, NBFCs are not required to comply with certain prudential measures such as Cash Reserve Ratio

(CRR) or provide, at RBI's behest, priority sector lending (NBFCs are, however, subject to higher Capital Adequacy Ratio requirements than banks). Although many internationally active banks have an 'India strategy', in order to succeed, it is imperative that FBs understand the culture within each state they wish to operate in. This alone is a significant challenge that should not be underestimated. (PwC).

The compounded growth rate of operational productivity of FBs in terms of the interest income / working funds in the pre-liberalisation period was 5.08 per cent. It declined in the post liberalization period to – 2.27 per cent. As far as the growth rate of the non-interest income / working funds was concerned, in the pre liberalization period, it was – 1.83 per cent. In the post liberalization period, though it was still negative i.e., – 0.18 but as compared to the pre liberalization period, it has improved. The compounded growth rate of operational expenses/ operational income was negative before liberalization ie., -1.04 per cent but in the post liberalization period, it was positive i.e., 0.89 per cent. The compounded growth rate in terms of cost of deposits improved in the post-liberalisation period. It decreased from 1.29 per cent before to 0.78 per cent after liberalization. The decline in the growth rate of spread / working funds could also be noticed in the post liberalization period as compared to pre-liberalisation period. The performance of FBs was better before liberalization, but surprisingly during post liberalization, deteriorated in terms of the interest income / working funds, operational expenses/ operational income, spread / working funds. They were concentrating on the non-fund based activities but they should also try to concentrate on their fund based activities and should improve their spread. (Dr Monika Aggrawal)

In line with the economic liberalization policy, the regulator is gradually relaxing the norms for these foreign banks. Since banking is a sensitive area, sudden opening up of the sector is also not desirable. Hence to prepare the banking sector for future, regulator has charted a road map for FBs on their entry strategy. The RBI roadmap has been divided in two phases. During the first phase, between March 2005 and March 2009, FBs can establish their presence by way of setting up a wholly owned subsidiary (WOS) or conversion of existing branches into a WOS. The second phase commences from April

2009 after a review of the experience gained and after due consultation with all the stakeholders in the banking sector.

In response to a recent survey conducted by FICCI, New Delhi it was expressed that FBs should be allowed to enhance their stake in private sector banks in line with FDI norms. Some of the respondents enlightened the related norms prevalent in other countries. In other Asian countries like China, Taiwan, etc., ceilings for foreign ownership are less stringent. In U.S.A., mergers and acquisitions within banks are freely permitted subject to applicable anti-trust laws. Also, in countries like UK, USA, France, Germany, and Italy there is no automatic limitation of shareholdings for FBs. An approval or prior notification from the respective Central Bank is required if the proposed holdings in the share capital arises or increases beyond certain threshold limits. In India, initially FBs can hope to acquire about 15% in a private sector bank and a prior approval of RBI is required to acquire only larger stake. (FICCI)

Efficiency and productivity of PSBs relative to private sector banks, both domestic and foreign was compared. This comparison is attempted over a nine year period (1992-2000), out of which eight years belong to what might be called the post-deregulation period, if we can use the generally accepted year of 1992-93 as the cut off date for the big push in bank deregulation. The findings of the study thus reinforce those of Ram Mohan (2002) and Ram Mohan (2003) that failed to uncover any significant differences between PSBs and other categories of banks using financial measures of performance or returns to stocks. One explanation could be that there has been a change in orientation in PSBs from social objectives towards an accent on profitability, especially given that some of these have come to be listed on the exchanges and have private investors. (TT Ram Mohan and Subhash C Ray).

In the year 1999, British Bank of Middle East (BBME) was merged with HSBC Bank. During the year 2002-2003, four Foreign Banks viz., (1) Commerzebank (2) Dresdener Bank AG (3) KBC Bank and (4) The Siam Commercial Bank PCL, closed their Indian operations. Further, Indian branches of Standard Chartered Grindlays Bank Ltd., were merged with the Indian branches of Standard Chartered Bank while The

Development Bank of Singapore Ltd., changed its name to DBS Bank Ltd. (IBA Bulletin Special Issue – January 2004). Similarly, during the year 2003 – 04, another three FBs in India were closed down. These are Oversea-Chinese Banking Corporation Bank Ltd. (OCBC), and The Toronto Dominion Bank Ltd while Bank Muscat SAOG was taken over by the Centurion Bank (also being merged with Bank of Punjab in 2005). Same year, Credit Agricole Indo Suez Bank, however, changed its name to CALYON Bank.

