# THE GATS AND INDIA'S TRADE IN BANKING SERVICES

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*Dissertation submitted in the partial fulfilment of the requirements for the degree of Master of Philosophy in Applied Economics of the Jawaharlal Nehru University*

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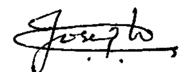
June 2005

I hereby affirm that the work for this dissertation, **The GATS and India's Trade in Banking Services**, being submitted as part of the requirements of the M.Phil. Programme in Applied Economics of the Jawaharlal Nehru University, was carried out entirely by myself. I also affirm that it was not part of any other Programme of study and has not been submitted to any other Institution/University for the award of any Degree.



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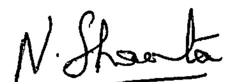

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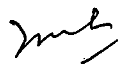

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ABSTRACT OF THE DISSERTATION

# THE GATS AND INDIA'S TRADE IN BANKING SERVICES

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Framing of the General Agreement on Trade in Services (GATS) is a significant stride towards trade policy formulation regarding services by the international forum under WTO's flag. Owing to the fact that provision of most services requires factor mobility, under the Agreement's categorisation of modes of service trade, FDI in any service sector is also considered as international trade in services. Banking services under financial services is a key sector which comes under the preview of the GATS and entry of foreign banks henceforth will be regarded as trade in baking services. Foreign bank entry in particular is viewed with an apprehensive note by the developing world owing to ambiguous outcomes and heavy risk associated with such entry over the potential benefits, given the crucial significance of financial intermediation on economy's vitality. As a signatory to the Agreement India has entered into certain commitments entailing banking services, bearing certain key implications for the governance of foreign banks operating in India and subsequently concerning her commercial banking sector as a whole. In this context this study aims to address certain issues pertaining to India's trade in banking services. Keeping this objective, the study reviews general provisions of GATS and India's commitments on banking services, the two arms through which the power of the Agreement is exercised. Thereafter, the role of foreign banks in Indian commercial banking and their comparative position vis-à-vis domestic banks (for the period 1990 to 2001) are examined to explore the prospects from India's commitments for her domestic banking industry.

The prime distinguishing feature of the Agreement is its definition of four modes of supply through which services are traded. India's trade in banking services is chiefly through mode 3 (analogues to FDI in banking or entry of foreign banks) and commitments are entered only with respect to that mode. Also, key banking services including basic financial intermediation can effectively be traded solely through mode 3. From an inspection of the major provisions in GATS it becomes evident that its crucial Articles on Domestic Regulation, Market Access and National Treatment and their disputed contents are aimed at facilitating liberalisation of mode 3 far more than other modes of supply. India's commitments offer full market access and national treatment to foreign banks except certain limitations specified in her commitment schedule. It could be found that the commitments exclude certain important limitations or differences in national treatment currently existing with respect to foreign banks operating in India, giving more leeway to their operations.

Examining the operations of foreign banks, we observe that, at an aggregated level, distribution of assets and liabilities of foreign banks follows almost the same pattern as that of their domestic counterparts, indicating their important involvement in domestic financial intermediation. Profitability indicators remained stagnant for all bank groups including foreign banks during the period despite an unprecedented growth in number and volume of business of banks, apparently suggesting failure of competitive pressure. Nevertheless, foreign banks show superior performance in terms of profitability. A region wise analysis shows that, while domestic bank groups depend on lucrative urban/metropolitan markets for leveraging the social banking costs incurred from maintaining rural branches, foreign banks are wholly concentrated in urban/metropolitan areas. Operations in disjoint markets account for more profitability enjoyed by foreign banks to a large extent and reflects primary differences in national treatment. This point is supported by the analysis of region wise operational aspects. Amount per Account of deposits and credit as well as number of accounts of deposits per branch for all bank groups is substantially higher in metropolitan areas compared to other regions, clearly distinguishing regional banking practices. This points out the fact that urban/metropolitan markets offer

significant scale economies and scope for risk diversification compared to rural areas where foreign banks have no compulsions to operate.

At a disaggregated level certain distinct trends are seen in the composition of assets and liabilities and subsequent differences in earning pattern. Large public sector banks register a gradual shift from advances to investments in securities as earning assets. This is attributable to competitive pressure in concentrated urban credit market as well as a means to circumvent social banking costs incurred by them owing to priority sector lending requirements. Comparative analysis shows that though their share in aggregate banking business is just around seven percent, urban concentration gives foreign banks better position in those markets. While comparative efficiency of domestic banks are high in deposit market operations, it is vice versa in credit markets. This, coupled with the fact that credit-deposit ratios are high for all commercial bank groups in urban centres, suggests that further urban concentration of foreign banks might turn restrictive for credit operations of domestic commercial banks. This in turn will disrupt the rural to urban circulation of surplus funds having certain serious implications. India's commitment on entry of new foreign banks under the GATS clearly indicates that it offers immense scope for further entry and subsequent urban concentration. It evidently follows that commitments should be reassessed and entered into by conserving regulatory authority over operations of foreign banks.

It is also noted that consolidated position of Indian bank branches abroad (analogues to exports of banking services through mode 3) is consistently registering losses. India's commitments do not properly address the issue of enhancing the presence of Indian commercial banks abroad, which is particularly ineffectual currently.

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## ACRONYMS

| | |
|---|---|
| FB | Foreign Banks |
| FDI | Foreign Direct Investment |
| GATS | General Agreement on Trade in Services |
| IPB | Indian Private Banks |
| MFN | Most Favoured Nation Clause |
| NB | Nationalized Banks |
| PB | Public Banks |
| RBI | Reserve Bank of India |
| RRB | Regional Rural Banks |
| SBA | State Bank of India and Associates |
| SCB | Scheduled Commercial Banks |
| WTO | World Trade Organisation |

# CHAPTER 1

# Introduction

## 1.1 Background to the Study

The growing significance of services, which constitute an essential and sizeable part of world economy, has induced a global rethinking on international trade in services. Being distinctive and hardly susceptible to general trade policy framework in several respects compared to goods, international trade negotiations sidelined commercial services till recent past. Framing of the General Agreement on Trade in Services (GATS) in 1995, to which India is also a signatory, is a significant stride towards trade policy formulation regarding services by the international forum under the World Trade Organisation. Given that provision of most services requires physical proximity of both producer and consumer and therefore mobility of factors of production, provision through branch or establishment instituted abroad by a service provider or broadly FDI in service sectors also is henceforth considered as trade under the Agreement. As barriers to such trade are chiefly internal regulations which vary widely across counties, the GATS primarily seeks to harmonise domestic regulations and their progressive delimitation through successive rounds of negotiations.

Financial services are singularly important and actively negotiated amongst the types of services under the domain of the GATS. Foreign entry into financial sector in particular has been viewed with an apprehensive note by the developing world owing to ambiguous outcomes and heavy risk associated with such entry over the potential benefits, given the indispensable bearing of financial intermediation on an economy's vitality. Moreover, because of the volatile nature and sensitivity towards policy changes, financial service sectors are conventionally highly regulated in most of the member countries. Banking services forms integral an part of financial services. As a signatory to the Agreement India has entered into certain commitments entailing banking services, holding certain important implications for the entry and regulation of foreign banks operating in India, subsequently concerning her domestic commercial banking sector as a whole. This is especially so because of an already significant foreign presence in Indian commercial banking which operates under domestic regulatory conditions.

While theoretical and empirical studies highlight several distinctions between goods and services and subsequent implications on international trade, gains from trade in services are widely considered at par with and often-supplementing goods trade. However, considering the heterogeneity amongst various services, aggregated treatment of such services and generalisations thereupon is questioned and the direction and extent of the outcomes of trade in services are also contested. This stresses the importance of sector specific studies. This study is therefore an attempt to analyse India's trade in banking services under mode 3 (analogous to entry of foreign banks with FDI) and enquire into certain issues therewith, in the light of commitments made by India under GATS with respect to banking services.

Section 1.2 of this chapter deals with definition of modes of supply in the GATS and trade in banking services. The study problem is delineated in section 1.3 and review of literature in section 1.4, followed by objectives of the study, conceptualisation and approach and sources of data. Chapterisation scheme is given at the end of the chapter.

## 1.2 GATS and Trade in Banking Services

The importance of commercial services has increased rapidly in recent years accounting for nearly 64 per cent of the world GDP by 2000 and 40 per cent of the world stock of foreign direct investment (FDI) in the year 2002[1]. This is but largely undermined and the actual significance of services is much higher. Data on trade in services are not as comprehensive, detailed, timely, or internationally comparable as data on trade in merchandise, resulting in a downward bias in the value of commercial service trade accounted worldwide, as reported in the *IMF Balance of Payments Manual*. India also claims a swelling share in service trade by enhancing her position amongst WTO members in terms of trade volume. India's rank in terms of volume of services exports has improved from 34 in 1995 to 19 by 2001. Corresponding improvement for imports is from 28 to 18.

International forum for trade policies, but sidelined negotiations on trade in services owing to certain distinguishing features associated with such trade.

- Hindrances to service trade are chiefly internal regulations which are hard to universalize across countries. Even in case of goods trade, only limited progress has been made in the front of policy on non-tariff barriers.

[1] Balance of Payments Statistics, IMF 2003.

- Intangible nature of services poses difficulty in proper assessment and accounting. Service transactions are recorded in national balance of payments accounts in extremely aggregated categories, and inconsistencies exist in the methodologies used to report certain items.
- Services, being heterogeneous in nature, were poorly defined and classified for the purpose of a framework for setting rules of trade.

Fueled by overwhelming presence of services in international trade, a pursuit in unison by policy making bodies and scholars resulted in evolution of General Agreement on Trade in Services (GATS). GATS was originally agreed at the end of the Uruguay Round of trade talks in 1994, and came into force in January 1995. As a multilateral framework agreement, it is administered and enforced by the World Trade Organization. The GATS is the first and only set of multilateral rules covering international trade in services. The GATS categorises services into 12 major heads with financial services one amongst them. Financial services are again broadly sub-classified into insurance and banking services[2]. Trade in banking services as under the GATS is a broad term constituting a multitude of international banking activities and an awareness of the definition of the modes of supply in the Agreement is a prerequisite for comprehending the same.

### *1.2.1 Defining Trade in Services*

At the outset, it is useful to have some notion about the nature of 'services', as the term remains quite elusive to any stringent definition. Conventionally, those which can be consumed for a price are grouped into goods and services, the distinction being goods are tangible and services are not. But the difficulty can be seen in a statement such as 'production of all goods are embedded with services (services of labor and capital, for instance), and goods are purchased for the services they provide (car for transport, food for appeasing hunger etc.)'. Any discussion on trade in services, therefore, should be preceded by proper circumscription of those which are produced and traded exclusively as a service. One useful effort to define services is that of B. Hill (1977) who says, 'service is an economic transaction between two agents which leads to a change in the condition of a person or good[3]'. Important

[2] See Appendix I

[3] Professor Hill notes two points in his article. In every case some change is brought about in the condition of some person or good, with the agreement of the person concerned or economic unit owning the good. Secondly, the change is the result of the activity of some other economic unit. These two points provide the key to the concept of a service.

element herewith is that a boundary line in the form of transaction is drawn between services and other activities and thereby preventing the expansion of 'services' to include the entire economic universe[4]. A proliferation of literature followed thereafter, aiming at construction of a framework for comprehending international service trade.

Bhagwati (1984) emphasized on the mutually complimenting nature between goods and services. Chiefly goods and services are indistinguishably embodied in each other and gets disembodied or in his words 'splintered off' in the process of consumption[5]. While live music concert is a service, a recorded track of the same is a good which is getting splintered off from this service[6].

The acceptance of the proposition that the production or consumption of a service takes place as the producer transforms the condition of a person or a good has an implication for international transactions in services. They take place when persons, capital or goods deliver services or absorbs services that transform them in some way after they have crossed an international border for a temporary stay abroad. Thus services can cross borders only if they are embodied in either material substances or people (Grubel, 1987). In this regard even an electronic signal is clubbed with material substances and therefore explains wiring of a service as trade which otherwise is apparently anomalous to Grubel's generalization. A technological improvement in embodying a service thus has tremendous implications for trade in services.

A framework of service trade for the international negotiating tables would come when the ways or modes through which crossing of an embodied service are specified. Sampson and Snape (1985) classified international transactions in services according to four modalities. These are: (1) through cross-border flows in which neither the supplier nor the producer move physically but instead rely upon an intermediate service such as telecommunications network; (2) through the movement of a consumer to a supplier's country (such as through tourism); (3) through the movement of a commercial organization to the consumer's country, which equates with foreign direct investment; and (4) through the movement of an individual service

[4] Many points of Qualifications to the general definition are given in Hill's Article. For, instance if the change I the condition of a good is too great then we refer to manufacture rather than a service transaction.

[6] Apart from this sort of disembodiment, there are other instances where the distinction between manufacturing and service provision is gradually disappearing. When activities of manufacturing enterprises abroad include research and development, engineering, construction management etc. the capital embodies both goods and services.

supplier to the consumer's country. This typology was agreed upon by participants during the Uruguay Round, and is set out in Article I of the General Agreement on Trade in Services. The schematic chart below summarizes this.

**Box 1.1 Schematic Representation Defining Four Modes of International Trade in Services**

| | Provider does not cross border | Provider crosses border |
|---|---|---|
| Consumer does not cross border | **Mode 1**: Cross-border trade | **Mode 3** : Long-term movement of capital(FDI)<br><br>**Mode4**: Temporary movement of service provider (personnel) |
| Consumer crosses border | **Mode 2**: Consumption abroad | |

### *1.2.2 Trade in Banking Services and International Banking Theory*

Several sub-classifications of banking services are defined by the Agreement[7]. This classification delineates types of banking functions in general. These functions or services may be traded through more than one mode of supply. Predominantly banking services are traded through modes 1 and 3, and such trade can be broadly matched with the term 'international banking', though a clear definition of an international bank is lacking in the literature as the terms 'multinational', 'transnational' and 'international' are often used indiscriminately. Two viewpoints can be distinguished if the various existing approaches to international banking are examined (Germidis and Michalet 1984) viz. (1) banking activities in a foreign country (corollary to multinationalisation of banking) and (2) banking activities with a foreign country (corollary to transnationalisation of banking). Though both banking in and with a foreign country forms part of international banking, the criterion mostly applied to assess a bank's international character is the extent of its presence abroad. The existence and geographical extent of a network outside the host country and the number of branches are all variables from which the degree of a bank's internationalization is measured in this approach. In the other assessment, it is the nature of international operations as opposed to domestic ones, which is emphasized. In this approach the essential difference lies in the use of national currency or of euro-currency, depending on whether or not there is an international dimension involved for banking operations. This differentiating definitions gives an idea of the paradox

[7] See Annex on classification of financial services.

that while most theorists treat banks simply as multinational enterprises, transnationalisation or 'banking with a foreign country' aspect is intrinsically involved in that (Aliber, 1984). Therefore international operations and international presence must be distinctively understood and at the same time both must be looked at together to the extent they are disassociable aspects of international growth of banks.

While internationalisation encompass trade in banking services across all modes of supply, sticking with the above mentioned categorisation, multinationalisation or banking activities in a foreign country coincides with trade in banking services through mode 3. International banking has been expanding at an unprecedentedly fast pace over the last few decades, accompanied by far-reaching changes in the structure of the business. While up to the early sixties the bulk of international banking operations was accounted by home-based transactions conducted predominantly in connection with foreign exchange and trade related operations, later years have witnessed a spectacular rise of activities carried out through offshoots located in foreign financial centers or multinational banking (OECD 1981). The rapid multinationalisation of banking has had a major bearing on individual banks' management and strategies, but its impact is also being increasingly felt on the competitive structure of banking, the role of national regulatory and supervisory authorities, and the efficiency of monetary and credit control systems. The structural changes in international banking have taken place as a result of market forces and official regulation.

At the outset studies concerning banking FDI followed literature on FDI in general. This approach regards that multinational banking is more appropriately studied as a subset of the study of multinational enterprise (MNE). Such works drew heavily from two alternative paradigms that have been proposed for analyzing the behaviour of MNEs; eclectic theory and internalization theory (Williams, 1997). Over time, the literature on banking FDI developed further with special theories incorporating distinguishing features of banking industry. However many of these theories share certain common arguments and thus are not mutually exclusive. Internalization theory draws upon the Coasian theory of the firm and location theory. The Coasian approach considers that transaction costs lead the firm to prefer outright ownership of complimentary assets rather than bearing the costs of contracting in the open market. This explains the why and how of production decision, while the location theory answers the where. Location factors like input prices, barriers to trade, tax regimes, institutional arrangements, the prospects of the economy, and socio political situations dictate appropriate FDI destinations. Internationalization is thus internalization across borders.

Internalization theory is in fact taking a broad sweep and is constituted by several sub-cases. Eclectic theory, on the other hand, is an integrated version of internalization, location and ownership related explanations of internationalization.

Yet another useful categorising of theories explaining banking sector FDI divides such theories into microeconomic and macroeconomic frameworks (Herrero and Simon, 2003). Virtually all existing theoretical paradigms focus on the comparison of benefits and costs of the investment decision. In order to operate profitably in a foreign market, international banks must be able to realise gains that are unavailable to local competitors. These expected gains, to be realized when operating in a foreign financial sector, generally stem from (i) competitive advantage factors, (ii) efficiencies that cannot be attained operating exclusively in local markets; and (iii) geographical risk diversification.

Mode 3 entry of banking is widely considered to be on grounds of profitability through exploring untapped markets for low-interest bearing funds. But this depends largely on which all types of banking services are supplied through this mode[8]. In fact, core banking services like acceptance of deposits and other repayable funds from the public, lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transactions etc. can effectively be supplied only through mode 3. Supply in banking services through each of the four modes invokes different sort of barriers and regulatory constraints and thus the mode of supply depends on the conducive environment existing for each mode.

### 1.3 Stating the Problem

Banks are financial intermediaries critical for mobilising public savings and for deploying them to provide safety and return to the savers. They thus have fiduciary responsibility. The deployment of funds mobilized through deposits involves banks in financing economic activity and providing the lifeline for the payments system. The banking system is something that is central to a nation's economy; and that applies whether the banks are locally- or foreign-owned. Participation of foreign banking enterprises in Indian banking can be traced back to pre-independence period. Those banks, operating as branches of banks Incorporated

[8] The GATS follows Services classification list developed by the embers and circulated as a Secretariat document during the Uruguay round negotiations. This document, titled *Services Sectoral Classification List* , MTN.GNS/W/120 and informally referred to as W/120 , is closely correlated with the Provisional Central Product Classification (CPC). For banking services, sub-classification and codes are given in the Annex of the Agreement. See Appendix II for the list of banking services.

outside Indian territory, were termed exchange banks, as financing of colonial trade was their close preserve. The nature of foreign banking operations has changed in a significant way since then, along with the growth of organised banking in India, as their participation in domestic financial intermediation has become integral part of our commercial banking system. With the advent of the GATS, the services provided by these banks come under trade in banking services through mode 3 and therefore subjected to jurisdiction of the Agreement.