IBA Bulletin of December 2004 carried a detailed annual review on Performance Highlights of FBs in 2003-04. Under Total Assets, it said that 10 banks reported higher growth than the group average with Antwerp Diamond Bank N.V. (entered India in 2002-03) occupying the top position with a growth of 102.8 per cent while 12 others showed decline in asset growth. Societe Generale recorded highest growth in deposits with 222.4 per cent closely followed by Development Bank of Singapore (DBS) with 202.7 per cent and JP Morgan Chase Bank with 111.0 per cent. 13 FBs recorded negative growth in deposits than the previous year. Credit disbursement by FBs during 2003-04 was impressive with figures of Rs. 60,507 crores compared to Rs. 52,018 crores in previous year. Societe Generale topped the position with a growth of 97 per cent followed by Antwerp Diamond Bank (69.2 per cent). 19 FBs out of the 32 recorded negative growth in advances which was more than compensated by the 14 other banks during the year. Gross NPAs of FBs increased from Rs 2,820 crores in 2003 to Rs. 2,893 crores in 2004 with growth rate of 2.6 per cent. Unlike FBs, the Public and Private Sector Banks showed decline in growth of gross and net NPAs during 2003-04 as compared to 2002-03. Overall, FBs repeated their good performance during 2003-04 also. Though the number of banks in India reduced from 36 in 2002-03 to 32 in 2003-04, the performance of the group was good. Deposit mobilization of the FBs was lower as compared to previous year. However, profitability ratios like Business per Employee and Profit per Employee showed considerable improvement during 2003-04. (IBA Bulletin : December 2004)

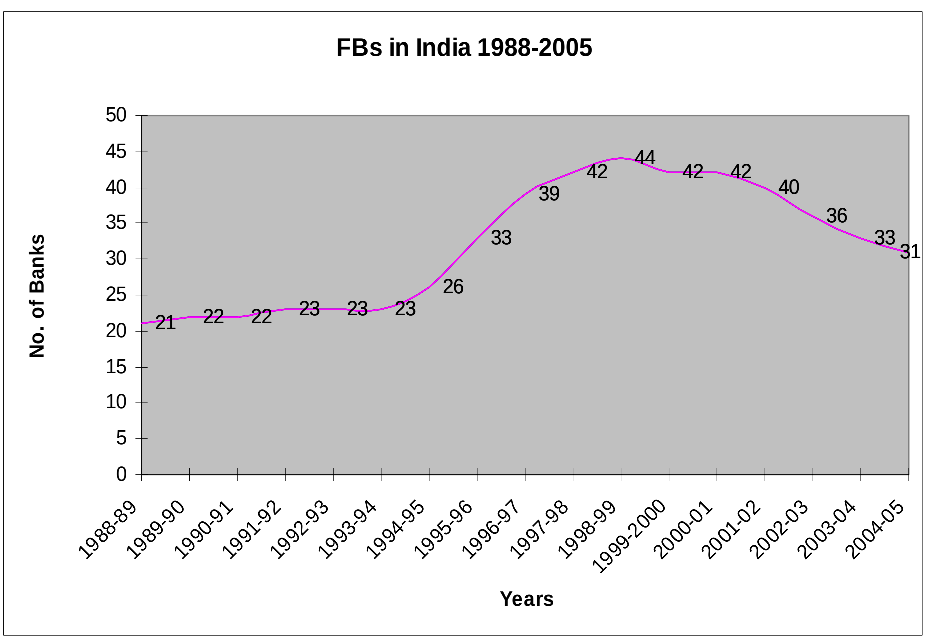
The Government of India and Reserve Bank are considering a proposal to expand FBs' share to around 20 per cent from the present 15 per cent. On the basis of funded assets, FBs' market share is only about 7-8 per cent. If, however, one takes into consideration non-funded assets, such as derivatives and fee-based businesses as well, their share could be around 15 per cent. The Government is now said to be contemplating a change in the formula for calculating the total share of FBs in India. The proposal has gained steam following the bilateral agreement signed with Government of Singapore in June 2005 which signaled better treatment to their banks to operate in India vis-à-vis other FBs. As per the agreement, three Singaporean banks will get to start with three branch banking licenses each and will also be allowed to enter the insurance industry. Normally, a Foreign Bank gets license to set up a representative office and depending on its performance, it converts the representative office into a branch. If the Government decides to raise FBs' share, it will lead to more relaxation in branch licensing policy for FBs in India.