Indian commercial banking is characterised by firm and changing regulatory environment and diversity of bank ownership. The Reserve Bank of India, central bank and apex institution of the banking system, primarily governs the organised and unorganised banking sectors. Organised banking sector constitutes of scheduled and non-scheduled banks, of which, scheduled commercial banks accounts for majority of the commercial banking business. Foreign banks operating India forms part of scheduled commercial banks. Prior to 1969, all banks except State Bank of India and its seven associates were privately owned. Phased Nationalization of 20 commercial banks under Nationalization Act of 1969 was a prudent step to increase reach of commercial banking and thereby effectively impose credit planning and direct control practices. This strategy did achieve significant strides in increasing the spread of commercial banks, in mobilization of savings and in becoming a source of credit to the small-scale industries and agriculture. Over the years, around 30 to 40 per cent of gross household savings have been in the form of bank deposits, and around 60 per cent of assets of all financial institutions have been accounted for by commercial banks. Keeping in view the huge social banking needs faced by India owing to a large population still deprived of basic banking services, India needs to retain regulatory authority in governance of banking sector. The new developments through the GATS and India's commitments bring about an international intervention in the conduct of foreign banks operating in India which holds some key implications for the commercial banking sector as a whole.

There have been several distinctions in the performance of foreign and domestic banks in India with the former fairing than the later. This could be either due to inherent differences in the banking practices or conditioned advantages[9] or both. Depending on this, as the Agreement pursues objectives of extending market access and national treatment to foreign service providers, liberalising commitments will have the effect of bringing down or raising

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[9] Conditioned advantages refer to those advantages, which are offered to foreign banks by the domestic operating environment. Exemption from priority lending requirement is an example.

disparities between foreign and domestic banks. This is because, extension of market access and national treatment will remove conditioned advantages but will allow to better utilise advantages from superior banking practices. Literature linking scope of the Agreement, trade in banking services and functioning of domestic banking industry in India being scarce and least exhaustive, this study addresses specificities of Indian commercial banking, scope of the GATS and India's commitments in the Agreement on banking services and their implications.

### 1.4 Review of Literature

As regarding liberalisation of trade in financial services, there exists a fairly developed literature contesting a range of issues both theoretical and empirical in the context of GATS. Ryan (1990) addresses the question of why trade in financial services takes place and who stands most to gain from such agreement and puts up the argument that countries that are currently strong in the market will tend to be principal providers of financial services in a liberalised and harmonised market. Because of the length of time necessary to establish oneself in the market, new entrants are unlikely to emerge and sustain. Ryan and Murinde (2003) shows that while there are overall gains from trade, if there is any rigidity in the system, the aggregate national gains from a completely liberalised market might be positive only for service exporting country. Two major reasons for multinationalisation of banking has been discussed in the literature. Firstly, foreign banks move abroad with their clients and hence presence of foreign banks from countries with which the host country has strong trade and investment relations is likely to be high (williams, 1997). Secondly, countries with high growth rates and unsaturated markets for basic financial intermediation offer profitable opportunities and attract foreign banks (Focarelli and Pozzolo, 2000).

Several empirical studies have enquired into various aspects of foreign banking operations. An econometric exercise based on data for 130 countries for the 1990s done by Francois and Eschenbach (2001) points to a strong positive relationship between financial sector competition/performance and financial sector openness. Claessens and Jansen (2001) compiled several empirical studies done on nature of operations of foreign banks. Foreign banks tend to be larger and have better quality loan portfolios, higher net worth and higher ratios of operating income to costs. Once established, foreign banks also specialize in different activities. Foreign banks have a slightly smaller share of income from services than domestic banks. Foreign banks also tend to be less involved in consumer lending, and focus their portfolios rather on the manufacturing sector.

Many empirical studies have enquired into various aspects of foreign entry in banking. Comparative studies show significant difference in operational focus and performance between foreign and domestic banks. Claessens, Kunt and Huizinga (2001) takes a broad approach by using bank-level accounting data for eighty countries - industrialized, developing and transitional economies - for the years 1988-1995. The chapter shows that foreign banks have lower interest margins, overhead expenses and profitability than domestic banks in developed countries, whereas the opposite is true in developing countries. This suggests that the reasons for foreign entry, as well as the competitive and regulatory conditions found abroad, differ significantly between developed and developing countries.

Papi and Revoltella (1999) analysed FDI data and individual bank balance sheet indicators in nine transitional economies and found that banks with foreign participation tend to be more involved in non-traditional operations and rely less on interest revenues. The study also provides some insights into the motivation for entry of commercial banks in transition economies. The authors find that attracting foreign investment in the financial sector depends on a number of factors. Foreign banks base their initial decisions on investing abroad on a wide range of factors, amongst which are market opportunities, economic stability, trade relations and the stability and efficiency of the host country's banking sector.

Bayraktar and Wang (2004) took banking sector of 30 countries as sample for the period 1995 to 2005 and found out that there is no specific relationship between the level of economic development and openness to foreign banks. It was also found that changes in foreign bank shares are not significant in determining domestic banks' performance indicators. The weakest relationship between performance indicators and foreign share is obtained for countries which liberalised their capital account first, where foreign banks tend to concentrate on transnational banking activities. Goldberg and Saunders (1981) enquired into the differences between organisational forms of foreign banks. Their study shows foreign banks that set up branches may be concerned with long-run profits. In particular, since branches tend to be more permanent fixtures than subsidiaries and agencies, usually requiring infrastructure and long-term commitment of resources, foreign owners may be willing to subordinate short-run profit objectives for long-run profit considerations.

As to the tenets of GATS itself, Sorsa (1997), Low and Mattoo (2000) and Steenkamp (2004) reviews the major provisions of the Agreement and argues that the most important

liberalisation issue is the harmonisation of domestic regulations so that natural competitive advantages can be established. The lack of harmonisation of regulations can give rise to significant advantages in world trade and that any attempt without harmonisation could lead to inefficient trading and countries abusing domestic regulation to increase their share of foreign markets (Ryan, 1990). Furthermore, in the absence of such harmonisation, beneficial trading agreements between countries with similar regulatory arrangements may be impeded by MFN (Most Favoured Nation) clause.

There exists a rich literature on various aspects of Indian banking, but studies concerning operations of foreign banks operating in India have been few in number. R. D Sharma (1987) studied financial working of foreign international banks in India and several aspects of their involvement in banking industry. Though this work point towards the fast growth in aggregate assets, deposits and advances of these banks and their successful local adaptation and penetration into core banking business in the post nationalization era, the specific reasons behind this phenomenon are not extensively dealt with. Studies by Nag and Shivaswamy (1990) and Angadi (1990) confirms the earlier observations on superior performance of foreign banks. The work of Joseph and Nitsure (2002) on WTO and Indian banking sector is an isolated study on the implications of the GATS on banking. While considerable gains by way of joining the global financial markets are in offering, the need for caution and an element of reciprocity in her stance while participating in the trade negotiations are mentioned at the outset. Particularly, six issues are addressed in the work viz., (1) permitting entry of foreign banks through subsidiaries, (2) removing restrictions on foreign share of banking assets, (3) removing restrictions on number of branches, (4) removing investment limit by branches of foreign banks in finance companies, (5) continuation of restrictions on national treatment and (6) allowing trade in banking services through other modes apart from mode 3. While it is argued that, relating to all the issues mentioned above, India should progressively respond in the next round of negotiations, the authors give one precondition as addendum. India needs to strengthen domestic financial sector through reforms and institutional capacity building in order to ensure that her proactive steps in the negotiations will not turn counterproductive. It is opined thereupon that India is unprepared for trade in banking services through other modes of supply for lack of efficient regulatory mechanisms, similar supervisory and legal frameworks as that governs mode 3 entry. However, the work, falling in the genre of commentary, lacks focus on specific issues and arguments are not empirically grounded.

## 1.5 Objectives of the Study

Objectives of the study are as follows:

- Review the Provisions of GATS and India's commitments on banking services.
- Analyse performance of foreign banking service providers vis-à-vis their domestic counterparts.
- Delineate the implications of the GATS provisions and India's commitments in the context of comparative analysis

## 1.6 Conceptualisation and Approach

As the present study seeks to focus on India's trade in banking services through mode 3, services of foreign bank group in Indian commercial banking is brought under review. Services of foreign banks currently operating in India and new entrants befall as corollary to imports of such services. As the Agreement and India's commitments are of relatively recent origin, the aftermath of the commitments cannot be fully captured observing data on banking. Moreover, India had initiated steps towards some of the liberalising commitments even prior to the GATS. In this context this study takes a prognostic approach, wherein India's commitments on banking services are appraised on the basis of the features of jurisdiction of the Agreement and the present position of foreign banks in the commercial banking industry.

In order to study the implications of commitments on banking services, firstly important general provisions in the GATS and India's commitments on banking services are reviewed for finding the domain which they cover. This is done with the objective of locating their likely implications and importance. Then a comparative analysis of functioning of foreign banks as against domestic banks is carried out. Certain crucial differences in the operation of foreign and domestic banks and the underlying reasons are subjected to scrutiny, as the commitments carry power to either bridge such differences or widen them further. The empirical evidences there from are used for critique on the implications of the commitments for commercial banking industry.

### 1.7 Sources of Data

Data on operational aspects of scheduled commercial banks are compiled by the Reserve Bank of India and published annually through *Basic Statistical Returns* and *Statistical Tables Relating to Banks in India.* Data for performance indicators are chiefly taken from various issues of *Basic Statistical Returns*. Information on branch networks of bank groups is availed from *Branch Banking Statistics: Volume-3, 2002*. In Addition, *Annual Accounts Statistics of Scheduled Commercial Banks (1989-90 to 2000-2001),* which is also published by the RBI, provides annual accounts including statement of income and expenditure (profit/loss account) and balance sheet of all scheduled commercial banks. This data is available individual bank wise and bank group wise (according to ownership category) for the period 1990 to 2001.

### Chapterisation Scheme

The study is organised into two core chapters apart from the introductory and concluding chapters. Chapter 2 deals with the general provisions of GATS and the commitments on banking services made by India. Relation between four modes of supply, the general provisions of GATS and various banking services are discussed in this chapter and the implications of India's commitments are drawn. Chapter 3 looks into the role of foreign banks in domestic financial intermediation in India and their comparative position. Financial ratios computed from balance sheets of banks and other performance indicators are used to study the differentials of bank groups. Relative efficiencies of functioning of foreign and domestic bank groups in the deposit and advances market are computed using Data Envelopment Analysis. Empirical Findings are then matched with inferences from chapter 2. Chapter 4 summarises the findings and draws some policy lessons.

# CHAPTER 2

## GATS and India's Commitments on Banking Services

### 2.1 Introduction

The significance of liberalising commitments entered into by participating countries in the GATS, rely much on the general rules and provisions in the Agreement. Owing to inherent difficulties in comprehending trade in services apart from intrinsic complexities involved in international trade negotiation, provisions in the GATS are relatively more convoluted compared to that of its counterparts. Certain provisions apply to service sectors irrespective of whether the member country concerned entered voluntary commitments or not and the scope of the GATS thus extends beyond commitments *perse.* Attributes of India's commitments on banking services as a signatory to the Agreement should therefore be considered in conjunction with the underlying provisions upon which they rest. This chapter examines certain distinguishing features of chief provisions in the GATS and India's specific commitments on trade in banking services.

Sections 2.2 and 2.3 explore the relation of four modes of supply with general provisions in the GATS and trade in banking services respectively. Section 2.4 deals with major provisions in the GATS. India's commitments on banking services are discussed in section 2.5.

### 2.2 Modes of Supply and Provisions in the GATS

The legal text of the GATS contains 29 Articles divided into six parts. Article 1 of the Agreement in Part I defines four modes, services can be traded through, which solely renders distinctive features to subsequent Articles in the Agreement. As mentioned in the introductory chapter, the definition of modes of supply is drawn from literature dealing with specificities of services which are, to a large extend, unlike that of goods. The different modes of supply in international services trade are essentially defined on the basis of the origin of the supplier and consumer, and particularly the degree and type of territorial presence which they have at the moment the service is delivered (WTO, 1993). In this respect, only mode 1 is analogues to typical trade in goods where no territorial presence of either consumer or producer is required.

In Mode 1 intangibility constraint of services is overcome by embodying them in tangible goods and physically moving those goods abroad. However, when a service is embodied in a tangible good, the distinction whether it is a good or service is hardly a sharp one and such

cases are, classified under goods trade, well outside the domain of GATS. This is so, as can be argued, currently with the exception of services 'exported' through electronic communication; where electronic signals are considered embodied goods which do not cross a border in the normal parlance of the concept and therefore excluded from the realm of goods trade as well. While this sort of service consumption is prevalent especially following the rapid advancement in electronic communication technologies, with no effective method presently to perceive the volume and content of such transactions they are a long way from being negotiated under WTO.

The other three modes of supply are characteristically subjected under the provisions of GATS according to the degree and type of territorial presence of consumers and producers at the occurrence of service trade. How the GATS applies to a transaction depends very much on where the service is supplied and consumed (Steenkamp, 2004). Whatever the mode of supply, obligations and commitments under the Agreement relate directly to the treatment of services and service suppliers. They only relate to service consumers insofar as services or service suppliers of other Members are affected. It should be noted that a Member may only be able to impose restrictive measures affecting its own consumers, not those of other Members, on activities taking place outside its jurisdiction (WTO, 1993). For instance, Tourism Services can only be consumed through mode 2 where the transaction takes place in producer's country and in this case GATS can only apply to the consumers country to the extend that that country allows its residents to tour abroad and consume the service. The policies in the consuming country as applicable to consumers' international mobility and consumption choices are in question when it comes to liberalisation of service trade through mode 2. Mobility and choices relating to consumption are barely restricted using direct measures amongst WTO members and more importantly the argument for liberalising those policies, if at all they exist, for the sake of trade is very weak. In this respect the role of much disputed major provisions in GATS in promoting mode 2 trade in services is trivial.

Policies and regulations applicable to producers instead of consumers make supply via modes 3 and 4 distinctive compared to that through mode2. In this case also GATS applies to the consuming country but in a highly significant way, as complete prohibition of foreign service providers or regulations and norms which hinder such provision are the prime barriers to trade in services. The Articles of GATS are in fact committed to facilitate unrestrained functioning of foreign service providers in the host country. In the case of temporary movement of service personnel or supply through mode 4, primarily restrictions on foreign nationals entering a

particular country pose as barrier to trade. But such restrictions vary immensely from country to country.

Mode 3 supply, on the other hand, involves long term capital movement and direct investment on establishments. Also mode 3 service providers engage in provision of a multitude of services which are sub-classified under one service type, participating within the framework of organised industry in the host country. Mode 3 entry is, moreover, the most viable method of supply given the specificities associated with many of the services which are internationally traded. Being analogues to FDI, supply through mode 3 entails all concerns associated with FDI as extensively discussed in the literature. Unlike other modes, mode 3 suppliers face exclusive regulatory bodies in the host country and are usually subjected to conditioned operating environment. GATS with its slogan of liberalisation lends its crucial Articles on Domestic Regulation and National Treatment and their disputed contents to facilitation of supply through mode 3 far more than other modes of supply.

## 2.3 Banking Trade and Modes of Supply

It is to be noted that same service could be supplied internationally through more than one mode depending on the nature of services[1] and the extent to which such trade is allowed. Certain banking services can be supplied through mode1, where either credit or debit financial transaction occurs between a bank and its client abroad via electronic fund transfer. While such transactions are distinct and not identified often with core banking function of intermediation, banking services are predominantly traded through mode 3. Banking services from basic intermediation to custodial services, payment and money transfer services including credit cards, travellers cheques, bankers' drafts and even dealings in foreign exchange, money market, securities etc, requires a great deal of local knowledge and expertise and more importantly local presence for trust building and expanding clientele. Moreover mode 3 allows establishments to club these services together and operate funds with better scale and scope efficiencies.

[1] Where a service transaction requires in practical terms the use of more than one mode of supply, coverage of the transaction is only ensured when there are commitments in each relevant mode of supply. For Example: A Member has made commitment in the cross-border supply of architectural services (e.g. by telecommunications or by mail). This commitment alone does not extend to the presence of natural persons (e.g. visits by architects). A separate commitment would have to be taken under "Presence of natural persons" to cover this case.

It is crucial to distinguish liberalisation and trade in financial services at this juncture. Liberalisation of financial services is a wider expression and basically delineates the following three aspects.

- *Domestic financial deregulation* allows market forces to work by eliminating controls on lending and deposit rates and on credit allocation and, more generally, by reducing the role of the state in the domestic financial system.
- *Capital account liberalisation* removes capital controls and restrictions on the convertibility of currency and removes barriers to the cross-border provision of financial services.
- *Internationalisation of financial services* eliminates discrimination in treatment between foreign and domestic financial service providers.

Trade in financial services is essentially internationalisation of financial services, but it requires the implementation of other two aspects in varying degrees according to the modes of supply. Trade through mode 1 could be facilitated by high degree of capital account liberalisation. Trade though mode 3, on the other hand, depends mainly on domestic financial deregulation as a prerequisite. It is therefore evident that, trade in banking services necessarily exerts pressure on regulatory authority of members of the Agreement, especially on developing countries which need to retain staunch regulation for prudential reasons.

Table 2.1 Summarises the commitments made in GATS by member countries across the four modes of supply in various service sectors. Commitments are classified as opening up of trade without any limitations, with limitations and those which are left unbound meaning the member retains full discretion regarding opening up and no commitments are taken up in the concerned mode of supply. It can be observed that commitments are most actively made towards opening up in mode 3 where percentage of unbound entries are the lowest in almost all the service categories. Financial services are distinguished in mode 3 where commitments with limits occupy up to 56 per cent which is far higher than other services. Though in services like construction and environment, cross-border supply or mode1 registers higher percentage of unbound commitments, the reason is technical unfeasibility in trading those services through mode 1. Despite the fact that financial services trade is highly viable through mode 1, compared to other services mode 1 is left unbound in most of the cases, adding up to 30 per cent of the commitments in that mode. This clearly suggests the existence of capital

controls and restrictions on convertibility of currency in member countries which poses barrier to financial services trade through mode1.

**Table 2.1 Sector-specific Limitations across Modes of Supply**

(Percentages within each mode)

| *Sector* | *Mode1* | | | *Mode2* | | | *Mode3* | | | *Mode4* | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | No limits | Limits | Un-bound | No limits | Limits | Un-bound | No limits | Limits | Un-bound | No limits | Limits | Un-bound |
| Financial | 51 | 19 | 30 | 57 | 17 | 26 | 39 | 56 | 5 | 75 | 15 | 10 |
| Business | 72 | 3 | 25 | 88 | 1 | 11 | 86 | 11 | 4 | 86 | 8 | 7 |
| Communication | 73 | 10 | 16 | 84 | 2 | 14 | 73 | 20 | 7 | 89 | 2 | 10 |
| Construction | 17 | 1 | 82 | 83 | 0 | 17 | 80 | 15 | 5 | 91 | 6 | 3 |
| Distribution | 69 | 3 | 28 | 93 | 0 | 7 | 87 | 12 | 1 | 92 | 5 | 3 |
| Education | 81 | 9 | 10 | 92 | 3 | 6 | 77 | 18 | 5 | 90 | 6 | 5 |
| Environment | 20 | 0 | 80 | 96 | 0 | 4 | 96 | 4 | 0 | 94 | 4 | 2 |
| Health | 20 | 0 | 80 | 89 | 2 | 9 | 76 | 16 | 8 | 89 | 6 | 6 |
| Tourism | 51 | 4 | 45 | 88 | 1 | 11 | 78 | 17 | 5 | 82 | 8 | 10 |
| Recreation | 68 | 0 | 31 | 94 | 1 | 5 | 86 | 9 | 5 | 89 | 5 | 6 |
| Transport | 48 | 3 | 49 | 94 | 0 | 5 | 74 | 13 | 13 | 91 | 3 | 6 |

Source: WTO (1999) Guide to the Uruguay Round Agreements
Note: Cross-border supply is unbound where it is technically infeasible
No limits - Full commitments or the Member does not seek in any way to limit market access or national treatment.
Limits - The Member details the measures maintained which are inconsistent with market access or national treatment, and implicitly commits itself to take no other inconsistent measures.
Un-bound - The Member remains free to maintain or introduce measures inconsistent with market access or national treatment.

## 2.4 Provisions in the GATS

Although the GATS is a separate agreement from that of the GATT, it encompasses the same basic principles aimed at promoting free trade by providing legal and institutional framework for international negotiations. For instance, binding clauses like most-favoured nation (MFN), transparency and market access are contained in the Agreement for services as well. However, due to the specific characteristics of services trade, particularly with regard to the different modes of supply and trade-political considerations surrounding services trade, the traditional application of these principles has been modified in the GATS. The result is arguably a more complicated agreement than the GATT with much room for uncertainty in the international services trade regime (Steenkamp, 2004).

The obligations contained in the GATS may be categorised into two groups. The first group consists of general or horizontal obligations that apply directly and automatically to all WTO members, regardless of the existence of sectoral commitments made under any of the four modes of supply in respect of a certain service sector. The second group consists of specific commitments or vertical obligations, whose scope is limited to those sectors and activities in

which a WTO member has decided to assume market access and national treatment obligations. Most important general obligations are Articles on Most-Favoured Nation (MFN) treatment and Transparency. Sector specific commitments are made by countries as limitations to Market Access and National Treatment. Crucial Article on Domestic Regulation is given as general obligation in the legal text, but in principle is applicable only to committed sectors.

In fact the provisions are designed to address market access issues both at entry level and post-entry operation level. But the exact realm of each of these provisions in this regard is not well delineated in the Agreement. This non-conformity between provisions evokes the primary concerns regarding implications of the sector specific commitments. Moreover, members enter their commitments, in such a way that their value is much intertwined with the provisions of various Articles.

### *2.4.1 Most-Favoured Nation Treatment (MFN)*

The MFN principle is most importantly a rule of non-discrimination that ensures equal or 'no less favourable' treatment of like services and service suppliers of the different member countries by a particular WTO member. Article II (1) of the GATS dealing with MFN states that 'with respect to any measure covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country'. MFN treatment per se, is, of course, not a liberalising condition. A member country that, for example, bans all trade with any non-national supplier would be acting in a manner consistent with the MFN principle. MFN operates at the entry-level issues. However, in terms of Article II (2) a member country is permitted to maintain a measure inconsistent with the general MFN requirement or if it has taken up exemptions as permissible under the provision. Such inconsistent measures are MFN exemptions, which are to be listed by members upon entry into force of the Agreement.

MFN exemptions are in principle to last no more than 10 years and are also subjected to future negotiations. The need for an annex on MFN exemptions arose from concerns on the part of certain members that an unconditional rule would allow competitors located in countries with relatively restrictive policies to benefit from their sheltered markets while

enjoying a free ride in less restrictive export markets[2]. Over 60 WTO members including India took MFN exemptions in the first round of negotiations. Exemptions for financial services were generally driven by reciprocity concerns, wherein countries sought to retain ability to discriminate against members that do not offer reciprocal access to financial services markets. The concern for the countries looking forward to expand international presence of their domestic service providers is that, reciprocity clause would allow such expansion at the cost of increased foreign presence in their domestic markets as well.

### *2.4.2 Domestic Regulation*

The issue of domestic regulation is extremely important for international services trade. The reason is that domestic regulation has great potential to discriminate against Foreign Service providers and therefore violate the principles in conjunction with other provisions. Moreover, Article VI of the GATS, dealing with Domestic Regulation, lacks definitional clarity in certain respects and thereby invokes a lot of confusion. It is important to note, however, that the GATS preamble recognises 'the right of Members to regulate, and to introduce new regulations, on the supply of services within their territories in order to meet national policy objectives'. Although article VI recognises this right as stated in the preamble, it also qualifies this right to a certain extent in line with the services trade liberalisation goal of the GATS. This apparent conflict may result in future trade disputes (Mattoo 2000). The root of this conflict can be traced back to the fact that it is extremely difficult to develop effective multilateral disciplines in domestic regulation without unduly constraining regulatory freedom of certain member countries. The result is a weak GATS provision (Steenkamp, 2004).

This Article clearly applies only to those services and service suppliers in respect of which specific commitments were undertaken. It does not require member countries to enact or maintain reasonable, objective, and impartial domestic regulations, but only mandates that domestic measures be administered in a reasonable, objective and impartial fashion. The intention of Article VI is to prevent members from denying, nullifying or impairing the GATS benefits to other WTO members through the use of onerous domestic administrative measures. For example, if a financial institution wants to provide financial services in another member country, and requires a license to do so, but the GATS-compliant licensing regulations are administered in a manner that makes it almost impossible for the foreigner to obtain the required authorisation, the value of the specific commitment (allowing other

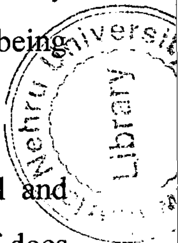
[2] Hoekman and Kostecki (2001), pp. 252.

countries' financial services providers to provide this specific service to its citizens) is nullified.

### *2.4.3 Market Access and National Treatment*

Articles in the GATS dealing with Market Access and National Treatment are specific obligations, which are applicable only to those sectors where commitments are taken up. In fact countries schedule their commitments as limitations to Market Access and National Treatment. These two clauses together dictate the broad potential for accessing the host market, though their respective role in this process is not sharply distinguished in GATS.

The GATS article XVI specifies that "each Member shall accord services and service suppliers of any other Member treatment no less favourable than that provided under the terms, limitations and conditions agreed and specified in its Schedule". This provision is very similar to the provision dealing with the MFN treatment obligation, the only difference being that it deals with market access in the context of the specific commitments made.



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The term 'market access' has gained importance against the background of bilateral and multilateral trade negotiations, but has no generally accepted definition, as GATS itself does not attempt to define market access. Rather, it provides a list of restrictive measures that are typically used to deny entry to a host country market to foreign services or service suppliers. In respect of those service sectors in which market access commitments were undertaken by a WTO member, it cannot maintain or adopt limitations, unless explicitly stated in the commitment schedule, on (1) the number of service suppliers; (2) the total value of services transactions or assets; (3) the total number of services operations or the total quantity of service output; (4) the total number of natural persons that may be employed in a particular sector; (5) specific types of legal entity through which a service can be supplied; and (6) foreign equity participation[3].

The foregoing actually provides us with an indication as to what exactly is meant by the term "market access", or, more precisely, what measures would be contrary to the principle of Market Access in terms of the GATS. The list of measures to be listed in a member's schedule in order to have legitimate effect is clearly exhaustive and any other measures that

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[3] GATS a XVI (2) states that the quantitative restrictions specified in sub-paragraphs (a) to (d) refer to maximum limitations.

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may in effect restrict market access are allowed, as long as they are not in contravention of the GATS[4]. For example, fiscal measures are not covered, which means that, without being obliged to schedule it, a member country could maintain a high non-discriminatory tax on a particular service that severely limits market access (Mattoo, 2000). Furthermore, the provision on Market Access covers both discriminatory and non-discriminatory measures. For example, a discriminatory measure stating that only a certain number of *foreign* banks will be allowed in a member country would be contrary to article XVI to the same extent as a so-called non-discriminatory measure stating that only a certain number of *foreign* and *domestic* banks will be allowed. The latter measure is non-discriminatory as it does not distinguish between foreign and local banks. However, should any quotas be listed in a member's schedule, they would be permitted. In addition, such a listing should be read as a 'minimum' guarantee rather than a 'maximum' guarantee (Mattoo, 2000). In other words, if a country has listed that only a certain number of banks would be allowed market access, that specific number may not be lowered, although it may be increased without contravening the GATS.

Market Access can, however, best be viewed as meaning non-discrimination between incumbents in a particular market and possible entrants (Steenkamp, 2005), which exactly is what National Treatment clause also stands for. Article XVII dealing with National Treatment is very similar to article XVI dealing with market access, except that it does not set out a list of measures that would be incompatible with such treatment. In terms of the National Treatment obligation, in sectors covered by a member country's schedule, and subject to any conditions and qualifications set out in the schedule, each member shall treat foreign services and service suppliers, in measures affecting the supply of services, no less favorably than it treats its own like services and suppliers. Therefore, where the MFN treatment obligation compares the treatment of foreign services and service suppliers with each other, in terms of the national treatment obligation, the treatment of foreign services and services suppliers is compared with that of domestic services and suppliers. In its simplest form, National Treatment calls for the application of regulations to foreign persons in the same way that it is applied to nationals; in that sense it can be seen as a basic territorial rule of regulatory jurisdiction (Sorsa, 1997).

The basic national treatment obligation may be met by the phrase "according to services and service suppliers of any other Member, either formally identical treatment or formally

[4] For example, all measures falling under article XIV of the GATS (General Exceptions) are exempted from all obligations and commitments under the GATS, and therefore need not be scheduled.

different treatment to that it accords to its own like services and service suppliers" (GATS a XVII (2)). This provision makes it clear that limitations on national treatment cover cases of both *de jure* and de facto discrimination (Steenkamp 2004).

It is important to note that there are two elements inherent to the national treatment obligation, namely (1) National Treatment can cover the right to establishment and entry into a market, as well as (2) post-entry operations. Also, at these two points National Treatment clause intersect with MFN and Market Access respectively. Mattoo identifies three possible types of national treatment in the context of the GATS. Firstly, he identifies the so-called *strong national treatment*, which would cover both the right to establish, as well as post-establishment treatment. Secondly, *post-entry national treatment* would exclude the right to establish from the scope of the national treatment obligation. Thirdly, the *limited national treatment* would be subject to all measures, including discriminatory quantitative restrictions, taken in terms of article XVI on market access (Steenkamp, 2004). The text of article XVII supports strong interpretation, since 'all measures affecting the supply of services' must cover also all quantitative restrictions, including those affecting the ability to use mode 3 – that is, to establish a commercial presence.

It is clear, however, that an interpretation of *strong national treatment* may sometimes find itself in direct conflict with the market access commitments entered into by a member and the restrictions listed in respect thereof. Such a situation would obviously be untenable. Thus, while there may be no limitation entered in the national treatment column, there may be a discriminatory measure inconsistent with national treatment inscribed in the market access column. However, in accordance with Article XX (2), any discriminatory measure scheduled in the market access column is also regarded as scheduled under Article XVII. Thus, the market access column contains measures that are inconsistent with Article XVI only (non-discriminatory market access limitations), and with both Articles XVI and XVII,

But there are often no indication as to whether the measures considered are non-discriminatory or discriminatory. Since the precise overlap between the two articles is not identified, the scope of the national treatment obligation remains ill defined. As the securing of market access under mode 3 is a two-stage process in practice – one set of measures will define the terms of entry for a foreign investor and another will establish the conditions for post-entry activity – the problem of identifying the scope of national treatment is most acute in this mode (Low & Mattoo 2000).

As in the case of Market Access in the context of the GATS, the basic National Treatment obligation of the GATS does not apply unconditionally and generally, but merely applies to those sectors scheduled, and subject to exceptions set forth in those schedules. Unlike article XVI on market access there is not an exhaustive list of possible exceptions to be indicated in the schedules. It can be inferred that all possible exceptions must be listed, except when provided for elsewhere in the GATS.

Market Access is more relative and flexible than National Treatment, and modern requirements for market access are often found in conjunction with requirements for national treatment. However, simple National Treatment may not be effective enough if a country's domestic rules are implicitly protectionist. Sufficient Market Access may therefore require better-than-National Treatment, with Market Access requirements going further and requiring a sufficient degree of harmonisation downward to allow foreigners access (Steenkamp, 2005). In other words, market access should be evaluated in the context of the actual trade barriers in existence and their effect in hindering market access for foreign service suppliers. This boils down to the basic question, whether there is access to the market or not. The National Treatment concept does not take this into account and only compares the barriers facing domestic service suppliers with those facing foreign service suppliers within the domestic scene. Therefore, each individual case has to be assessed on its own merits in order to determine whether existing barriers hinder sufficient market access. Whether Market Access can be regarded as sufficient or not depends on a factual evaluation, taking into account the specific service sector, existing barriers and their effect, as well as the real access and potential access.

There is one major shortcoming of the Market Access standard when seen in a better-than-National Treatment context. A better-than-National Treatment may disadvantage domestic service suppliers relative to their foreign counterparts, leading to demands by domestic service suppliers for a lessening of the burden of domestic regulation and, by doing so, at least ensuring equal treatment for both foreign and domestic service suppliers. This situation may lead to a sacrificing of the effectiveness of a country's regulations (Steenkamp, 2005).

**2.5 India's Banking Services Commitments under GATS**

With the advent of GATS, India as a signatory to the Agreement faces a contrasting precarious position regarding management of domestic banking sector amidst a lot of

conflicting views on its present position against unique opportunities for making her banking globally competitive. Much of the concerns arise out of implications of GATS on domestic banking regulatory regime under which an already significant presence of foreign banks exists.

As expressed in the preceding sections, the services obligations of each WTO member cannot be understood by reference only to the general rules of GATS as a member's obligations depend largely on the specific commitments it has undertaken in its national schedule. Many observers have pointed to aspects of the design of schedules and scheduling techniques that introduce an unwelcome element of opacity and interpretative ambiguity into the GATS, making the agreement less effective as a system of rules and vehicle for further liberalization (WTO, 1999). Since the precise overlap between Article XVI and Article XVII is not identified, the scope of the national treatment obligation remains ill-defined resulting in considerable amount of indefiniteness in commitment schedules filed by members of the Agreement. Further, a significant number of Members have scheduled limitations, in particular under market access, that cannot be clearly associated with relevant GATS provisions. Imprecise entries may be explained in part by government's lack of experience, co-ordination problems between ministries, and a traditional bureaucratic preference for risk minimisation (Adlung, 2004). Further, the GATS as an entirely new agreement, has no past history on which countries could rely to schedule limitations, which inevitably led to idiosyncratic approach or even technical errors (WTO 1999).

The confusion relating to scheduling of commitments, which is visible in most of the member country schedules, is resonated in India's Commitment Schedule as well. India's initial commitments on banking services are indeed reflecting a cautious stance, in conformation with the strict regulatory environment in commercial banking which has been prevalent despite banking sector reforms and subsequent entry deregulation measures adopted well before GATS. It has been explicitly stated in the commitment schedule[5] that 'the commitments are subject to entry requirements, domestic laws, rules and regulations and the terms and conditions of the Reserve Bank of India, Securities and Exchange Board of India and any other competent authority in India', showing India's intention to maintain status quo with respect to entry and operation of foreign banks. Nevertheless from a legal point of view the statement is out of place in the schedule and hardly holds authority here. India's signatory

[5] See Annex 1 of India's commitment Schedule on banking services.

status would invoke the general obligations by default and the limitations enlisted will set in effect the articles applicable to committed sectors.

Modes 1 and 2 are left unbound, meaning India remains free to maintain or introduce measures inconsistent with market access or national treatment. Opening up of mode 1 or cross-border delivery channel is fundamentally linked towards full capital account convertibility, which would certainly take some time as the present macro economic environment and fiscal management are not very conducive to go ahead with full convertibility on capital account (Joseph and Nitsure, 2002). In mode 3, which is particularly important for banking, Commitments are entered with limitations.

Limitations scheduled as applying to mode 3 implicitly commits itself to take no other measures inconsistent with market access and national treatment. Only two limitations are entered in National treatment column, of which only the quantity restriction on term deposits directly applies to business aspects. Seven limitations are listed in Market Access column which, in fact, are in a way entered in non-conformity with the stipulated form. Out of the six restrictive measures, as stated in Article XVI, only type of legal entity should be specified qualitatively. India's schedule contains qualitative limitations under other heads as well. Table 2.2 classifies Market Access limitations according to restrictive measures.

It is evident that the limitations follow the general note of prudence largely owing to the uncertainties associated with the novice Agreement. Limitations enlisted under market access, according to Article XVI are subjected to national treatment as well. In fact there are primarily two matters in which foreign banks are discriminated against domestic banks: public sector company term deposits are not available to foreign banks and foreign bank profits are taxed higher than domestic banks (Joseph and Nitsure, 2002). The first of this is entered as limitation in national treatment column and while the second one is not at all scheduled even while considering that limitations enlisted in Market Access column are also applicable as national treatment limitations under Article XX(2). The reason for these discriminations is that foreign banks are branches and not entities incorporated in India and it must be noted that these discriminations are automatically removed once subsidiaries are allowed, as they are incorporated entities unlike branches.

**Table 2.2 Limitations on Market Access according to Restrictive Measures[6]**

| Market Access Restrictive Measures | Limitations Scheduled |
|---|---|
| Number of Service Suppliers | Grant of licence as permissible under existing laws.<br>A limit of twelve licences per year both for new entrants and existing banks.<br>Licences for new foreign banks may be denied when the maximum share of assets in India both on and off balance sheet of foreign banks to total assets both on and off balance sheet of the banking system exceeds 15 per cent.<br>Banks may install ATMs (subject to licence if installed outside the licensed branch premises). |
| Total value of service transactions or assets | Investments in other financial services companies by branches of foreign banks licensed to do banking business in India individually not to exceed 10 per cent of owned funds or 30 per cent of the invested company's capital whichever is lower.<br>Foreign banks are subject to non-discriminatory resource allocation requirements. |
| Total number of service operations or total quantity of service output | Foreign banks are subject to non-discriminatory resource allocation requirements. |
| Total number of natural persons | -- |
| Type of legal entity of the supplier | Only through branch operations of a foreign bank licensed and supervised as a bank in its home country. |
| Participation of foreign capital | -- |

Source: Schedule of Specific Commitments, India (GATS, 1997)

Currently, fully owned branches of banks incorporated outside Indian territory are termed foreign banks as per the RBI's schedule on commercial banks and only such branches are allowed to participate in commercial banking industry. Limitation for type of legal entity clarifies this and on the other hand, limitation for participation of foreign capital is left blank. Giving subsidiary status to foreign banks involves subjecting them to equal priority lending stipulations and rural branching which may act as a disincentive for foreign entry through subsidiary route (Joseph and Nitsure, 2002). On the contrary, foreign capital can circumvent limitations on national treatment by choosing the alternative route of equity participation (operating through subsidiaries) rather than opening branches, discounting the power of national treatment limitations. This contradiction leads to India's own existing indecisiveness as to type of legal entity for foreign participation in banking. Post GATS developments in which equity participation cap on banks by foreigners was proposed to raise, is therefore one step forward from the commitments.

[6] limitations on market access in India's commitment schedule with related to key banking services is classified according to the 6 market access restrictive measures specified in GATS Article XVI. See Annex I for the commitment schedule of India.

According to services classification codes, there are various sub classifications for each main service category. While Banking is an integral part of financial services, banking is further sub classified into further heads. Interestingly India's Schedule of Commitments groups primary banking activities and other auxiliary services in banking separately. While it is specified that for primary banking services starting from acceptance of deposits and other repayable funds from the public to lending, money transmission and custodial services the type of legal entity allowed is branches of foreign banks, additional services like financial leasing, factoring and venture capital can only be carried out by incorporation of separate institutions with foreign equity not exceeding 51 per cent. In the case of participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues and financial consultancy services, both foreign bank branches and entities incorporated with foreign equity not exceeding 51 per cent are allowed. Thus importance for participation in basic intermediary services are ascribed to foreign banks in the schedule.