Under the World Trade Organisation (WTO) Treaty, India is committed to increase the number of foreign banking licenses from 12 a year to 15 – 18. The RBI is, however, in favour of inserting a clause of reciprocity with respective nations who get licenses to operate banks in India. This will pave the path for Indian banks setting shops overseas. The RBI is believed to have pointed out to GOI that FBs do not serve un-banked areas and normally focus only on metros which are heavily banked. Therefore, the new branching licenses may have some riders on areas to serve or kind of services to focus on. Once this is done, the formula for arriving a banks' share in the market is likely to change to take into account to include non-fund business which for FBs is too large. This will prop up FBs' share in the total banking pie substantially. FBs from Japan, China and the Middle East have evinced interest in opening branches in India. Recently, Commonwealth Bank of Australia got the license to set up a Representative Office. Union Bank of Switzerland had applied for a bank license but the application has hit the roadblock after Securities & Exchange Board of India (SEBI) found fault with UBS Securities of the Group in its stock market activities. General Electric (GE) also wants to set up a bank in India through the acquisition route. (Business Standard – July 05, 2005)
The Chartered Financial Analyst of ICFAI, Hyderabad in its Special issue of October 2005, contained a comprehensive study and ranking of the performance of banks in India, based on the CAMEL model. The study covers 55 banks (including 15 FBs) whose

annual results for 2004-05 were available at that time. These 55 banks were divided into three categories – 21 large sized banks, 15 Medium and 19 Small banks. While one Foreign Bank each found place in 21 Large banks (Citibank with 4th rank) and 15 Medium banks (American Express Bank Ltd with 12th rank) categories, 13 other FBs occupied different ranks in the third category of 19 Small Banks. With Indian banks going global and many global banks setting up shop in India, the Indian banking system is set to evolve into a totally new level. International banks like Deutsche Bank are planning to re-open retail operations in India. GE is also showing signs to start banking operations in India. Merrill Lynch is looking to get a banking license in India. The Credit Suisse Group is also looking at augmenting its Indian operations. UBS, the world's seventh largest bank has also applied for banking license from RBI. All this could well mark the beginning of a trend of big financial service conglomerates looking at India. (CFA – October 2005)

REVIEW OF WORKING OF FOREIGN BANKS IN INDIA

The starting point of studying the Foreign Banks in India is the number of banks and branches over the study period. From the chart given below, it may be observed that number of foreign banks in India have risen from mere 21 in the year 1988-89 to a peak of 44 in 1999-2000, and the decline to 31 by end of March 2005.



Between the years 1997 and 2005, the total number of FBs has come down from 43 to 31 despite entry of several new FBs while number of their branches increased from 188 to 215. The details can be observed from the Table No. 1 given below:-

Table No. 1 : Number of Foreign Banks and Branches during 1997-2005

(Data as on June every year)

Year	No. of Foreign Banks	No. of Branches
1997-1998	43	188
1998-1999	42	178
1999-2000	42	186
2000-2001	42	192
2001-2002	40	246
2002-2003	36	204
2003-2004	33	213
2004-2005	31	215

Source: Trend and Progress of Banking in India : RBI various reports

FBs in India trailed the revitalized domestic banks in 2004-2005. The growth in credit as well as deposits of FBs during the year was lower compared to that for the public sector and the private sector banks. FBs annual credit growth was 24.6 per cent, as on March 31, 2005 against the highest growth of 33.5 per cent for nationalized banks, 31.9 per cent for private sector banks and 26 per cent for State Bank of India (SBI) and its Associates. FBs lagged behind in credit disbursements even though their loan books swelled much more than they had done in 2003-2004. And FBs fell behind despite the fact that their credit growth in 2004-2005 was much higher than the 15.3 per cent rise in 2003-2004.

The growth in deposits for FBs in 2004-05 was scanty – only 5.2 per cent compared to 15.7 per cent for SBI group, 15.9 per cent for nationalized banks and 17.8 per cent for private sector banks. This is in contrast with FBs' deposits growth in 2003-2004 – the highest at 28.6 per cent against 19.7 per cent for the SBI group, 16.2 per cent for nationalized banks and 23 per cent for private sector banks. In 2004-2005, the banking sector's aggressive credit jumped 30.6 per cent to Rs.11,57,807 crores, while total deposits grew 15.6 per cent to Rs.17,53,174 crores.