Issues relating to the type of legal entity and foreign equity participation stem from the relation between ownership and management in Indian banking. Major share of commercial banking being controlled by public sector, there is an argument for gradually consolidating these banks by allowing mergers as well as domestic private and foreign equity holdings. The need for this consolidation, as drawn from the literature, arise out of the contention that optimal size and scale of operation will have a positive bearing on efficiency and profitability. But there are strong counter arguments concerning the level of optimal size in Indian banking and the very nature of relationship between size and efficiency [Ram Mohan (2004), Bagchi and Banerjee (2005)]. One important point, which is undermined in this debate, is the consideration of potential benefits expected of foreign entry and such a consideration can be seen lacking in the commitments.

There are three particularly important implications arising out of commitment schedule for commercial banking. Firstly, the schedule automatically entitles foreign banks to full market access and national treatment apart from the limitation entered in the commitment schedule. The limitations listed by India are rather vague and miss important limitations currently offered to foreign banks. As will be dealt with in the next chapter, there are certain national treatment limitations in Indian banking at present, which turn out to be advantageous for foreign banks instead of domestic ones. Limitations in India's schedule of commitments are

too few and non-specific to deal with this counter-intuitive situation. This occurs despite the fact that market access limitations automatically qualifies for national treatment limitations as well. Market access in terms of total number and value of banking transaction is limited in the schedule by stating foreign banks are subjected to non-discriminatory resource allocation requirements. Not only is this statement unclear, the non-discriminatory resource allocation cannot be stringently imposed beyond an extent as enlisting of the limitation itself involuntary appeal to Article VI on Domestic Regulation. This opens up a lot of leeway for operations of foreign banks in both markets for deposits as well as advances market.

Secondly, entry limitation for new foreign banks is entered in the Schedule by stating that licenses for new foreign banks may be denied when the maximum share of assets in India both on and off balance sheet of foreign banks to total assets both on and off balance sheet of the banking system exceeds 15 per cent. Currently foreign banks possess around 7 per cent of the total commercial banking assets. But the operations of such banks being regionally concentrated in relatively more profitable urban centers, their markets intersect with that of domestic banks in those areas only. Given the immense rural penetration and large branch networking of domestic banks, a huge portion of banking assets lie well outside the boundary of areas in which foreign banks are located which is growing at a fast rate following the branching policies of the Reserve Bank of India. The branching policies addresses the issue of expanding the reach of commercial banking in India where roughly 60 to 80 per cent of enterprises and individuals within the country still lack access even to basic financial services such as savings and credit (Mor, 2005). The entry limitation entered in the schedule thus translates into a very wide scope for foreign entry in commercial banking and subsequently to complex post entry operation and management issues.

Thirdly, the crucial implications of the commitments on domestic regulatory authority come up. Though the Annex of the legal text of the Agreement on financial services further qualifies the Article on domestic regulation by allowing members to take measures for prudential reasons, including for protection of investors, depositors and policy holders to ensure the integrity and stability of the financial system, it is mentioned alongside that such measures shall not be used as means of avoiding the member's commitments or obligations under the system. As mentioned before, Indian commercial banking has been predominantly under the RBI as a regulatory agency and with major share of banking functions has been carried out by public sector, given the inevitable state support required for extensive social banking needs. The regulatory power has been exercised by the RBI in all aspects of

commercial banking from entry norms to guidelines on resource allocation. Considering India's commitments relating to entry and post entry activities, the single major concern is with regard to the extent which the commitments exerts pressure on domestic regulation.

Foreign banks operating in India, which are branches of banks incorporated outside Indian territory, constitute a prominent place amongst scheduled commercial banks. Scheduled commercial banks including all public commercial banks, domestic private scheduled commercial banks and Regional Rural Banks account for bulk of the commercial banking assets in India. In order to understand the current market access and national treatment status held by foreign banks, it is important to consider operational aspects of commercial banking in India. The implications of the commitments can only be appreciated in the light of a comparative analysis wherein performance of each bank group and reasons for differentials therein are examined. Chapter 3 serves this purpose, where current status of foreign banks compared to domestic bank groups is explored and thereafter related to India's commitments on banking.

## Annex I

## India's Schedule of Commitments on Banking Services

| Sub-sectors | Limitations on Market Access | Limitations on National Treatment |
|---|---|---|
| B. Banking and other financial services (excluding insurance) | | |
| **Modes of supply: (1) Cross-border supply (2) Consumption abroad (3) Commercial presence (4) presence of natural persons** The commitments in financial services are made in accordance with the General Agreement on Trade in Services and the Annex on Financial Services. All the commitments are subject to entry requirements, domestic laws, rules and regulations and the terms and conditions of the Reserve Bank of India, Securities and Exchange Board of India and any other competent authority in India. | | |
| 1.(i) Acceptance of deposits and other repayable funds from the public 5(a)(v)<br>(ii) Lending of all types, including consumer credit, mortgage, credit and financing of commercial transactions but excluding factoring Ex. 5(a)(vi)<br>(iii) All payment and money transmission services including credit, charge and debit cards, travellers cheques and bankers' drafts 5(a)(viii)<br>(iv) Guarantees and commitments 5(a)(ix).<br>(v) Trading for own account of:<br>(a) money market instruments<br>(b) foreign exchange<br>(c) transferable securities<br>Ex. 5(a)(x)(A)(B)(E)<br>(vi) Portfolio management, custodial and trust services<br>Ex. 5(a)(xiii)<br>(vii) Clearing services for other banks for cheques, drafts and other instruments Ex. 5(a)(xiv). | (1) Unbound<br>(2) Unbound<br>(3) (i) Only through branch operations of a foreign bank licensed and supervised as a bank in its home country.<br>(ii) Grant of licence as permissible under existing laws.<br>(iii) A limit of eight licences per year both for new entrants and existing banks.<br>(iv) Banks are allowed to instal ATMs at branches and at other places identified by them. Installation of ATM at a place other than in licensed branches is treated as a new place of business and requires a licence. Licences issued for ATMs installed by foreign banks will not be included in the ceiling of eight licences referred to in item (iii) above.<br>(v) Investments in other financial services companies by branches of foreign banks licensed to do banking business in India individually not to exceed 10 per cent of owned funds or 30 per cent of the invested company's capital whichever is lower.<br>(vi) Licences for new foreign banks may be denied when the maximum share of assets in India both on and off balance sheet of foreign banks to total assets both on and off balance sheet of the banking system exceeds 15 per cent.<br>(vii) Foreign banks are subject to non-discriminatory resource allocation requirements.<br>(4) Unbound except as indicated in the horizontal section | (1) Unbound<br>(2) Unbound<br>(3) (i) Foreign banks are required to constitute Local Advisory Boards consisting inter alia of professionals and persons having expertise in areas such as small-scale industry and exports. The Chairman and members of the Local Advisory Board must be resident Indian nationals except for the Chief Executive Officer who may be a foreign national. The appointment of Chairman and members of the Board requires Reserve Bank of India approval.<br>(ii) Public sector enterprises can invest surplus funds in term deposits only with Scheduled Commercial Banks incorporated in India.<br>(4) Unbound except as indicated in the horizontal section |
| 2. Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or | (1) Unbound<br>(2) Unbound | (1) Unbound<br>(2) Unbound |

| | | |
|---|---|---|
| privately) and provision of services related to such issues 5(a)(xi) | (3) (i) Foreign banks branches licensed to do banking business in India. (ii) Through incorporation with foreign equity not exceeding 51 per cent by financial services companies (including banks). | (3) None |
| | (4) Unbound except as indicated in the horizontal section | (4) Unbound except as indicated in the horizontal section |
| 3. Stock broking Ex. 5(a)(x)(E) | (1) Unbound (2) Unbound | (1) Unbound (2) Unbound |
| | (3) Through establishment of locally incorporated joint venture company with foreign equity not exceeding 49 per cent. The foreign equity participation will be limited to recognize foreign stock brokering companies. | (3) None |
| | (4) Unbound except as indicated in the horizontal section | (4) Unbound except as indicated in the horizontal section |
| 4. Financial consultancy services, i.e. financial advisory services provided by financial advisers, etc. to customers on financial matters, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy Ex. 5(a)(xvi) | (1) Unbound (2) Unbound | (1) Unbound (2) Unbound |
| | (3) (i) Foreign bank branches licensed to do banking business in India. (ii) Through incorporation with foreign equity not exceeding 51 per cent by financial services companies (including banks). | (3) None |
| | (4) Unbound except as indicated in the horizontal section | (4) Unbound except as indicated in the horizontal section |
| 5. Factoring Ex. 5(a)(vi) | (1) Unbound (2) Unbound | (1) Unbound (2) Unbound |
| | (3) Through incorporation with foreign equity not exceeding 51 per cent by financial services companies including banks. | (3) None |
| | (4) Unbound except as indicated in the horizontal section | (4) Unbound except as indicated in the horizontal section |
| 6. Financial leasing 5. (a)(vii) | (1) Unbound (2) Unbound | (1) Unbound (2) Unbound |
| | (3) Through incorporation with foreign equity not exceeding 51 per cent by financial services companies (including banks). | (3) None |
| | (4) Unbound except as indicated in the horizontal section | (4) Unbound except as indicated in the horizontal section |
| 7. Venture capital | (1) Unbound (2) Unbound | (1) Unbound (2) Unbound |

|  | (3) (i) Through incorporation with foreign equity not exceeding 51 per cent, by financial companies including banks.<br>(ii) Funding has to be entirely out of equity. | (3) None |
|---|---|---|
|  | (4) Unbound except as indicated in the horizontal section | (4) Unbound except as indicated in the horizontal section |

Source: the Ministry of Commerce's web site (http://commerce.nic.in/IndiaSchedules.doc)
Note: The column for additional commitments is left blank.

Countries are at liberty to schedule our commitments in one of the following ways:
(i) *Full commitment*: none or "no limitations", which implies that the Member does not seek in any way to limit market access or national treatment through measures inconsistent with Articles XVI or XVII of GATS.
(ii) *Commitment with limitations*: the Member details the measures maintained which are inconsistent with market access or national treatment, and implicitly commits itself to take no other inconsistent measures.
(iii) *No commitment*: "unbound" indicates that the Member remains free to maintain or introduce measures inconsistent with market access or national treatment.
(iv) *No commitment technically feasible*: "unbound" indicates that in the sector in question, a particular mode of supply cannot be used.

**Ongoing GATS Round on Financial Services.**

**Requests received by India[1]:**

Take full market access and national treatment commitments in Modes 1 & 2 for all services and in Modes 1, 2 & 3 for financial information and advisory services.
Remove limitations on preferred form of presence, numerical quotas, monopolies, exclusive service suppliers, economic needs tests and discrimination between domestic and foreign suppliers in application of laws and regulations.
Remove restrictions on use of foreign capital and ceiling on equity.
Remove the nationality requirement for Local Advisory Boards in financial consultancy services.
Remove restrictions on investment by PSEs in foreign banks.
Remove discrimination between Indian and foreign banks in income tax, solvency ratios and borrowing limits.
Remove requirement of lending for priority sectors.
Clarify the rules with regard to "Qualified Foreign Investor" status and ease the aggregate limits on foreign investment in portfolio investment.
In Mode 4, remove restrictions on location of workforce.
Adopt the Annex on Transparency in financial services. Ensure greater transparency in domestic regulations and apply without discrimination.
Remove restrictions on land acquisition by foreigners and ease the regulations on closure of offices and operations.
In Mode 4, address ENTs and remove residency and work permit requirement. Administer the visa process in a transparent and time bound manner.
Eliminate requirement of repatriation of earnings by foreign nationals with the consent of RBI.

[1] Available at http://commerce.nic.in/wto_counsel_paper.htm

# CHAPTER 3

## Position of Foreign Banks in Indian Commercial Banking Industry

### 3.1 Introduction

Historically, the occupancy of foreign banks in Indian commercial banking has been highly significant. Many of the foreign banks currently operating in India were set up in the pre independence period chiefly for financing colonial trade and have, over time, expanded and involved into functions of commercial banking at large. Such banks started operating in urban centers of commerce, a convention, which continued through to the modern era of India's banking industry. Though the number of foreign banks has almost doubled during 1990s and they outnumber other domestic scheduled commercial bank groups, foreign banks which have been existing prior to 1990 account for 95 per cent of banking business within that category. Notwithstanding the fact that share of foreign banks in gross commercial banking is not so high, they play a vital role in areas where they are concentrated, which translates into certain important connotations for the functioning of domestic banks. Currently subjected to rather stringent regulatory environment under the RBI and other competent authorities, commitments in the GATS does throw up opportunities for foreign banks to enhance their functioning further. In this context it is important to analyse the present position of foreign banks and distinguishing features of their performance to understand the effect of India's signatory status in the GATS on banking.

As exposition in the previous chapter shows, the GATS aims at extending market access and national treatment to foreign service providers. Literature on Indian commercial banking points to consistent higher profitability exhibited by foreign banks. Clue to probable effects of liberalized market access and national treatment to foreign banks essentially lies in the reasons behind their superior performance. This chapter addresses issues in this regard. Sections 3.2 and 3.3 describe the origin and growth of foreign banks in India and the structure of Indian commercial banking industry. Section 3.4 deals with operational differentials of foreign and domestic banks, where regional concentration of these bank groups as an underlying reason is discussed. Differences in performance indicators and composition of assets and liabilities of bank groups are discussed in section 3.5. Section 3.6 examines India's commitments in the light of empirical observations made in preceding sections.

### 3.2 Origin and Growth of Foreign Banks in India

Transnational banking originated in India in the second quarter of nineteenth century with the establishment of Oriental Banking Corporation through a Royal Charter in the year 1842. Its Head Office was shifted to London in 1845 providing it a real multinational character. Two more banks which registered under Royal Charters in England, (i) The Chartered Bank of India, Australia and China and (ii) The Chartered Bank of Asia (later became Mercantile Bank of India, England and China), commenced Business in Calcutta in the Year 1853. These banks with British origin facilitated, as was their primary purpose, financing of trade and transfers of the colonial administration and were called exchange banks because of their investment of considerable funds in discounting of foreign bills during busy season. Foreign Banks enjoyed near monopoly in the lucrative trade finance and exchange business and thus quickly gained prominence in the banking scene as presidency banks were legally restricted from such activities almost till 1935 and Indian joint stock banks played a negligible role. Besides exchange transactions they were also engaged in financing of internal trade, accepting deposits, lending to industry and so on.

As Multinational Banking made its headway in India, a real impetus would come to the same with the entry of four foreign banks in 1914 (Gupta 1992). Since then, the number of banks rose to 15 in 1920, commanding 31.9 per cent of the total deposits with commercial banking system. However, recession in world economy starting from mid 20s had its impediments on growth of foreign banks for nearly a decade. By 1940 there were 20 banks operating with an average deposit of Rs. 426 lakhs per bank. The table below summarizes the relative share of foreign banks in deposit mobilization till Indian Independence.

**Table 3.1 Aggregate Deposit of Commercial Banks in India (1870 to 1946)** (in Rs lakh)

| *Year* | *Foreign Banks* | | | *Presidency Banks* | | | *Other Indian Banks*** | | |
|---|---|---|---|---|---|---|---|---|---|
| | No. | Deposit | % Share | No. | Deposit | % Share | No. | Deposit | % Share |
| 1870 | 3 | 52 | 4.2 | 3 | 1183 | 94.7 | 2 | 14 | 1.1 |
| 1880 | 4 | 340 | 22.0 | 3 | 1140 | 73.9 | 3 | 63 | 4.1 |
| 1890 | 5 | 754 | 26.4 | 3 | 1836 | 64.2 | 5 | 271 | 9.5 |
| 1900 | 8 | 1050 | 30.6 | 3 | 1569 | 45.8 | 9 | 808 | 23.6 |
| 1910 | 11 | 2479 | 28.5 | 3 | 3654 | 42.0 | 16 | 2566 | 29.5 |
| 1920 | 15 | 7481 | 31.9 | 3 | 8629 | 36.8 | 58 | 7348 | 31.3 |
| 1930 | 18 | 6811 | 31.0 | 1 | 8397 | 38.2 | 88 | 6765 | 30.8 |
| 1940 | 20 | 8533 | 27.4 | 1 | 9607 | 30.8 | 629 | 13042 | 41.8 |
| 1946 | 15 | 18128 | 15.3 | 1 | 27167 | 22.9 | 690 | 73411 | 61.8 |

Source: Karunakaran 1993

Stature of commercial banking and foreign banks underwent tremendous changes in the post independence era. Several landmark policy changes starting from Nationalisation of Reserve Bank of India to introduction of deposit insurance scheme directly affected the functioning of commercial banks. With the passing of Banking Companies Act of 1949, it brought both foreign and domestic banks on an equal footing. The Act bestowed Regulatory power on the Reserve Bank of India and contained several vital provisions relating to issue, cancellation of license, filing of returns, maintaining certain portion of assets and liabilities in India, etc. In 1947, there were 15 foreign banks owning 12.45 per cent of total assets and having a share of 14 per cent in aggregate deposits.

Data on growth on foreign bank assets is available from the year 1960. The value of aggregate asset holdings of foreign banks stood at 411.4 crores in 1960 which added up 115989.7 crores by 2003. Annual average rate of growth in value of assets registered highest figure of 23.79 during 1985 to 1990 period. The growth trend of deposits is almost corresponding to that of assets. 1980s registered deposits growing faster than late 90s. Table 3.2 gives the figures.

**Table 3.2 Growth of Asset Holdings and Deposits of Foreign Banks**

| *Year* | *Assets (Rupees in Crores)* | *Annual Compound Growth Rate* | *Deposits (Rupees in Crores)* | *Annual Compound Growth Rate* |
|---|---|---|---|---|
| 1960 | 411.4 | | 238.95 | |
| 1965 | 491.81 | 3.64 | 344.39 | 7.58 |
| 1970 | 773.47 | 9.48 | 548.33 | 9.75 |
| 1975 | 1249.14 | 10.06 | 871.64 | 9.71 |
| 1980 | 2261.34 | 12.60 | 1227.8 | 7.09 |
| 1985 | 5525.76 | 19.57 | 2878.1 | 18.58 |
| 1990 | 16060.44 | 23.79 | 8929.88 | 25.41 |
| 1995 | 37835.17 | 18.69 | 28031.52 | 25.71 |
| 2000 | 82849.85 | 16.97 | 49324.17 | 11.97 |
| 2003 | 116401.1 | 12.00 | 69312.82 | 12.01 |

Source: Gupta 1992 and RBI Bulletins various issues

Deposits, Credit and Investments of Foreign banks increased sharply during the decade of 1980s as compared to previous periods. The credit-deposit ratios of foreign banks have also been high, touching the highest of 87.5 per cent in 1984. Reflecting the strong growth in deposits and credit of foreign banks in the 1980s, the total profits of these banks had also risen substantially. Foreign banks' share in total profits of SCBs moved up from 17.65% in 1979 to 27.59% in 1984 and came down close to 15 % by 2001.

### 3.3 Structure of Commercial Banking Industry in India

The organized sector in Indian banking system comes under the preview of the Reserve Bank of India (RBI) Act, 1934 and the Banking Regulation Act, 1949 and thereby the regulations of

the RBI. The organised sector is divided into scheduled and non-scheduled banks. The scheduled banks are those which satisfies certain norms on minimum paid up capital and reserves as stipulated and updated by the RBI and are included in the second schedule of the RBI Act. Non-scheduled commercial banks are those private sector banks which are not included in the schedule due to non-compliance with the RBI and are very insignificant in number. The scheduled banks are further classified into Public Sector, Private Sector and Regional Rural Banks. The State Bank of India and its Associates and 20 Nationalised Banks form the public sector. The private sector banks comprise of Indian Private commercial banks and Foreign Banks operating in India. Foreign banks operating in India are only the branches of those incorporated outside the Indian territory. Table 3.3 gives the profile of scheduled commercial banks.

**Table 3.3 Profile of Scheduled Commercial Bank Groups as on March 2003**

| *Bank Group* | *No of Banks* | *No of Offices* | | *Total Deposits* | |
|---|---|---|---|---|---|
| SBA | 8 | 13700 | 20.12 | 30633377 | 24.00 |
| NB | 19 | 33979 | 49.91 | 64651929 | 50.66 |
| IPB | 32 | 5531 | 8.12 | 21622121 | 16.94 |
| FB | 43 | 197 | 0.29 | 5756329 | 4.51 |
| RRB | 196 | 14671 | 21.55 | 4955814 | 3.88 |
| All | 298 | 68078 | 100.00 | 127619570 | 100.00 |

Source: RBI, Basic Statistical Returns, 2003.
Note: SBA-State Bank and its Associates, NB- Nationalised Banks, IPB- Indian Private Banks, FB-Foreign Banks, RRB-Regional Rural Banks[1].

### 3.4 Differentials in Operations of Foreign and Domestic Banks

The high rates of growth in deposits and loans of foreign banks in India from early eighties onwards signifies their position as a group in domestic financial intermediation system, shedding their erstwhile status as exchange banks. But there have been certain distinctions with which these banks participated in intermediation compared to Indian banks in general. Several studies addressed the nature of such distinctions and their outcome in comparative performances and came up with results that foreign banks stand out in terms of performance compared with that of Indian segment of the banking industry. R. D Sharma (1987) studied financial working of foreign international banks in India and several aspects of their involvement in banking industry. Though this work point towards the fast growth in aggregate assets, deposits and advances of these banks and their successful local adaptation and penetration into core banking business in the post nationalization era, the specific reasons

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[1] Abbreviations are followed in succeeding tables.

behind this phenomenon are not extensively dealt with. Studies by Nag and Shivaswamy (1990) and Angadi (1990) confirm the earlier observations on superior performance of foreign banks. Karunakaran (1993) enquired into performance differentials of foreign and domestic banks and shows that foreign banks are distinct in several ways, not only with respect to outcome indicators like profitability, but also in terms of the very nature of fund based activities and composition of their earning funds.

Nag and Sivaswamy (1990) explores the explanations for the outstanding performance of foreign banks leading to the question as to whether foreign banks have adopted management practices, procedures and policies of day to day nature that are different from their Indian counterparts and whether there have been special factors at work to facilitate the relatively better functioning of these banks. Their work suggests that it is a combination of both these factors, which goes decisive. Relationship between ownership, governance and management and in-built incentive structures in Indian banking are extensively dealt with in the literature. Public control is vehemently criticized on the grounds that efficiency objective in terms of cost, profitability and market share is subordinated to the poorly defined public interest objectives. The relative failure of Indian pubic banks which control more than 70 per cent of banking is solely explained in these terms in many works (Patel, 1997). On the contrary public interest objective in India is indeed very clearly defined given the huge rural population without access to banking. While maintaining a rural bank branch is 'unprofitable' from a purely managerial perspective these rural branches of large public sector banks in India pool in savings and channels them to fund deficient investment activities forming the very backbone of economic development goals. It should be noted that despite of performance differentials between bank groups overall profitability of Indian banking is one of the highest when internationally compared (Ram Mohan, 2004). As the primary goals of managerial practices in public, private and foreign bank groups are different, performance differentials arising out of these factors comes to the forefront.

Scheduled Commercial Banks in India are classified into five groups. Though this classification is broadly based on type of ownership, other distinguishing features of their operation is more important from a comparative analysis' point of view. Before comparing foreign banks vis-a-vis domestic bank groups, it should be noted that functioning in terms of region of operation, number of branches and volume of business is highly disproportionate accross bank groups. For instance, 196 Regional Rural Banks (RRBs) with more than 21per cent of total bank branches command only 3.88 percent of aggregate deposits with the

commercial banking system, where as the figures for 8 State Banks together are 20.12 and 24 respectively (Table 3.3). RRBs, holding merely 3.69 percent of total assets of all scheduled commercial banks, are scattered over rural and semi-urban centers catering to a limited area of operation. This is in contradiction to foreign banks which are soly concentrated in urban, particularly metropolitan centers. Table 3.4 shows the regional distribution of branches of various bank groups. It is evident that FBs and and RRBs are having disjoint market segments. It is meaningful, therefore, to compare FBs with the other three groups only.

**Table 3.4 Region -Wise Distribution of Banking Offices, 2003**

| *Population Group (Region)* | *SBA* | *NB* | *IPB* | *RRB* | *FB* |
|---|---|---|---|---|---|
| Rural | 40.10 | 40.27 | 20.21 | 81.72 | 0.00 |
| Semi-Urban | 29.42 | 20.97 | 30.81 | 14.88 | 0.00 |
| Urban | 17.26 | 20.96 | 25.96 | 3.25 | 12.18 |
| Metropolitan | 13.23 | 17.81 | 23.02 | 0.15 | 87.82 |

Source: RBI, Basic Statistical Returns, 2003
Note: figures represent precentage distribution of branches across regions.

Though the asset and liability portfolios of all bank groups follow similar pattern, there is immense differece in volume of funds handled by foreign and domestic banks. Phased nationalization of 20 commercial banks under Nationalization Act of 1969 was a prudent step to increase reach of commercial banking and thereby effectively impose credit planning and direct control practices. This strategy did achieve significant strides in increasing the regional spread of commercial banking, in mobilization of savings and in becoming a source of credit to the small-scale industries and agriculture. Over the years, around 30 to 40 per cent of gross household savings have been in the form of bank deposits, and around 60 per cent of assets of all financial institutions have been accounted for by commercial banks. The branch networking of 28 public banks grew in an unprecedented fashion, linking rural an urban fund markets. With their regional reach and vast access to savings, these public banks facilitated flow of funds from surplus to deficient regions in huge scales. Table 3.5 shows region wise share of deposits and advances of bank groups (excluding RRBs).

**Table 3.5 Region - Wise Distribution of Deposits and Advances of Bank Groups, 2003**

| *Population Group (Region)* | *SBA* | | *NB* | | *IPB* | | *FB* | |
|---|---|---|---|---|---|---|---|---|
| | %of Deposits | % of Advances | %of Deposits | % of Advances | %of Deposits | % of Advances | %of Deposits | % of Advances |
| Rural | 13.51 | 9.46 | 14.27 | 11.45 | 4.21 | 2.22 | 0.00 | 0.00 |
| Semi-Urban | 28.08 | 17.93 | 18.03 | 10.80 | 12.74 | 6.67 | 0.00 | 0.00 |
| Urban | 26.22 | 20.82 | 25.57 | 18.89 | 18.17 | 11.68 | 2.68 | 1.15 |
| Metropolitan | 32.19 | 51.79 | 42.14 | 58.87 | 64.88 | 79.43 | 97.32 | 98.85 |
| All-India | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 | 100.00 |

Source: RBI, Basic Statistical Returns, 2003

For all bank groups the shares of deposits and loans in metropolitan centers are far higher than other regions. One crucial point to be noted is that, again accross all bank groups, share of advances in aggregate advances is higher than the corresponding figure for deposits only in metropolitan. For public banks there is difference of almost 20 per centage points. This data coupled with credit-deposit ratios (CD ratios) accross regions (Table 3.6) clearly highlights dependancy of domestic banks in metropolitan branches, while the business of foreign banks is almost wholly in that region.

**Table 3.6 Region -Wise Credit-Deposit Ratios of Bank Groups**

| *Population Group (Region)* | *1997* | | | | | *2000* | | | | | *2003* | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **FB** | **IPB** | **NB** | **SBA** | **All** | **FB** | **IPB** | **NB** | **SBA** | **All** | **FB** | **IPB** | **NB** | **SBA** | **All** |
| Rural | - | 0.39 | 0.41 | 0.46 | 0.42 | - | 0.34 | 0.39 | 0.43 | 0.4 | - | 0.35 | 0.44 | 0.42 | 0.43 |
| Semi-Urban | 0.02 | 0.43 | 0.34 | 0.43 | 0.38 | 0.02 | 0.38 | 0.32 | 0.38 | 0.35 | - | 0.35 | 0.33 | 0.38 | 0.35 |
| Urban | 0.21 | 0.53 | 0.4 | 0.51 | 0.44 | 0.41 | 0.49 | 0.38 | 0.48 | 0.42 | 0.4 | 0.43 | 0.4 | 0.47 | 0.43 |
| Metro | 0.76 | 0.71 | 0.66 | 1.08 | 0.76 | 0.84 | 0.72 | 0.71 | 1.05 | 0.79 | 0.95 | 0.81 | 0.76 | 0.96 | 0.83 |
| All-India | 0.74 | 0.59 | 0.5 | 0.66 | 0.57 | 0.83 | 0.59 | 0.51 | 0.63 | 0.56 | 0.93 | 0.66 | 0.55 | 0.6 | 0.6 |

Source: RBI, Basic Statistical Returns, various issues

CD ratios for all bank groups in metropolitan centers are far higher than their respective national averages for all domestic bank groups. When we read the data along with spread of branches as given in Table 3. 4, it can be seen that about 60 to 70 percent of branches of public banks in rural and semi-urban regions, which is roughly half of total branches of all scheduled commercial banks put together (including RRBs), command only around 30% of their total deposits and less than 25% of total loans. This is enough indication as to an important role played by public commercial banks. With access to vastly scattered small savings, they pool in surplus funds in large scale and unbundle them in urban centers where such funds finance investments (in the economic sense of the term), fueling growth and in that process add value to the rural household savings which is returned in turn as interest expended on deposits. In the process of rural -urban recycling of surplus funds these huge banks incur 'inefficiencies' in terms of servicing relativly costlier rural branches which again hardly offer enough oppurtunities within their immediate region to reclaim interest expended with interest earnings, as is evident from the low CD ratios.

Though data for operating costs of banks for region-wise branches is not available, comparatively low average number of deposit and loan accounts to be serviced per branch and

low average amount of deposits per account supports the contention that operation costs are higher for rural branches. Domestic public banks look forward to earnings from urban branches to make up for such costs. Table 3.7 gives region wise distribution of accounts per branch and amount per account of deposits respectively of various bank groups. It can be seen that figures for both the indicators increase as we move from rural to urban for all bank groups. Higher the value for accounts per branch and amount per account, lesser the operation costs invoved in servicing the accounts and scope for reaping scale efficiency. Figures of foreign bank group for both the indicators are higher than those of domestic banks. Amount per account is substantially higher at roughly more than 3 times that of domestic banks in urban and metropolitan centers. This gives an indication as to the distinctive profile of the clientile of foreign banks.

**Table 3.7 Region - Wise Figures of Deposit Accounts per Branch and Amount per Account of Bank Groups as on 2003**

| *Population Group* | *SBA* | | *NB* | | *IPB* | | *FB* | | *All Banks* | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Accounts /Branch | Amount /Account | Accounts/ Branch | Amount /Account | Accounts /Branch | Amount /Account | Accounts /Branch | Amount/ Account | Accounts/ Branch | Amount/ Account |
| Rural | 4.77 | 15.79 | 4.74 | 14.23 | 4.29 | 18.98 | - | - | 4.24 | 12.91 |
| Semi-urban | 9.12 | 23.40 | 8.45 | 19.37 | 5.96 | 27.10 | - | - | 7.81 | 20.57 |
| Urban | 9.10 | 37.33 | 8.54 | 27.18 | 7.89 | 34.67 | 6.38 | 100.68 | 8.41 | 30.23 |
| Metropolitan | 8.44 | 64.47 | 9.75 | 46.17 | 14.75 | 74.72 | 14.97 | 216.39 | 10.26 | 59.29 |
| All India | 7.28 | 30.70 | 7.21 | 26.41 | 8.15 | 47.98 | 13.92 | 209.93 | 6.55 | 28.61 |

Source: Basic Statistical Returns, RBI 2003.
Note: Account per branch in 1000s
Amount per account in 1000 rupees.

Accounts per branch of credit also is far higher for foreign banks compared to other bank groups (Table 3.8). On the contrary, amount per account is much lower for them. While the figure for amount per account for all banks taken together is 447.12 in thousands of rupees in metropolitan region, for foreign banks it is merely 113.81. This significant difference could be due to the differences in sectors in which domestic and foreign banks deploy credit. Pattern of the regional didtribution emerging out of these figures clearly indicates that even when we compare foreign banks with operations of urban/metropolitan branches of domestic banks, there is significant differences between them. While amount per account of deposits of foreign banks is solidly higher than the average of all banks, amount per account of credit is very low for them than the figure for all banks together. By dispersing credit through small bundles in large number of accounts foreign banks spread and reduce credit risks.

**Table 3.8 Region - Wise Figures of Advances Accounts per Branch and Amount per Account of Bank Groups as on 2003**

| *Population Group* | *SBA* | | *NB* | | *IPB* | | *FB* | | *All Banks* | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Accounts /Branch | Amount /Account | Accounts/ Branch | Amount /Account | Accounts /Branch | Amount /Account | Accounts /Branch | Amount/ Account | Accounts/ Branch | Amount/ Account |
| Rural | 0.82 | 38.22 | 0.75 | 39.24 | 0.63 | 44.94 | - | - | 0.79 | 30.22 |
| Semi-urban | 1.29 | 62.89 | 0.92 | 58.61 | 0.76 | 73.40 | - | - | 1.03 | 55.30 |
| Urban | 0.88 | 183.62 | 0.65 | 144.46 | 0.53 | 219.42 | 3.79 | 67.62 | 0.70 | 154.44 |
| Metropolitan | 0.55 | 943.29 | 0.56 | 615.14 | 1.14 | 787.62 | 26.92 | 113.81 | 1.13 | 447.12 |
| All India | 0.93 | 142.68 | 0.73 | 142.37 | 0.76 | 339.71 | 24.11 | 112.92 | 0.87 | 127.07 |

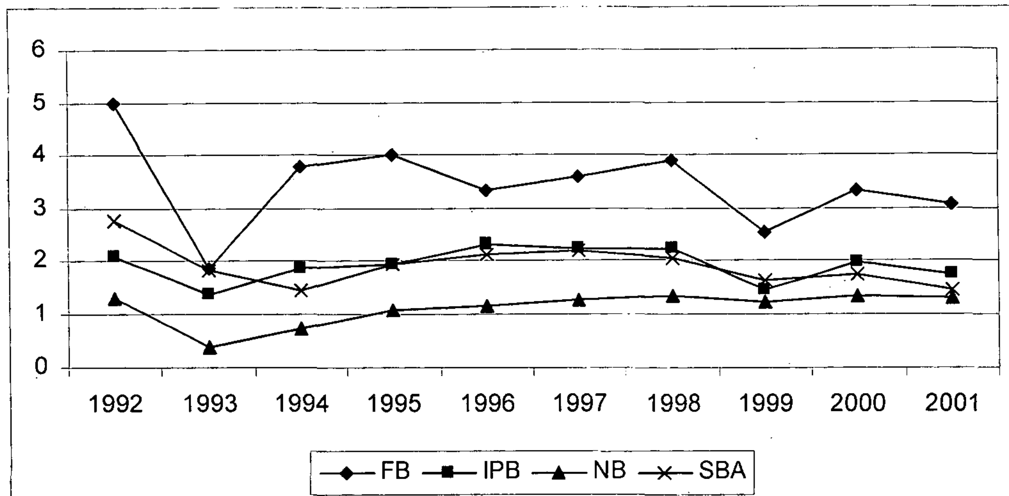
Source: Basic Statistical Returns, RBI 2003.
Note : Account per branch in 1000s
Amount per account in 1000 rupees.

Dependency of domesic bank groups on urban/metropolitan centers hold certain important implications for commercial banking system. Owing to large gaps in scale of operation and regional spread aspects within them, we would expect certain differences in asset and liability composition and performance indicators of various bank groups.

## 3.5 Performance Indicators and composition of balance sheets of Foreign and Domestic Banks

Single best indicator of performance of an organisation is its profit ratio. Return on assets (ROA) is most commonly used profit ratio, where gross profit after deducting operation expenditures is normalised using total assets. ROA for different bank groups for the period 1992 to 2001 is given by Figure 3.1. It is clearly revealed that foreign banks distinctly outperform rest of the bank groups with nationalised banks at the bottom. None of the bank groups show high fluctuations and more importantly the trend for all bank groups remain more or less stable. The dominance of foreign banks in profitability should be expected for reasons discussed in the previous section. CD ratios of urban/metropolitan concentrated foreign banks are higher and operating costs are also less for them. Though comparatively lower, public banks maintained their earning potential during the period. But a look into the composition of earning assets and fundbased activities would only give a clear picture on the differentials in activities of various bank gropus.

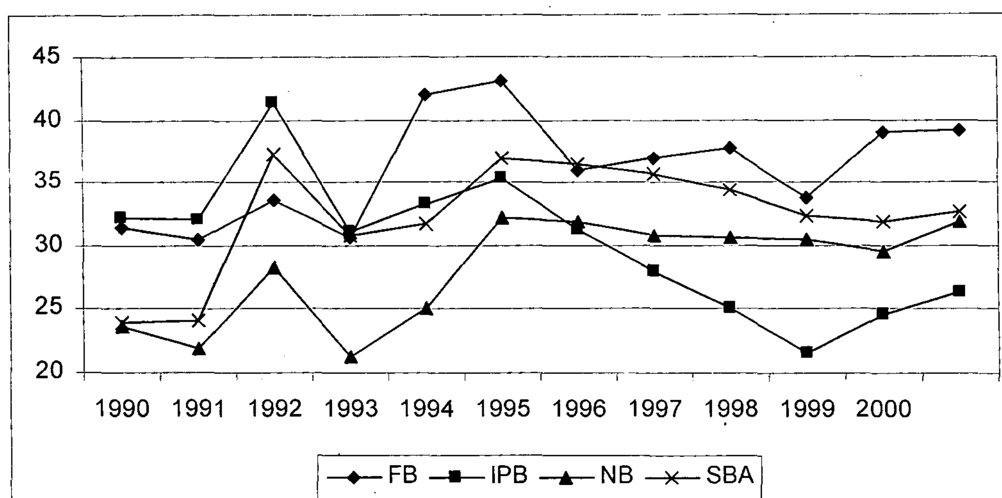
**Figure 3.1 Return on Assets (ROA) of Bank Groups, 1992-2001**




Source: Annual Accounts of Scheduled Commercial Banks, RBI 2003
Note: Return on Assets = Gross Profit/Total Assets

The earning capacity of banks from fund based activities can be captured by spread ratio. Interest is the major sourse of income as well as expenditure for all bank groups in general. Spread is the difference betwen interest earned and interest paid. In order to normalise the figures and compare between bank groups we take spread ratio, given by spread as a percentage of interest earned. Higher the spread ratio, higher is the net interest income contribution towards overall profitability of banks. Previous study (Karunakaran 1993) for the period 1969 to 1988 shows foreign banks consistently maintainig higher spread than domestic public and private banks along with a steady decline for all bank groups. Spread ratio for 1990 to 2001 is given Figure 3.2. It can be obseved that foreign banks exhibit higher spread, but despite yearly fluctuations none of the bank groups exept private scheduled commercial banks shows decline. Spread is otherwise considered as an indicator of cost of intermediation. ROA and spread together give some indication of competitive pressure in commercial banking. Almost stable figures of both the indicators shows competitive pressure is not working out in reducing the cost of intermediation despite an increase in number of banks during the period of analysis. New foreign banks together constitutes only a small share in aggregate banking assets to make an impact and more importantly, the markets of bank groups are disjoint to certain extent that, they cannot influence aggregate banking any better than banking within their respective groups. New private sector banks like ICICI Bank and HDFC Bank grew rapidly within a short span and accounts for a part of contraction in spread of IPBs.