Table-No.2 – Growth of Banks' business in 2004 -2005

Growth in Percentage	Credit	Deposits
SBI and Associates	26.0	15.7
Nationalised Banks	33.6	15.9
Private Sector Banks	31.9	17.8
Foreign Banks (FBs)	24.6	5.2

Source: Business Standard - August 20, 2005

One major cause of concern was the reduction in number of FBs in the post reforms and WTO era. While the strong and long staying banks like Citi Bank, American Express, HSBC, Standard Chartered, Bank of America, etc are going steady with their operations in Metros and big Cities, new entrants are moving in and out with short periods of stay. Surprisingly, with limited and focused operations too, these FBs are not able to catch up in growth of deposits or advances like their counterparts in public and private sectors. The table number 2 above gives a comparative position of growth in the year 2004-05.

Data on Capital Adequacy Ratio (CAR) of all types of banks in India for seven years between 1998 and 2004 is given in Table No. 3 below.

Table No. 3 : Bank Group-wise CRAR as at the end of March

Bank Group	1998	1999	2000	2001	2002	2003	2004
Scheduled Coml Banks	**11.5**	**11.3**	**11.1**	**11.4**	**12**	**12.7**	**12.9**
Public Sector Banks	11.6	11.3	10.7	11.2	11.8	12.6	13.2
Nationalised Banks	10.3	10.6	10.1	10.2	10.9	12.2	13.1
State Bank Group	14	12.3	11.6	12.7	13.3	13.4	13.4
Old Private Sector Banks	12.3	12.1	12.4	11.9	12.5	12.8	13.7
New Private Sec. Banks	13.2	11.8	13.4	11.5	12.3	11.3	10.2
Foreign Banks (FBs)	**10.3**	**10.8**	**11.9**	**12.6**	**12.9**	**15.2**	**15**

Source : RBI / IBA

It may be noted that while all the types of banks in India complied with RBI stipulation of CAR of 9%, FBs have strengthened with a higher percentage between 10.3 and 15 per cent in the last seven years. ASCBs have had an average between 11.5 and 12.9 (with a marginal increase by 1.4 per cent) of CAR during the same period.

Table No. 4 : Movements in Prime Lending Rates : 2002 – 2004

	Types of Banks / Year	2001-2002	2002-2003	2003-2004	Jun-04
1	Public Sector Banks	10.00 - 12.50	9.00 – 12.25	10.25 – 11.50	10.25 - 11.50
2	Private Sector Banks	10.00 - 15.50	7.00 – 15.50	10.50 – 13.00	9.75 - 13.00
3	Foreign Banks	9.00 - 17.50	6.75 -17.50	11.00 – 14.85	11.00 - 14.85

Source: RBI T&P OF BANKING IN INDIA 2003-4/IBA Year Book 2004

Table No. 4 above indicates the movement of (Prime) Lending Rates of all types of banks in India during the previous three years 2002 to 2004. In a falling interest rates regime, there has been stiff competition among all the players to accept deposits at around 5 – 7 per cent per annum and lend at about 11 – 12 per cent with an exception of retail loans like housing finance, auto loans, etc., which are offered on liberal terms at 7 – 8 per cent (sub-PLR rates) interest rates per annum by even the Public Sector Banks. However, for reasons best known to them, FBs are not able to offer such low priced lending and this is evident from the range of their PLRs.

Further, the Table No. 5 below indicates that post Reforms and WTO Era, the performance and market shares of FBs have been coming down as the other two sectors viz., Public and Private have been gearing up their efficiency. Addition of new FBs does not seem to have any major impact on the system when compared to new Private Sector Banks. In fact, all the indicators viz., Income, Expenditure, Total Assets, Net Profit and Gross Profit have gone down drastically between the year 1995-96 and 2002-03 vis-à-vis the other two types of players.

Table No. 5 : Bank Group-wise Shares, Select Indicators

(Per cent)

Types of Banks/Select Indicators	1995-96	2000-01	2002-03
PUBLIC SECTOR BANKS			
Income	82.5	78.4	74.5
Expenditure	84.2	78.9	74.8
Total Assets	84.4	79.5	75.7
Net Profit	-39.1	67.4	64.8
Gross Profit	74.3	69.9	76.6
PRIVATE SECTOR BANKS			
Income	8.2	12.6	18.5
Expenditure	7.4	12.3	18.6
Total Assets	7.7	12.6	17.5
Net Profit	59.3	17.8	15.6
Gross Profit	10.1	14.4	18.7
FOREIGN BANKS			
Income	9.4	9.1	7.0
Expenditure	8.3	8.8	6.6
Total Assets	7.9	7.9	6.9
Net Profit	79.8	14.8	19.6
Gross Profit	15.6	15.7	4.7

Source: Rakesh Mohan (2004) : EPW March 19, 2005 'Financial Sector Reforms in India'

Further data on FBs in India given in the Table no.6 below is for seven years period between 1997-1998 and 2003-04 indicates that in general, their market share of certain business parameters as percentage terms is either very low or on the decreasing trend although in absolute terms they are increasing. This, again, shows that the other categories of banks viz., Public and Private are growing at a better rate with regard to deposits, advances, assets/ liabilities, etc.

Table No 6 : Aggregate Deposits, Assets/Liabilities of Foreign Banks in India (Rs in Crores)

Particulars	2003-04	2002-03	2001-02	2000-01	1999-00	1998-99	1997-98
Deposits	79,745 (5.2)	69,095 (5.2)	56,129 (4.8)	59,228 (5.8)	49,377 (5.7)	46,476 (6.3)	42,824 (7.0)
Assets/ Liabilities	1,36,316 (6.9)	1,16,314 (6.8)	1,01,064 (6.6)	1,11,657 (8.2)	89,770 (7.8)	81,367 (8.2)	70,099 (8.3)
Advances	60,507 (7.4)	52,018 (7.4)	47,048 (7.7)	43,051 (8.7)	35,857 (8.6)	29,300 (8.8)	29,317 (9.8)
Priority Sector	14,058 (5.1)	11,417 (5.2)	10,446 (5.9)	9,222 (6.0)	7,624 (5.9)	6,475 (5.8)	5,490 (5.7)
No. of Branches	217 (0.4)	180 (0.3)	184 (0.3)	189 (0.4)	181 (0.4)	175 (0.3)	182 (0.4)
Staff in Numbers	14,662 (1.7)	11,751 (1.4)	11,083 (1.3)	14,143 (1.6)	13,509 (1.4)	14,910 (1.6)	14,893 (1.5)

Source: EPW March 19, 2005 : Figures in brackets are percentage to total for all banks in India

RESEARCH METHODOLOGY

Business India, one of the country's leading fortnightly magazines collects annual data of all types of banks in India every year and carries out the exercise of ranking of banks. They adopt CRAMEL method to analyse the annual financial data and assign ranks on the overall performance of each bank.

CRAMEL stands for Capital Adequacy, Resources Deployed, Asset Quality, Management, Earnings Quality and Liquidity which is a well known and accepted method. The authors have worked on the above data, pertaining to FBs for a five year period for the years 1997-98, 1998-1999, 2000-2001, 2001-02 and 2002-03. Data with CRAMEL analysis for one year in the middle i.e., 1999-2000 was not available. The number of FBs in each of these years was 38, 40, 33, 32 and 26 respectively but the gross list of names of FBs during the study period was at 50. Wherever there was merger and / or change of name was there, data was not reckoned and hence the list was condensed to 45 banks. There have been both entry and exit of FBs during the study period or mergers and changes of names of banks. These were 1.Antwerp Diamond Bank, 2.British Bank of

Middle East, 3.Bank Nova Scotia, 4.Commerz Bank, 5.Dresdner Bank, 6.Fuji Bank, 7.JP Morgan Bank, 8.Mizuho Bank, 9.Standard Chartered Bank, 10.Grindlays Bank, 11.BNP Paribas, 12.ING Bank, 13.DBS, 14.OCBC, 15.KBC, 16.Credit Agricole, 17.Sanwa Bank, 18.Sakura Bank, 19.Siam Commercial Bank, 20.Bank Muscat International, 21.Chase Manhattan Bank, 22.UFJ Bank, etc.

We have considered the 17 foreign banks since their data is available throughout the study period i.e., 1997 to 2003 (except 1999-2000) under **Closed Model**. In all, 45 FBs were operating at any time during the five years of study. Wherever the data was not available for any of the five years, interpolations / extrapolations were carried out to fill up the gaps and the exercise was carried out for all the 45 foreign banks (including the 17 under closed model) for the purpose of Open Model. As a first step under **Open Model**, data pertaining to 35 banks (after adjustment of gaps in data) for the first parameter - Capital Adequacy for all five years has been compiled. This has been forecasted for next three years 2003-2004, 2004-2005 and 2005-2006 and other steps have been repeated. The exercise was completed for the remaining five parameters and their respective sub-parameters and furnished

For each of the six parameters under CRAMEL, equal weightage of 16.66% was given aggregating to 100%. These parameters were divided into sub-parameters which were given appropriate weightages. For example, in respect of the first letter / parameter C – Capital Adequacy, there are 5 sub-parameters are CAR, D/E, A/A, GS/I, GS/A with a further weightage of 3.33 each. Similar exercise was carried out in respect of other parameters / and the respective sub-parameters for each parameter too (like R, A, M, E and L) as explained in the table below:-