**Figure 3.2 Spread Ratios of Bank Groups, 1990-2001**




Source: Annual Accounts of Scheduled Commercial Banks, RBI 2003
Note: Spread Ratio = (Interest earned – Interest paid)/ Interest Earned

Spread is affected primarily by movements in inerest earned and expended. The componets of these two are interest on deposits and borrowings for interest expended and interest on advances and investments for interest earned. When we move to the underlying funds of interest expenses and earnings[2], on the liability side, deposits constitute 90 to 95 per cent for domestic banks. Foreign banks holds a comparatively lesser share of deposits; about 80 per cent on an average for the decade and declining down to 70 per cent by 2001. They make up for the rest from borrowed funds. Cost of borrowings being at par with or sometimes lesser than interest on deposits, foreign banks still manage to avail required funds cost effectively.

On the othe hand, interest earned has got two major contributors viz advances/loans and investments in securities and bonds. There has been a gradual decline in advances/loans from earning asset portfolio of domestic banks, especially large public banks, giving way to investments in securities. When we take absolute spread between interest expenses on deposits alone and interest income earned on advances/loans, domestic banks gives negetive figures as against foreign banks. As the aggregate spread for all bank groups are positive, the dependency of domestic banks on income from invesment becoms clear from this. Table 3.9 gives margin between interest on deposits and Advances calculated as interest expended on deposits minus interest earned on advances.

[2] Format of annual accounts of banks is given in Annex II. Earnings and expenditure statement and balance sheet gives the structure of major items of earnings and expenditure and their underlying assets and liabilities.

**Table 3.9 Spread/Interest Margin between Interest on Deposits and Advances of Bank Groups**

| *Year* | *SBA* | *NB* | *IPB* | *FB* |
|---|---|---|---|---|
| 1992 | 157354 | 12672.41 | 4128.1 | 79326.5 |
| 1993 | 22518.97 | -227677 | -7127.5 | 60401.22 |
| 1994 | -75149.1 | -321875 | -8789.97 | 25714.2 |
| 1995 | -94054.1 | -304423 | -3460.58 | 38361.66 |
| 1996 | 13501.83 | -176231 | 16734.29 | 100966.4 |
| 1997 | -16153 | -352639 | 5766.84 | 107189.6 |
| 1998 | -203156 | -628595 | -87673.6 | 92531.65 |
| 1999 | -427639 | -824475 | -196089 | 33425.43 |
| 2000 | -585939 | -945153 | -208803 | 76420.16 |
| 2001 | -651611 | -884103 | -253146 | 149884.5 |

Source: Annual Accounts of Scheduled Commercial Banks, RBI 2003

Not only that the deposits-advances margin gives negetive values, it shows a deteriorating trend as well. Table 3.10 gives growth trend of total advances of bankg groups during 1991 to 2001. Indian private banks exhibits the higest growth rate among the group. Foreign banks' advances grew at an average rate of 21.06 per cent during the decade as against 12.6 per cent for public banks.

**Table 3.10 Annual Growth of Advances of Bank Groups**

| *Year* | *SBA* | *NB* | *IPB* | *FB* |
|---|---|---|---|---|
| 1991 | 16.89 | 13.11 | 16.78 | 27.95 |
| 1992 | 9.71 | 9.25 | 30.26 | 31.15 |
| 1993 | 9.33 | 6.49 | 23.85 | 13.96 |
| 1994 | -8.94 | -2.83 | 22.92 | 9.10 |
| 1995 | 20.01 | 21.57 | 61.24 | 31.17 |
| 1996 | 21.30 | 14.16 | 41.39 | 47.91 |
| 1997 | 6.11 | 6.13 | 27.98 | 18.76 |
| 1998 | 17.69 | 18.17 | 23.71 | 9.49 |
| 1999 | 11.13 | 16.40 | 20.59 | 0.74 |
| 2000 | 19.01 | 18.08 | 30.50 | 20.71 |
| 2001 | 16.55 | 18.45 | 22.10 | 20.72 |

Source: Annual Accounts of Scheduled Commercial Banks, RBI 2003

Table 3.11 gives the difference of interest/income earned per 1000 rupees of advances and investments. Here earnings on investments is deducted from earnings on advances and therefore positive figures shows higher returns on advances. Data shows that interest income earned per 1000 rupees of advances is on an average higher than earnings per 1000 rupees of investments. The shift to investments is not because of increasing earning capcity by doing so. Domestic banking institutions are required to to meet priority sector target of 40 per cent of total advances (with sub- targets of 18 per cent for agricultural advances and 10 per cent of advances to weaker sections). As against this, the priority lending requirements for foreign banks are lower at 32 per cent of total credit with sub-targets of 10 percent to small-scale

sector and 12 per cent for export credit). Banks have found it expedient not to meet the norms for priority sector lending when less demanding options have been open to them like investment in government securities (Ram Mohan, 2004).

**Table 3.11 Difference in earnings per 1000 rupees of Advances and Investments of Bank Groups**

| *Year* | *SBA* | *NB* | *IPB* | *FB* |
|---|---|---|---|---|
| 1992 | 43.7 | 34.8 | 27.7 | 114.2 |
| 1993 | 24.3 | 15.7 | 28.8 | 94.3 |
| 1994 | 30.0 | 28.2 | 23.7 | 48.3 |
| 1995 | -14.4 | 1.8 | 3.4 | 1.0 |
| 1996 | 0.0 | 16.3 | 8.6 | 9.5 |
| 1997 | 19.4 | 31.4 | 48.9 | 51.1 |
| 1998 | -5.3 | 7.7 | 23.8 | 37.6 |
| 1999 | 1.2 | 4.9 | 18.4 | 45.6 |
| 2000 | -4.3 | 0.2 | 9.9 | 8.5 |
| 2001 | 5.3 | -2.2 | 4.4 | 19.0 |

Source: Annual Accounts of Scheduled Commercial Banks, RBI 2003
Note: interest earned on advances/advances in Rs 1000 - inerest earned on investments/investments in Rs 1000

Table 3.12 and 3.13 gives the sector wise and region wise distribution of bank credit respectively for the year 2003. All Bank groups alike allocate highest share of their aggregate credit to industry constituted chiefly by manufacturing sector and secondly to personal loans. Interestingly, the percentage of credit for trade by foreign banks is much lower than domestic bank groups, while share of personal loans out of aggregate credit is much higher than that of domestic ones. Higher share of personal loans accounts for lower amount per accounts of foreign bank group. If we take region wise distribution of credit, apart from agriculture, well more than 50 per cent of bank credit within each sector is being dispursed in urban/metropolitan centers.

**Table 3.12 Bank Group and Sector Wise distribution of credit, 2003**

| *Sector* | *SBA* | *NB* | *IPB* | *FB* |
|---|---|---|---|---|
| Agriculture | 11.19 | 11.18 | 3.23 | 1.26 |
| Industry | 38.23 | 36.69 | 59.15 | 44.69 |
| Transport Operators | 0.90 | 1.29 | 1.52 | 0.92 |
| Professional And Other Services | 1.83 | 4.14 | 7.67 | 7.97 |
| Personal Loans | 17.22 | 13.95 | 8.20 | 29.47 |
| Trade | 14.11 | 17.48 | 8.41 | 3.59 |
| Finance | 6.56 | 6.92 | 6.47 | 9.10 |
| All Others | 9.96 | 8.35 | 5.37 | 3.00 |
| Total Bank Credit | 100.00 | 100.00 | 100.00 | 100.00 |

Source: Basic Statistical Returns, RBI 2003.

**Table 3.13 Region and Sector - Wise Distribution of Credit, 2003**

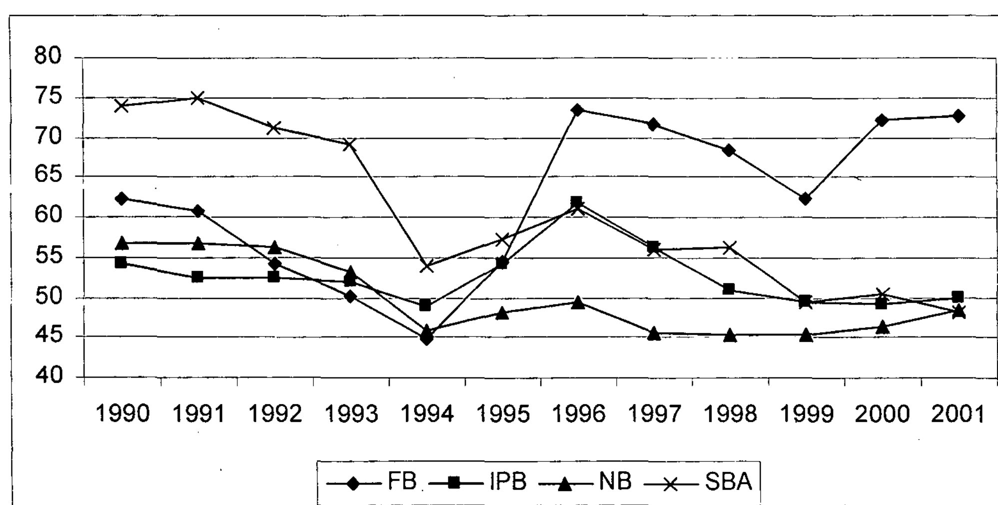
| *Sector* | *Rural* | *Semi-Urban* | *Urban* | *Metropolitan* |
|---|---|---|---|---|
| Agriculture | 39.43 | 29.12 | 12.86 | 18.59 |
| Industry | 8.03 | 10.83 | 19.68 | 61.45 |
| Transport Operators | 11.74 | 14.61 | 14.99 | 58.66 |
| Professional And Other Services | 6.21 | 10.29 | 20.79 | 62.71 |
| Personal Loans | 11.29 | 19.36 | 26.60 | 42.76 |
| Trade | 13.01 | 10.25 | 20.87 | 55.88 |
| Finance | 7.30 | 2.22 | 2.89 | 87.59 |
| All Others | 13.19 | 16.85 | 22.09 | 47.87 |
| Total Bank Credit | 12.31 | 13.54 | 19.28 | 54.87 |

Source: Basic Statistical Returns, RBI 2003.

Note: figures are precentage share of each region in aggregate cerdit given to each sector.

In conformation with the declining share of deposits in earning assets, the overall credit-deposit ratio shows a gradual decline for domestic bank groups, while foreign banks have improved thier figures.

**Figure 3.3 Trends in Credit-Deposit ratios of Bank Groups, 1990 - 2001**




Source: Annual Accounts of Scheduled Commercial Banks, RBI 2003

Note: Credit – Deposit ratio (CD ratio) = (Credit/Deposits) × 100

As shown by preceding exposition, foreign banks in India operate in niche markets with certain operational distinctions. However there is no evidence for volume wise dominance of foreign banks in any single banking operation and apparently poses no threat to franchise value of domestic banks. Operational distinctions, nevertheless, have significant bearing on the efficiency with which each bank group performs the central function of intermediation, subsequently resulting in an uneven augmentation of competitive advantages across bank groups. This in turn gives ample space for rapid expansion for those banks with comparative advantages. Indicators of relative efficiency with which banks collect funds by expending interest and earn interest by lending those funds can throw light upon this issue. For this

purpose we analyse comparative efficiency in functioning of bank groups in deposit and advances markets.

### 3.6 Functional Efficiency of Bank Groups in Deposit and Advances Markets

As has been observed, there are significant differences across regions in the portfolios of deposits and advances handled by various bank groups. These differences in turn influence interest margins of banks depending on the regional spread of banks. In fact regional spread and large branch networking are advantageous for commercial banking in terms of easy transferability of funds from one location to another in two important ways. Transferability attracts large clientele and provides greater leverage to banks as they can move surplus funds to locations according to demand for such funds and thereby enhance earning potential. In the case of commercial banking in India, it has been observed that branch networking and reach helps banks to collect funds in large scale but the same endowments may not necessarily translate into advantage when it comes to earning through lending.

Measurement of efficiency is an attempt to assess the performance of industries or individual firms in using real resources to produce goods and services. There are parametric and non-parametric statistical methods for assessing efficiency of a firm's activity. Data Envelopment Analysis (DEA), first proposed by Charnes, Cooper and Rhodes in 1978, is a non-parametric linear programming method to measure efficiency, which assumes the production function is unknown. DEA works by identifying, from among a group of firms performing similar function, the best practice firm in terms of obtaining maximum output/outputs with minimum input/inputs. Then each of the other firms in the group will then be compared to the best practice firm and an efficiency score will be assigned to each firms, measured in terms of distance from the best practice firm or frontier created by best practice firms. In an output oriented DEA method, the score is calculated by the amount of output required to reach the efficient level of output divided by efficient level of output. Therefore, firms on the frontier will be assigned an efficiency score of 0, and a firm inside the frontier will be assigned score between 0 and 1. The higher the score the farther the firm is from the frontier and the worse its inefficiency is. Though DEA does not work on the basis of a pre-specified functional form, variable returns to scale (VRS) frontiers can also be made, as very often relationship between inputs and outputs are not linear and in the case of banking functions also there is no reason to believe otherwise.

DEA can be used for analysing the efficiency with which a decision making unit or organisation works in any of its numerous functions and therefore the choice of variables is an empirical issue, where they are determined by the definition of the particular function under question. Thus a DEA study, being a method rather than a model, can be conducted in many ways depending on the situation or problem (Roland and Vassdal, 2000). The methodology has been used to study relative efficiencies in Indian commercial banking in studies like Das (1997) and Das, Nag and Ray (2005) in different contexts and using different sets of input and output indicators. Das (1997), examined overall, pure technical and scale efficiencies of public banks and found that main source of inefficiency is technical in nature than allocative. Das *et al* (2005) found banks differing sharply in terms of revenue and profit efficiencies. We use this method to find out relative efficiency with which Indian commercial banks collect and disperse loanable funds[3]. Therefore two stages of functioning of a bank are considered for the purpose. In the first stage banks use interest expended on deposits and fixed assets as inputs for collecting deposits, while in the second stage Advances and fixed assets are used as inputs for earning interest income. Fixed assets are used as inputs here as proxy for branch networking also. Average scores for each bank group for constant returns to scale (CRS) inefficiency and variable returns to scale (VRS) inefficiency and scale inefficiency are given in the figures below for both the stages. The analysis is done for the period 1992 to 2001. Inputs and outputs used are given in the following table.

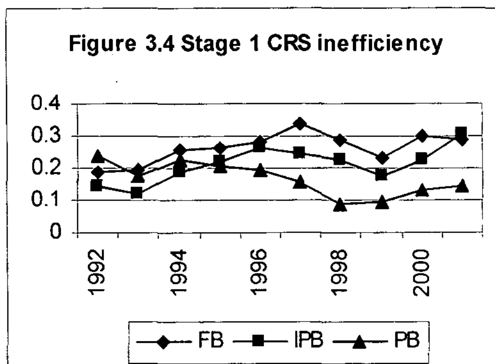
**Box: 3.1 Input and Output Indicators Used for Efficiency Analysis**

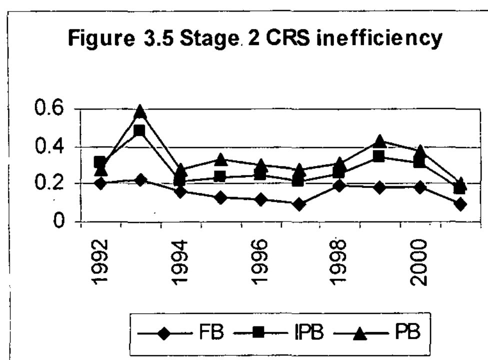
| | Inputs | Outputs |
|---|---|---|
| Stage 1 | • Fixed Assets<br>• Interest on Deposits | • Demand Deposits<br>• Saving Bank Deposits<br>• Time Deposits |
| Stage 2 | • Fixed Assets<br>• Bills Purchased<br>• Cash Credit, Overdrafts and Loans<br>• Term Loans | • Interest/Discount on Advances/Bills |

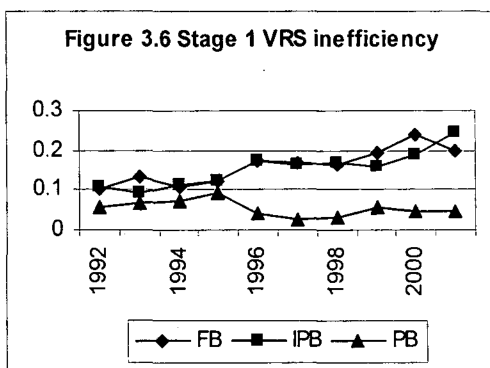
Since we are taking average scores for bank groups public banks are taken together to avoid the influence of extremes values. As, certain new banks which operate at very low scale can turn out to be anomalous to the standard practice in the industry, in order to avoid such banks forming the best practice frontier, 70 scheduled commercial banks, which have been existing from 1992 or before, are taken for the analysis.

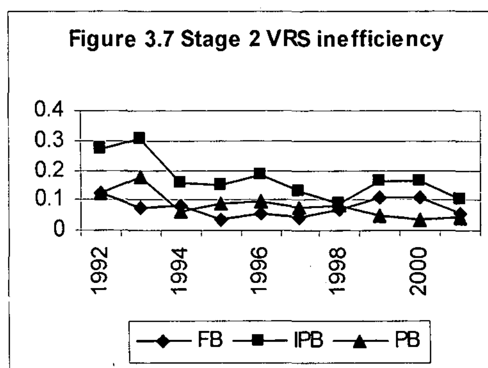
[3] See Annex III for brief introduction of the methodology.

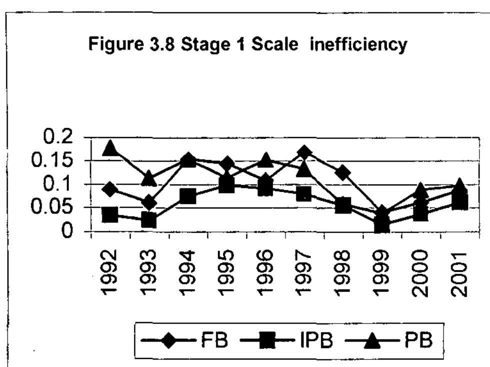
## DEA Results[4]

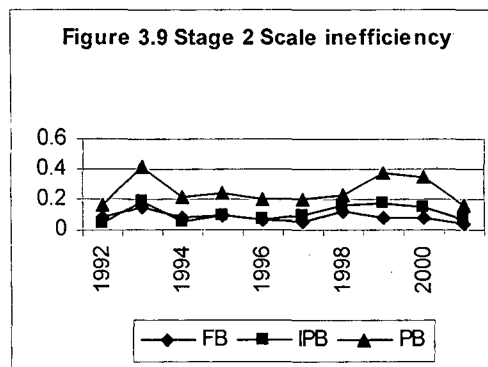



[4] The vertical axis of figures show average inefficiency score of each bank group for the years 1992 - 2001. Inefficiency increases from 0 to 1. The Abbreviations used for bank groups are FB - Foreign Banks, IPB - Indian Private Banks, PB - Public Banks. A brief introduction to DEA methodology is given in Annex III. The list of banks used for the analysis is given in Annex III, Box AIII. 1.