Table No. 7 : Parameters and Weightages for Study

Parameter	Weight-age	No of Sub-parameters	Sub-Parameters	W'tage of S'parameter
Capital Adequacy	16.67	5	CAR, D / E, ADV / AST, G-SEC/INV, G-SEC/AST	3.33
Resources Deployed	16.67	6	TOTAL AST, LIQ.AST, INV, ADV, FIX.AST, OTHER AST	2.78
Asset Quality	16.67	7	NNPA / NADV, ADV / AST, ADV/GTH, INV/AST, A/YLD, I/YLD, I/GTH	2.38
Management	16.67	4	CRED / DEP, NP / EMP, BUS / EMP, ROANW	4.17
Earnings Quality	16.66	5	NP, NP / GTH, SPREAD, OI / NII, NP / TAA	3.33
Liquidity	16.66	3	LIQ / TOT AST, G-SEC / T.AST, A-SEC / T.AST	5.56
TOTAL	**100.00**	**30**		

NOTE: Please see List of Abbreviations furnished at the end of Paper

For each of the five years under study i.e., 1997-98, 1998-1999, 2000-2001, 2001-2002 and 2002-2003, the actual financial figures for the six parameters of CRAMEL were considered by taking secondary data from Business India. These parameters were already divided into sub-parameters. These data in each sub-parameter were given ranking based on their nature/type. For example, CAR being the first sub-parameter under Capital Adequacy, the bank with highest value was given the highest ranking. Then, the rank number was multiplied with corresponding weightage of the sub-parameter (in this case 3.33) to arrive at the weighted scores. Thereafter, the cumulative weighted scores were calculated by adding up all the weighted scores of all the sub-parameters for each of the six parameters viz., CRAMEL. Using the cumulative weighted scores for each year, we have forecasted cumulative weighted scores for the next three time points i.e., years 2003-2004, 2004-2005 and 2005-2006. Since there was no published data available for the years 2004-2005 and 2005-2006, we have given again ranks to the cumulative weighted scores for each of the seventeen banks. Based on our observations, we have identified these banks as (a) performing well (b) average and (c) weak banks.

Annexure no. 1 shows the working of the above under **Closed Model** pertaining to **17 banks** for five years for the parameter Capital Adequacy and its sub-parameters. It also shows the forecasted data for next three years, the last two years data having been ranked. **Annexures no. 2 to 6** furnish similar data for the remaining five parameters and their respective sub-parameters with forecasted figures and ranking. **Annexure no. 7** is the summary for all 17 banks for the five years as well as next three years forecasted data for all parameters – CRAMEL at a glance. Data for the last two forecasted years were again ranked in the statement.

Annexures no. 8 to 14 contain names of 45 FBs who were operating at any time during the five years of study. Wherever the data was not available for any of the five years, interpolations / extrapolations were carried out to fill up the gaps. Antwerp Diamond Bank entered Indian scene during the year 2002-2003 and hence forecasting calculations were not carried out for this bank. 10 foreign banks viz., 1. Bank Muscat International, 2. British Bank of Middle East (BBME), 3. Chase Manhattan, 4. Commerz Bank, 5. Dresdner Bank, 6. Fuji Bank, 7. KBC Bank, 8. Sakura Bank, 9. Sanwa Bank and 10. Siam Commercial Bank closed their shops during the period of study. In respect of at least 14 other banks, information gaps were observed between 1 to 3 years and the same were extrapolated / interpolated to fill the same.

As a first step under **Open Model**, data pertaining to 35 banks (after adjustment of gaps in data) for the first parameter Capital Adequacy for all five years has been compiled. This has been forecasted for next three years 2003-2004, 2004-2005 and 2005-2006 and others steps have been repeated. The exercise was completed for the remaining five parameters and their respective sub-parameters and furnished in the Annnexure nos. 8 to 13 while the summary for all six parameters for the five plus three years is given in Annexure no. 14. The exercise of awarding weightages and multiplying with scores to arrive at sustainability was repeated under Open Model for all the 35 (45 minus 10 closed down) banks that are functional during the year 2002-2003. Even though data for 35 banks were calculated/forecasted in the Annexures no. 8 to 14 up to the years 2005-06, by the end of next financial year 2003-04 two more banks viz., OCBC Bank and Toronto Dominion Bank Ltd were not considered as they were closed down thus bringing the number down to 33 (35 minus 2). For academic purpose, the data pertaining to the 17 FBs which were already dealt with under Closed Model were included in the list of 33 banks under Open Model. No ranking was, therefore, carried out for these 33 banks in view of gaps in data which were adjusted by us and other reasons like closure in subsequent year(s), but only to have total picture of all the functioning FBs and to assess sustainability.