The results, in conformity with certain observations made earlier, shows comparative efficiency of domestic banks in deposit assortment (Stage 1) and exactly the contrary in advances market (Stage 2). CRS efficiency concept compares banks with the best practice or highest input-output ratio, irrespective of the scale at which banks are operating. CRS inefficiency or total inefficiency scores are shown by figures 3.4 and 3.5 for stages 1 and 2 respectively. The trend shows that, while domestic banks are comparatively more efficient in collecting deposits than foreign banks (fig 3.4).

In stage 2, total inefficiency scores of foreign banks are clearly and consistently the lowest (fig 3.5). This indicates that using lower amounts of advances they earn more returns by way of interest. Public banks distinctively exhibit highest total inefficiency for the whole period in stage 2. It should be remembered that Public banks operate with significant scale differences with large branch networking compared to other bank groups.

Figures 3.6 to 3.9 represents the break-up of total inefficiency into scale and pure technical inefficiencies for both the stages. In the deposit markets, the major source of inefficiency for public banks arises out of technical inefficiency rather than scale (fig 3.6). On the other hand, scale inefficiency of public banks is prominent in stage 2 (fig 3.9). The break up of total inefficiency scores of foreign banks in Stages 1 and 2 highlights a point in particular. In both cases scale inefficiency scores are low for them, implying their ability to avoid wastage by operating at or near to the most productive scale. In stage 1 the VRS or technical inefficiency scores of foreign banks are found to be comparatively higher than that of public banks and show an increasing trend. So, problem they face in deposit market is not that of non-optimal scale at which they operate, but certain constraints they face in the form of limited clientele base. But an increasing trend of borrowed funds in liability side of balance sheets of foreign banks indicates that such constraints as to deposit mobilisation can be overcome by inter-bank borrowings, where surplus deposits of domestic banks can be availed for meeting credit demands.

The results, with their limitations, but give an indication as to the rural - urban divide in Indian banking practices and resultant differences in comparative efficiencies due to operations in various regions. In general urban/metropolitan concentration offers certain advantages in terms of efficient use of funds for advances to foreign banks. At the same time, constraints in access to funds from such concentration can be countered by availing funds by borrowings. In a dynamic setting, these differential practices leads to accumulation of

competitive advantages to foreign banking service providers and can potentially become a problem of sustenance for domestic players in the banking industry.

### 3.7 India's Commitments and Foreign Entry

Participation of foreign banks in domestic financial intermediation is highly significant in several respects. They enjoy certain privileges in managing their overall commercial banking business, even within the regulatory constrains, by concentrating on lucrative urban/metropolitan markets. The primary motive behind foreign entry in Indian banking is high rate of profitability through domestic intermediation margin. Location in urban areas, where advanced bank practices and procedures are better known and followed, makes local adaptation easier for foreign banks. The massive social banking needs faced by India, as more than 500 million in the country continue to have no access to financial services, are met almost wholly by domestic public sector. In this regard, policy constraints on resource allocation are less restrictive for foreign banks. While still unattained goals of rural penetration and integration of regional financial markets require public intervention and increased sophistication in regulation of banks, India cannot do away with its restrictive banking regulatory policies. In this context further opening up via the GATS poses serious implications.

As discussed in the previous chapter, three important concerns arise out of the GATS: (1) India's commitment on entry of foreign banks, (2) post entry market access and national treatment and (3) implications for domestic regulation. It has been argued in this chapter that urban concentration of foreign banks can be restrictive for even large domestic public banks which control a lion's share in total banking, if not at present, with more entry and continuos growth with their competitive advantages. The serious implication in such a case would be a hindrance to rural-urban circulation of funds, which is indispensable for the economic goals of India. It should be remembered that currently more than 95 per cent of the volume of baking handled by foreign banks is commanded by only 50 percent of such banks operating in India. Some of such banks are already exhibiting faster growth than many of the incumbents within a very short span. Limitation filed by in India in the schedule relating to entry states that licenses for new foreign banks may be denied when the maximum share of assets in India both on and off balance sheet of foreign banks to total assets both on and off balance sheet of the banking system exceeds 15 per cent. This figure stood at 7.57 per cent in 2003. But while we take the share of total banking assets of foreign banks in urban/metropolitan commercial

banking segment alone, it is around 13 per cent. Moreover, following the branch expansion policies of the RBI for enhancing the spread of banking services, aggregate commercial banking assets is rising at a fast pace. Thus the limit of 15 per cent gives ample room for inflow of foreign banks and to enhance their position further in core centres of commercial banking.

India's signatory status in the GATS, and the commitment schedule on mode 3 trade in banking services entitles foreign banks to full market access and national treatment apart from the limitation entered in the commitment schedule. The limitation, but disregard some of the practices still followed after the enforcement of GATS. For instance, priority sector lending requirements is one area where domestic banks are put under more strain, even though it is explicitly stated in the commitment schedule that foreign banks are subjected to non-discriminatory resource allocation conditions which they would not want to be subjected to. From international negotiations' point of view, given the state of affairs of Indian commercial banking, foreign service providers are least likely to press for full national treatment. Conventional policies confine foreign banks to operation in urban centres. As pointed out earlier, bank markets in India are highly compartmentalized regionally with vast differences in their features. Full access to foreign banks in urban segment where banking practices offer high returns and low risks acts as a comfortable cushion for profitable functioning. Such uncontrolled access may lead to exclusion of domestic banks, which depend on the same segment to mitigate the social costs they bear through rural operations. Current level and degree of market access offered to foreign service providers, which is not restricted by market access commitments in the Schedule, itself is to be reconsidered in this context.

Implications for domestic regulation are more important though subtle. Despite bank nationalisation and branch licensing designed to control the ratio of rural and urban branches, a large section in the country is still deprived of even basic banking services. As pointed out by Mor (2005), most of the 'un-banked' are very poor, landless and do not have any tangible collateral and without access to any kind of steady wage employment. Moreover their exposure to systemic shocks such as poor crop due to exogenous factors is very high and often could be the principal driver of return to poverty. Serving such a customer base imposes social costs. Continuing with the nationalisation legacy is very much needed and the policy prescription inevitably should accommodate staunch regulation of banks. Regulatory authority is not only to be exercised in expanding rural reach by compulsion, but also should ensure non-occurrence of bank failures that could arise as a consequence of such rural

expansion. This requires regulatory focus on aggregate level solvency, liquidity and capital adequacy of banks. India therefore very much requires to retain full domestic regulatory authority in successive rounds of GATS negotiations.

As against imports of mode 3 banking the avenues for exports for India through GATS is still unexplored to a large extend. The broad picture of presence of Indian banks abroad is in fact very bleak and unmatched compared to foreign banks in India. Table 3.14 shows the total assets and liabilities of Indian banks abroad. As is evident from the figures the activities of these banks are in a declining phase and they consistently make losses.

**Table 3. 14 Aggregate Assets and Liabilities of Indian Banks Abroad (in US $ million)**

| *Year* | *2000* | *2001* | *2002* | *2003* |
|---|---|---|---|---|
| No. of banks | 9 | 9 | 9 | 9 |
| No. of branches | 96 | 94 | 92 | 93 |
| Liabilities | | | | |
| 1. H. O. funds | 1359.69 | 1336.47 | 1127.15 | 1370.42 |
| 2. Customer deposits | 5728.15 | 4833.93 | 5379.47 | 5456.91 |
| 3. Inter-branch borrowings | 6111.85 | 4162 | 4314.65 | 3669.41 |
| 4. Inter-bank borrowings | 2995.24 | 3204.5 | 2815.79 | 3168.5 |
| 5. Other debt Instruments | 0.01 | 8.82 | 0.02 | 9.92 |
| 6. Other liabilities | 360.35 | 627.47 | 1408.47 | 388.69 |
| Total liabilities | 16555.29 | 14173.19 | 15045.55 | 14063.85 |
| Assets | | | | |
| 1. Cash on hand & balances | 181.02 | 368.34 | 1189.25 | 210.35 |
| 2. Investments in securities | 1847.78 | 2243.76 | 2804.07 | 3052.85 |
| 3. Inter-branch deposits | 1717.28 | 183.12 | 579.85 | 921.39 |
| 4. Inter-bank deposits | 6408.39 | 4266.98 | 3266.18 | 1844.33 |
| 5. Customer credit | 5889.8 | 6486.19 | 6817.69 | 7607.58 |
| 6. Accumulated losses | 184.56 | 152.89 | 162.56 | 174.07 |
| 7. Other assets | 326.46 | 471.91 | 225.95 | 253.28 |
| Total assets | 16555.29 | 14173.19 | 15045.55 | 14063.85 |

Source: Statement of assets & liabilities of overseas branches, Department of Banking Supervision, RBI (2003).

In 1984, 13 native banks together constituted 141 branches in about 25 countries (Rao, 1991). By 2003 the number of banks as well as branches came down to 9 and 93 respectively. This is against 43 banks of foreign origin with 197 branches in India. Though the existing branches take part in credit and investment activities their functioning has not been profitable. Customer credit and investment in securities were 54.09 per cent and 21.7 per cent of total assets respectively in 2003, while accumulated losses rose to 174.07 million US Dollars.

Most of the member countries in GATS including India has opted MFN exemption in terms of reciprocity. Opportunities for enhancing branches abroad for India in GATS are thereby largely dependent on this account. As reciprocity promotes mutual removal of entry

restrictions, multinationalisation of Indian banks would mean increasing entry of foreign banks into India as well. On the other hand, the experience so far shows that domestic banking is hardly equipped for acquiring international status. Even though mode 3 trade in services does offer scope for spread of Indian banks in foreign countries, the question of how far that opportunity can be explored is still uncertain and not addressed in the Commitment Schedule of India.

## Annex II
## Format of Profit/Loss Statement and Balance Sheet of Banks[1]

### Profit and Loss Account

<table>
<tr><th>Total Expenses</th><th>Total Income</th></tr>
<tr><td>❑ Interest Expended<br>▪ Interest on Deposits<br>▪ Interest on RBI/Inter-Bank Borrowings<br>▪ Interest Expended on Others<br><br>❑ Operating Expenses<br>▪ Payments To and Provisions For Employees<br>▪ Rent, Taxes and Lighting<br>▪ Printing and Stationery<br>▪ Advertising and Publicity<br>▪ Depreciation on Banks Property<br>▪ Directors Fees, Allowances and Expenses<br>▪ Auditors Fees and Expenses<br>▪ Law Charges<br>▪ Postage, Telegrams, Telephones, etc<br>▪ Repair and Maintenance<br>▪ Insurance<br>▪ Other Expenditure</td><td>❑ Interest Earned<br>▪ Interest/Discount on Advanced/Bills<br>▪ Income on Investments<br>▪ Interest on Balances with RBI and Other Inter-Bank Funds<br>▪ Interest Earned on Others<br><br>❑ Other Income<br>▪ Commission, Exchange and Brokerage<br>▪ Net Profit/Loss on Sale of Investment<br>-Profit on Sale of Investment<br>-Loss on Sale of Investment<br>▪ Net Profit/Loss on Revaluation of Investment<br>-Profit on Revaluation of Investment<br>-Loss on Revaluation of Investment<br>▪ Net Profit/Loss on Sale of Land, Buildings and Other Assets<br>-Profit on Sale of Land, Buildings and Other Assets<br>-Loss on Sale of Land, Buildings and Other Assets<br>▪ Net Profit/Loss on Exchange Transactions<br>-Profit on Exchange Transactions<br>-Loss on Exchange Transactions<br>▪ Miscellaneous Income<br>-Dividend Income<br>-Other Miscellaneous Income</td></tr>
<tr><td>❑ Provisions and Contingencies<br>❑ Profit</td><td>❑ Loss</td></tr>
</table>

[1] The Format of Annual Accounts consisting of Profit/Loss Account and Balance Sheet of Banks are given here as presented in the *Annual Account Statistics of Scheduled Commercial Banks (1990-2001)* published by the Reserve Bank of India. This is different from the original format in which banks are required to file their annual accounts, in terms of order of arrangement of items. Each year, the balance of Profit/Loss account (either profit or loss) will be carried over to Balance sheet. Profit will come as Balance in Profit and Loss Account under Reserves and Surplus in the liabilities' side of the Balance Sheet. In case of loss, the amount will be carried over to the Asset side of the Balance Sheet.

## Balance Sheet

| Liabilities | Assets |
|---|---|
| ❑ Capital<br>❑ Reserves and Surplus<br>• Statutory Reserves<br>- Opening Balance of Statutory Reserves<br>- Additions during the year to Statutory Reserves<br>- Deductions during the year from Statutory Reserves<br>▪ Capital Reserves<br>- Opening Balance of Capital Reserves<br>- Additions during the year to Capital Reserves<br>- Deductions during the year from Capital Reserves<br>▪ Share Premium<br>- Opening Balance of Share Premium Reserves<br>- Additions during the year to Share Premium Reserves<br>- Deductions during the year from Share Premium Reserves<br>▪ Revenue and Other Reserves<br>- Opening Balance of Revenue and Other Reserves<br>- Additions during the year to Revenue and Other Reserves<br>- Deductions during the year from Revenue and Other Reserves<br>▪ Balance in Profit and Loss Account<br>❑ Deposits<br>▪ Demand Deposits<br>- Demand Deposits from Banks<br>- Demand Deposits from Others<br>▪ Saving Bank Deposits<br>▪ Term Deposits<br>- Term Deposits from Banks<br>- Term Deposits from Others<br>▪ Deposits of Branches<br>- Deposits of branches in India<br>- Deposits of branches outside India<br>❑ Borrowings<br>▪ Borrowings in India<br>- Borrowings from Reserve Bank of India<br>- Borrowings from Other Banks<br>- Borrowings from Other Institutions and Agencies<br>▪ Borrowings Outside India<br>❑ Other Liabilities and Provisions<br>▪ Bills Payable<br>▪ Inter Office Adjustment<br>▪ Interest Accured<br>▪ Others (including provisions) | ❑ Cash and Balance with RBI<br>▪ Cash in Hand<br>▪ Balances with RBI<br>- Balances with RBI in Current Account<br>- Balances with RBI in Other Deposits Accounts<br>❑ Balances with Banks<br>▪ Balances with Banks in India<br>- Balances with Banks in India in Current Account<br>- Balances with Banks in India in Other Deposits Accounts<br>▪ Balances with Banks Outside India<br>- Balances with Banks Outside India in Current Account<br>- Balances with Banks Outside India in Other Deposits Accounts<br>❑ Money at Call and Short Notice<br>▪ Money at Call and Short Notice in india<br>- Money at Call and Short Notice in india with Banks<br>- Money at Call and Short Notice in india with Other FIs<br>▪ Money at Call and Short Notice outside India<br>❑ Investments<br>▪ Investments in India<br>- Investments in India in Government Securities<br>- Investments in India in Other Approved Securities<br>- Investments in India in Shares<br>- Investments in India in Debentures and Bonds<br>- Investments in India in Subsidiaries and/or Joint Ventures<br>- Investment in India in Others<br>▪ Investments outside India<br>❑ Advances<br>▪ Category1<br>- Bills Purchased and Discounted<br>- Cash Credits, Overdrafts and Loans Repayable an Demand<br>- Term Loans<br>❑ Fixed Assets<br>▪ Premises<br>- Premises at Cost as on 31st March of the Preceding Year<br>- Additions During the Year to Premises<br>- Deductions During the Year from Premises<br>- Depreciation of Premises to Date<br>▪ Assets Under Construction<br>▪ Other Fixed Assets(OFA)<br>- OFA at Cost as on 31st March of the Preceding Year<br>- Additions During the Year to OFA<br>- Deductions During the Year from OFA<br>- Depreciation of OFA to Date<br>❑ Other Assets<br>▪ Inter Office Adjustment (Net)<br>▪ Interest Accrued<br>▪ Tax Paid in Advance/Tax Deducted at Source<br>▪ Stamps and Stationery<br>▪ Others(if any) |

## Annex III

## Data Envelopment Analysis

Data envelopment analysis (DEA), first introduced by Charnes et al. (1978), is a linear programming based technique for measuring the relative performance of organisational units or decision-making units (DMUs), where the presence of multiple inputs and outputs makes comparisons difficult. Unlike traditional analytical tools that look for the average path through the middle of a series of data points, DEA identifies the most efficient units to construct a frontier of best performance DMUs as a reference for calculating the comparative efficiencies of other units. DEA is non-parametric, meaning that the precise form of the production function does not need to be specified or assumed as in, for example, regression analysis.

The standard DEA models have input and output orientation. An input orientation identifies the efficient consumption of input resources while holding outputs constant. An output orientation identifies the efficient level of output production given existing input resource consumption. In addition, DEA models can be either constant returns to scale (CRS) or variable returns to scale (VRS). In chapter 3, out-put oriented CRS and VRS specifications are computed for bank data for finding relative efficiencies with which Indian commercial banks perform in deposit market and credit market. The results are computed using *DEA Excel Solver* developed by Joe Zhu (see Zhu (2003).

The basic out-put oriented constant returns to scale DEA model in the case of multiple inputs and outputs can be expressed as the following liner programming problem[1].

$$\text{Max}\,\phi - \varepsilon\left(\sum_{i=1}^{m} s_i^- + \sum_{r=1}^{s} s_r^+\right) \qquad (1)$$

subject to constraints

$$\sum_{j=1}^{n} \lambda_j x_{ij} + s_i^- = x_{io} \qquad i = 1,2,\ldots,m; \qquad (2)$$

$$\sum_{j=1}^{n} \lambda_j y_{rj} - s_r^+ = \phi y_{ro} \qquad r = 1,2,\ldots,s; \qquad (3)$$

$$\lambda_j \geq 0 \qquad j = 1,2,\ldots,n. \qquad (4)$$

where, $x$ – represents *i* inputs 1 to m,

$y$ – represents r outputs 1 to s,

$\lambda$ – represents weights given to j DMUs (banks in our case) 1 to n.

$S_i$ – represents input slacks where input reduction is possible for a DMU at frontier level of output.

$S_r$ – represents output slacks where output increase is possible for a DMU at frontier level of input[2].

To get the output oriented variable returns to scale (VRS) frontier constraint (4) in the above formulation has to be replaced by the following constraint.