CRAMEL being an established method of evaluating the performance of banks of all types, the same was adopted for our study. All the parameters and sub-parameters in this method focus on compliance to prescribed regulations like CAR etc., efficiency ratios like D/E, liquidity and profitability ratios as also the quality of management. Banks which maintain consistency and compliance, registering growth and continue to operate over the years amidst stiff competition, offer excellent customer service, etc can be treated as meeting the sustainability standards. Instead, those whose results show declining trend or close their business within short period of operations leaving the customers – both depositors and borrowers – in lurch can be deemed to be unsustainable, particularly in view of the banking reforms that have taken place.

FINDINGS

From the Annexure no. 7, we can observe that out of the list of 17 FBs operating throughout the period of study, ten banks were identified by as performing well, five as average performers and the remaining two as weak performers in view of the respective scores obtained at the end of the exercise. These are furnished in the table no. 8 given below:-

Table No. 8 : Categorisation of 17 FBs under Closed Model

Ranking for 2005-06	Category of Banks	Names of Banks
1 to 10	Performing Well	1.Bank of Tokyo-Mitsubhishi 2.HSBC Holdings 3.Citibank 4.Deutsche Bank 5.Credit Loynnais 6.ABN Amro Bank 7.Credit Agricole Indosuez (Calyon Bank) 8.Bank of America 9.Mashreq Bank 10.Bank of Bahrain and Kuwait
11 to 15	Average Performance	1.Barclays Bank 2.Scotia Bank 3.DBS 4.Krung Thai Bank 5.Sonali Bank
16 & 17	Weak Performance	1.BNP Paribas 2.Sumitomo Bank

Out of the total 35 FBs considered under Open Model, 17 have already been considered under Closed model and categorised into three types as per table given above. 2 more banks viz., OCBC and Toronto Dominion Bank have wound up their business in the year 2003-04. The remaining 16 banks have obtained forecasted cumulative weighted scores for the year 2005-06 ranging between -150.3 and 1688.8 based on past performance trends and interpolations. Once again, based on the criteria of cumulative weighted scores for 2005-06, (above 1000, 501 to 1000 and up to 500 score) these sixteen FBs were categorised by us as (a) performing well (b) average and (c) weak performers. These individual scores were extracted from Annexure – 14 and shown in the Table No. 9 given below:-

Table No. 9 : Categorisation of 16 FBs under Open Model

Range of Cumulative Weighted Scores	Category of Banks	Names of Banks (with Cumulative Weighted Scores in Annexure 14)
1000 and above	Performing Well	1.JP Morgan Chase Bank (1,688.8) 2.Abu Dhabi Commercial Bank (1,532.1) 3.Antwerb Diamond Bank (1,501) 4.Mizuho Corporate Bank (1,500.1) 5.State Bank of Mauritius (1,402.1) 6.China Trust Commercial Bank (1,280.6) 7.Standard Chartered Grindlays (1,194.1)
501 to 1,000	Average Performance	1.UFJ Bank (848.3) 2.Oman International Bank (757.6) 3.Societe Generale (686.1) 4.Cho Hung Bank (680.2) 5.Bank of Ceylon (664.9)
Up to 500	Weak Performance	1.Arab Bangladesh Bank (364) 2.American Express Bank (217) 3.Bank International Indonesia (26.9) 4.ING Bank (- 150.3)

CONCLUSIONS

As already stated in the beginning, Foreign Banks have been functioning in India as part of the banking system side by side with Public, Private, Regional Rural and Cooperative Banks for over one hundred sixty years. For obvious reasons, they have been operating in Urban and Metropolitan cities only with limited number of branches; catering to elite clientele. These banks have been complying with the 32% requirement under Priority Sector Lending but mostly concentrate on Retail Banking. The low Credit Deposit ratio and high Capital Adequacy Ratios in some of the FBs indicate that more than lending to business and industry, they resort to investment operations. Globalisation or Financial Service Agreement under WTO have encouraged more frequent traffic of moving in and out of Indian banking scene by some FBs with short standing.

However, banks like ABN Amro, American Express, Bank of America, Bank of Bahrain and Kuwait, Barclays, Bank of Tokyo-Mitsubishi, Citi Bank, Deutsche Bank, HSBC and Standard Chartered Bank have been in long and successful business in India retaining the confidence of the customers and regulators. Liberalisation by RBI to invite more branches has not been utilized by some FBs efficiently calling for close supervision and policy changes. Banking is a financial service where tremendous trust is essential. Else, RBI has to nominate its representatives on the Boards of management of these banks to monitor their performance at quarterly intervals to the best advantage of the customers – both depositors and borrowers.

The following table gives at a glance view of the 33 FBs now in India and their functioning. While 17 of them are performing well as indicated by the research findings, 10 are in the average category and the remaining 6 need to be closely monitored. Otherwise, there is a threat that their poor performance will lead to unwanted repercussions and stringent corrective steps to be taken for remedial action.

Table No. 10 Summary of Findings from Closed & Open Models

Category	No. of FBs under Closed Model	No of FBs under Open Model	Total No Of FBs	Remarks
Performing Well	10	7	17	Progress to be maintained
Average	5	5	10	Performance to be watched / improved
Weak Performance	2	4	6	Progress to be closely monitored and corrective steps taken immediately
TOTAL	17	16	33	2 FBS already closed in 2003-2004

Accordingly, the first two categories of FBs (17 plus 10) can be considered as sustainable while the remaining six FBs of third category can be treated as not sustainable.

Limitations:

1. The study period covered five years between 1997 and 2003 with secondary data taken from Business India magazine. Data for the year 1999-2000 was not available.

2. Two more financial years viz., 2003-5 have already been over and several developments have taken place. Forecasting of data for these two years does not convey proper meaning but helps in projecting further for 2005-2006.
3. Data for the year 2003-2004 is available in RBI website and Indiastat.com but is not in the form of CRAMEL format for a comparative study.
4. Data for the year 2004-2005 is yet to be released so as to study the performance in real terms and arrive at realistic conclusions and offering better recommendations.
5. Best Banker and other Surveys carried out by business magazines are readily available to the general / investing public and carry stronger impressions in the absence of authentic data from RBI well in time.

SCOPE FOR FURTHER RESEARCH:

The present work done was based on the secondary data available from the business magazines. It is more than two and half years old and many changes have occurred in the interregnum. RBI announced its new policy in February 2005 and there has been overwhelming response from a fresh bunch of six leading banks from Singapore, Switzerland, etc. Further research can be taken up with regard to identifying the specific reasons for frequent moving in and out by some FBs to and from India so that meaningful solutions can be offered with regard to branch licensing policy, taxation policy, repatriation of foreign exchange policy, priority sector lending by FBs and relaxations to encourage more and more banks to set up offices in India.

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LIST OF ABBREVIATIONS

1.	ADV	Advances
2.	ADV/GTH	Advances / Growth
3.	ASCB	All Scheduled Commercial Banks
4.	ASEC/AST	Approved Securities / Assets
5.	AST	Assets
6.	ADV/AST	Advances to Assets
7.	ATMs	Automated Teller Machines
8.	BBME	British Bank of Middle East
9.	B/E	Business per Employee
10.	CAR	Capital Adequacy Ratio
11.	C/D	Credit Deposit Ratio
12.	CRAR	Capital to Risk Adjusted Ratio
13.	CRR	Cash Reserve Ratio
14.	D/E	Debt to Equity Ratio
15.	DFI	Development Finance Institutions
16.	FBs	Foreign Banks
17.	FICCI	Federation of Indian Chambers of Commerce and Industry
18.	FDI	Foreign Direct Investment
19.	FIX/AST	Fixed Assets to Total Assets
20.	GOI	Government of India
21.	G-SEC	Government Securities
22.	HNI	High Networth Individuals
23.	IBA	Indian Banks Association
24.	INV	Investment
25.	I/YLD	Investment to Yield
26.	LABs	Local Area Banks
27.	LIQ/A	Liquidity to Assets
28.	NADV	Net Advances
29.	NBFC	Non Banking Finance Company
30.	NII	Net Interest Income
31.	NP/EMP	Net Profit per Employee
32.	NP/GTH	Net Profit to Growth
33.	NPA	Non Performing Assets
34.	NNPA	Net Non Performing Assets
35.	OCBC	Overseas China Banking Corporation
36.	OI	Other Income
37.	OTH/AST	Other Assets to Total Assets
38.	PSBs	Public Sector Banks
39.	PLR	Prime Lending Rate
40.	RBI	Reserve Bank of India
41.	ROANW	Return on Average Net Worth
42.	SBI	State Bank of India
43.	T A	Total Assets
44.	WOS	Wholly Owned Subsidiary
45.	WTO	World Trade Organisation

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List of Annexures 1 to 14

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