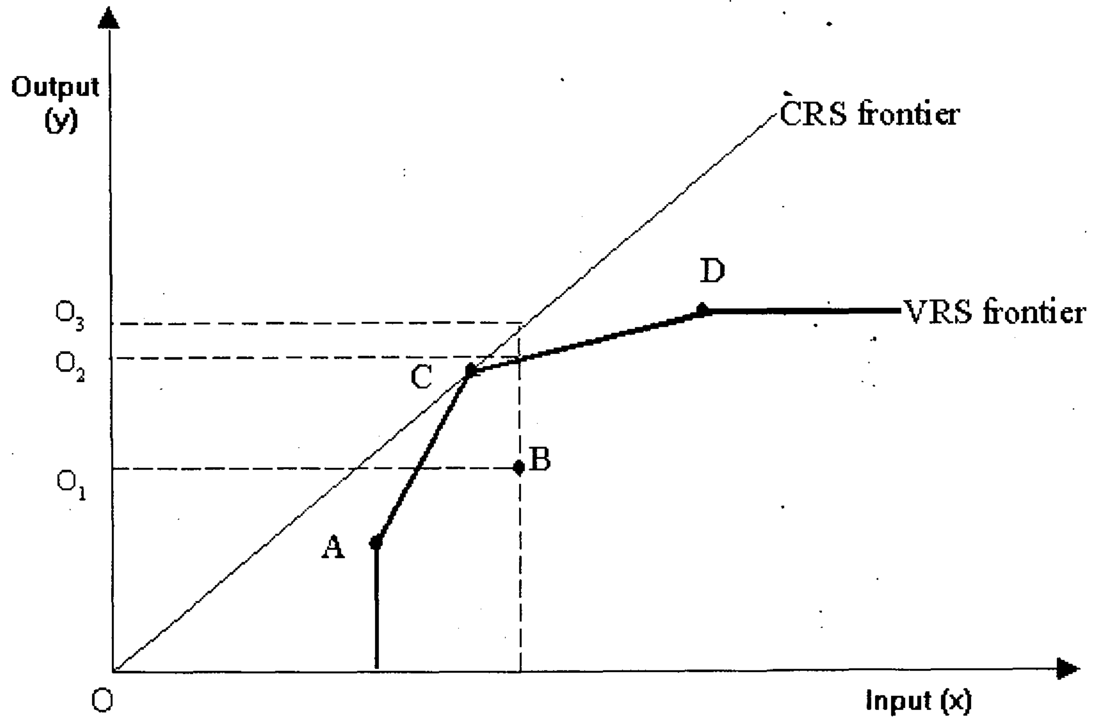
[1] See Zhu (2003) pp. 5 – 13 for detailed explanations.

[2] For instance, if in Figure AIII.1, there is a DMU 'E' lying in the line segment 'X-axis to A' below A, then even though it is in the frontier, E can increase its output keeping the same level of input by moving up along the line segment to reach A. This is a case for output slack. The concept of input slack can be grasped similarly.

$$\sum_{j=1}^{n} \lambda_j = 1 \qquad j = 1,2,...,n. \qquad (5)$$

The following figure illustrates functioning of DEA methodology in single input and output case.

**Figure A III. 1: Illustration of CRS and VRS Frontiers Formed by DEA Model With Single Input and Output**




The figure gives efficient frontiers formed by DMUs A, B, C and D by solving the above linear programme specification. DMU C is both CRS and VRS efficient. DMUs A, C and D form the VRS efficient frontier. B is inefficient and can reduce its input at the current output or increase output at current input to reach the frontiers. An output oriented specification gives inefficiency indices as inefficiency as a proportion of target level of output for reaching the frontier. Hence for unit B in the figure;

CRS efficiency score $\phi_1 = (O_3 - O_1 / O_3)$ (6)

VRS efficiency score $\phi_2 = (O_2 - O_1 / O_2)$ (7)

$0 \geq \phi_1, \phi_2 \geq 1$, Inefficiency increases or otherwise efficiency decreases as $\phi_1, \phi_2$ moves from 0 to 1.

CRS efficiency frontier is restrictive in the sense that it assumes efficiency is not affected by scale of production. This may not be realistic and consequently may severely influence the interpretation of results. If the technology of the process under evaluation exhibits variable returns to scale, it is clear that some of the existing inefficiency could be due to in-optimal scale. Constructing a technology rendering VRS frontier helps to overcome this problem. Also, comparing relative efficiencies with both CRS and VRS frontiers helps to break the

inefficiency index of each DMU into two parts namely total technical inefficiency and pure scale inefficiency. From the figure above, for unit B;

Total inefficiency - $\phi_1$ (CRS inefficiency) = $(O_3 - O_1 / O_3)$ (8)

Technical inefficiency - $\phi_{11}$ (VRS inefficiency[3]) = $(O_2 - O_1 / O_3)$ (9)

Scale inefficiency – (Total inefficiency - Technical inefficiency) = $\phi_{12} = (O_3 - O_2 / O_3)$ (10)

This framework can be extended to multiple input-output case using the model expressed by equations 1 to 5 above. In our Exposition in Section 6.3 of Chapter 3, DEA methodology in a multiple input-output case is used to see functional efficiency of bank groups in deposit and advances market. For this purpose a total of 70 scheduled commercial banks are selected belonging to one of three groups viz., Foreign Banks, Indian Private Banks and Public Banks. Two cases are considered namely stage 1 and 2, wherein stage1 deals with functioning in deposit market and stage 2 deals with that in advances market. For both stages frontiers are constructed for finding $\phi_1$, $\phi_{11}$ and $\phi_{12}$ respectively of each of the 70 banks, as given in equations 8 to 10 above. Average $\phi$ scores of banks belonging to each bank group is taken for ascertaining total (CRS) inefficiency, technical (VRS) inefficiency and scale inefficiency of bank groups. The analysis is repeated for years 1992 to 2001 to see trends in inefficiency scores for the period.

**Strengths of DEA**

A few of the characteristics that make DEA powerful are:

- DEA can handle multiple input and multiple output models.
- It doesn't require an assumption of a functional form relating inputs to outputs.
- DMUs are directly compared against a peer or combination of peers.
- Inputs and outputs can have very different units. For example, X1 could be in units of lives saved and X2 could be in units of dollars without requiring an *a priori* tradeoff between the two.

**Limitations of DEA**

- Since DEA is an extreme point technique, noise such as measurement error can cause problems.
- DEA is good at estimating 'relative' efficiency of a DMU but it converges very slowly to 'absolute' efficiency. In other words, it can tell how well DMUs are doing compared to their peers but not compared to a 'theoretical maximum'.
- Since DEA is a nonparametric technique, statistical hypothesis tests are difficult and are the focus of ongoing research.

[3] Note that in this case the denominator in equation 7 is changed to $O_3$ in equation 9 and hence VRS inefficiency is redefined here.

## Box AIII. 1 List of Banks Included in DEA Analysis

| *FOREIGN BANKS (FB)* | *INDIAN PRIVATE BANKS (IPB)* | *PUBLIC BANKS (PB)* |
|---|---|---|
| 1) ABN AMRO BANK | 1) BANK OF RAJASTHAN | 1) ALLAHABAD BANK |
| 2) ABU-DHABI COMMERCIAL BANK | 2) BENARES STATE BANK | 2) ANDHRA BANK |
| 3) AMERICAN EXPRESS BANK | 3) BHARAT OVERSEAS BANK | 3) BANK OF BARODA |
| 4) BANK OF AMERICA | 4) CATHOLIC SYRIAN BANK | 4) BANK OF INDIA |
| 5) BANK OF BAHRAIN & KUWAIT | 5) CITY UNION BANK | 5) BANK OF MAHARASHTRA |
| 6) BANK OF NOVA SCOTIA | 6) DHANALAKSHMI BANK | 6) CANARA BANK |
| 7) BANK OF TOKYO | 7) FEDERAL BANK | 7) CENTRAL BANK OF INDIA |
| 8) BARCLAYS BANK | 8) GANESH BANK OF KURUNDWAD | 8) CORPORATION BANK |
| 9) BNP PARIBAS | 9) JAMMU & KASHMIR BANK | 9) DENA BANK |
| 10) CITIBANK | 10) KARNATAKA BANK | 10) INDIAN BANK |
| 11) CREDIT AGRICOLE INDOSUEZ | 11) KARUR VYSYA BANK | 11) INDIAN OVERSEAS BANK |
| 12) CREDIT LYONNAIS | 12) LAKSHMI VILAS BANK | 12) ORIENTAL BANK OF COMMERCE |
| 13) DEUTSCHE BANK | 13) LORD KRISHNA BANK | 13) PUNJAB & SIND BANK |
| 14) HONGKONG & SHANGHAI BANK | 14) NAINITAL BANK | 14) PUNJAB NATIONAL BANK |
| 15) MASHREQ BANK | 15) NEDUNGADI BANK | 15) STATE BANK OF BIKANER & JAIPUR |
| 16) OMAN INTERNATIONAL BANK | 16) RATNAKAR BANK | 16) STATE BANK OF HYDERABAD |
| 17) SAKURA BANK | 17) SANGLI BANK | 17) STATE BANK OF INDIA |
| 18) SANWA BANK | 18) SOUTH INDIAN BANK | 18) STATE BANK OF INDORE |
| 19) SOCIETE GENERALE | 19) TAMILNAD MERCANTILE BANK | 19) STATE BANK OF MYSORE |
| 20) SONALI BANK | 20) UNITED WESTERN BANK | 20) STATE BANK OF PATIALA |
| 21) STANDARD CHARTERED BANK | 21) VYSYA BANK | 21) STATE BANK OF SAURASHTRA |
| 22) STANDARD CHARTERED GRINDLAYS BANK | | 22) STATE BANK OF TRAVANCORE |
| | | 23) SYNDICATE BANK |
| | | 24) UCO BANK |
| | | 25) UNION BANK OF INDIA |
| | | 26) UNITED BANK OF INDIA |
| | | 27) VIJAYA BANK |

# CHAPTER 4

## Summary and Conclusions

Growing significance of services induced a global rethinking on international trade in services. Framing of General Agreement on Trade in Services (GATS), the first comprehensive set of rules for international trade in services, is a significant step towards services trade policy by the international forum under the WTO's flag. Having undergone a series of policy reforms starting from early 1990s for strengthening domestic banking sector, India is now addressing wider challenge of making commercial banking globally competitive. In this regard, India's participation in WTO negotiations for trade in financial services and commitments regarding the same under General Agreement on Trade in Services, holds several key implications. GATS identify FDI in service segment specifically as a form of trade in services. Activities of foreign banks operating in India are therefore henceforth considered as traded services and come under the purview of the Agreement. In order to comprehend the implications of GATS and India's commitments on banking services for commercial banking in India, firstly an examination of the structure of and major provisions in the Agreement and the content of commitment schedule of India on banking sector is taken up in the present study. The inferences drawn from this are then matched with an analysis of the operations of foreign banks in India.

The prime distinguishing feature of the Agreement is its definition of four modes of supply through which services are traded. Definition of modes of supply originates out of intangible nature of services and subsequently factor mobility becoming a prerequisite for trade in most services to occur. Mode 3 is defined as commercial presence abroad, wherein capital moves to a foreign country to establish a service providing organization. Unlike other modes of supply, Mode 3 involves long term capital movement and direct investment on establishments and mode 3 service providers engage in provision of a multitude of services which are sub-classified under one service type. Such foreign firms participate within the framework of organised industry in the host country. Mode 3 entry is, moreover, the most viable method of supply given the specificities associated with many of the services which are internationally traded. Being analogous to FDI, supply through mode 3 entails all concerns associated with FDI as extensively discussed in the literature. Barriers to services trade are chiefly internal regulations and other non-tariff measures and especially so in the case of mode 3. Mode 3 suppliers face exclusive regulatory bodies in the host country and are usually subjected to

conditioned operating environments. From an inspection of the major provisions in GATS it becomes evident that its crucial Articles on Domestic Regulation, Market Access and National Treatment and their disputed contents are aimed at facilitating liberalisation of mode 3 far more than other modes of supply.

As brought up in literature, key banking services can only be traded through mode 3, though mode 1 is also a viable mode of supply for some of them. The reason is that services from basic intermediation to custodial services, payment and even dealings in money transfer services including credit cards, travellers cheques, bankers' drafts etc, requires a great deal of local knowledge and expertise and more importantly local presence for trust building and expanding clientele. Moreover mode 3 allows establishments to club these services together and operate funds with better scale and scope efficiencies. Therefore issues of domestic regulation and market access is very much pertinent in the case of banking services.

The GATS acts through two channels viz. (1) the general provisions or horizontal obligations contained in its Articles which are applicable to member countries irrespective of whether they have committed to liberalise any of the service sectors or not and (2) the Schedule of commitments filed by individual countries which are applicable to respective sectors for which the member country has made commitments. By studying the general provisions, it could be observed that the Agreement aims at facilitating the mitigation of both entry level barriers and post entry operation level barriers for foreign service providers. As barriers to services are chiefly non-border measures like regulatory norms, as is particularly the case with services like banking, crucial Articles on domestic regulation, market access and national treatment renders their power to such services especially for entry through mode 3. As India has entered commitments for banking services in her Schedule, both horizontal and sectoral obligations come into play as far as banking is concerned. As Indian commercial banking has been highly regulated on a number of counts for prudential reasons and domestic interests and the country requires to maintain its regulatory authority, the first and foremost concern arising out of GATS for her banking sector is the implications on domestic regulation. Though Article VI on domestic regulation and again the Annex on financial services of the Agreement allows a country to exercise prudential regulations including for the protection of investors, depositors, policy holders or persons to whom a fiduciary duty is owed by a financial service supplier, or to ensure the integrity and stability of the financial system, it has been stated that where such measures do not conform with the provisions of the Agreement, they shall not be used as a means of avoiding the Member's commitments or obligations under the Agreement.

This is rather a vague stipulation and signatory status of India in the Agreement leaves uncertainty regarding its full impact on banking regulatory authority, but clearly implicates that India has to stick to the commitments as entered in the Schedule and cannot use regulatory power to circumvent those commitments.

Examining India's commitments in banking services, it could be observed that assertion is given for retaining domestic regulatory authority over governance of foreign banks. But India's signatory status in the GATS, and the commitment schedule on mode 3 trade in banking services entitles foreign banks to full market access and national treatment apart from the limitation entered in the commitment schedule. The limitations to full market access and national treatment are specified in the schedule rather vaguely and omit certain important limitations currently offered to foreign banks operating in India. Particularly, three important limitations are made in the market access column for key banking services: (1) Service provision is allowed only through branch operations of a foreign bank licensed and supervised as a bank in its home country, (2) Foreign banks are subject to non-discriminatory resource allocation requirements and (3) Licences for new foreign banks may be denied when the maximum share of assets in India both on and off balance sheet of foreign banks to total assets both on and off balance sheet of the banking system exceeds 15 per cent.

The first of these limitations specify the type of legal entity which is the conventional form of foreign entry in Indian commercial banking. But as such branches are not entities incorporated in India, policies on rural branching and priority lending requirements could not be imposed on such banks at par with domestic banks and this practice is not in compliance with national treatment clause. Since these discriminations in fact put foreign banks in an advantageous position, it is not likely that foreign banks will press for full national treatment. The second limitation gives room for increasing the priority sector lending requirements of foreign banks to match with that of domestic banks. But such requirements for foreign banks are at present not at par with that for domestic counterparts. Strict imposition of this limitation will increase the burden of foreign banks and might obstruct them from entry. Therefore, execution of non-discriminatory resource allocation requirements must be considered on the face of expected gains from foreign entry. The third limitation is very crucial in the sense that it determines the scope and extent of new foreign entry into the banking industry. The current position and operations of foreign banks have to be studied in order to understand the impacts of these limitations on the industry.

Amidst studies addressing various aspects of commercial banking in India, there is a dearth of literature concerning distinctive aspects of operation of foreign banks in India and so much so in the context of GATS and India's Commitments. Existing comparative studies on functioning of foreign banks in India vis-à-vis that of domestic banks concurrently show better performance of foreign bank group in terms of profitability. The reason for this is attributed to superior banking practices and techniques adopted by those banks. But the phenomenon can be better explained, as our own analysis shows, by differences in operational constraints faced by foreign and domestic banks. Differences in operational constraints primarily arise from rural-urban divide existing in banking markets in India. Rural centers are in many ways different from urban ones, starting from profile of customers and nature of their banking service requirements. Region wise analysis of banking operations shows that number of accounts and amount per account for both deposits and credit are far less in rural branches than in urban branches. Thus urban centers facilitate opportunities to reap scale economies and reduce operation costs. Apart from this, there are significant differences in sectors in which credit is being deployed between rural and urban centers. While rural branches serve agriculture and small-scale industries, credit markets in urban centers caters to sectors like heavy industries, transport, professional services, trade and finance which are comparatively less prone to systemic and other credit risks. This gives leeway to urban/metropolitan branches for managing funds efficiently. More importantly urban banking is characterized by advanced technologies in service provision and innovative financial instruments which suits the economically better off clientele.

Keeping in view the staunch credit support required for sustenance of our huge rural population, through bank nationalisation and subsequent branch licensing policies of the regulatory authority, expansion of rural reach of banking has been achieved in India to certain extent. More than 60 per cent of total branches of public banks are concentrated in rural/semi-urban areas, while foreign banks are wholly concentrated in urban/metropolitan areas. The principal reason for better performance of foreign bank group is thus very much evident from mere examination of the regional distribution of branches of bank groups. Analysing region-wise distribution of deposits and credit we observed that the business of all bank groups are concentrated in urban/metropolitan centers. Credit deposit ratios also register highest values in those centers. This clearly indicates dependency of domestic banks on urban centers for leveraging for social banking costs incurred from rural operations. While domestic banks have ample and unscathed access to deposits or funds for credit by way of pooled in rural savings,

profitable credit deployment opportunities are confronted by steady competition in the concentrated urban-metropolitan markets.

Two important observations arise out of analysing the composition of assets and liabilities of bank groups. Firstly, there is a shift from advances/credit to investments in securities, government bonds and other financial assets in the earning assets portfolio of domestic banks. As there is no significant differences in earnings per rupee from advances and investments, it cannot be argued that this shift is based on profitability concerns. On the other hand, as priority lending requirements are stipulated as a percentage of total advances made by banks, this shift gives leeway for banks to bring down aggregate advances and circumvent costs involved in priority lending. Secondly, while the funds for advances and investments comes by way of deposits for domestic banks, foreign banks meet fund deficiency from inter bank borrowings as their deposit base is very low comparatively.

In order to see the comparative efficiency with which various bank groups operate in deposit and credit markets we employed Data Envelopment Analysis and the results show that domestic banks are efficient in deposit mobilization incurring low interest expenses while foreign banks fair in credit market operations. Eventhough there is no evidence for volume-wise dominance of foreign banks in any single banking operation and apparently pose no threat to franchise value of domestic banks, in a dynamic environment, differences in operational distinctions and comparative efficiency with which each bank group performs the central function of intermediation result in an uneven augmentation of competitive advantages across bank groups. Efficiency in credit markets and ability to over come fund deficiencies by inter bank borrowings in turn gives ample space for rapid expansion of foreign banks.

In this context the three important commitments made by India mentioned above invokes certain momentous implications. Though type of legal entity is specified as fully owned branches of banks incorporated outside Indian territory, which retains status quo in the current policy on foreign entry, Ministry of Finance has recently planned for giving subsidiary status to foreign banks. Also, limitation on equity participation is left blank in the commitment schedule. Subsidiary status will Subject foreign banks to equal priority lending stipulations and rural branching which may act as a disincentive for foreign entry through subsidiary route. On the other hand, foreign capital can circumvent limitations on national treatment by choosing the alternative route of equity participation (operating through subsidiaries) rather than opening branches, discounting the power of national treatment limitations.

Limitation on nondiscriminatory resource allocation requirements is rather vaguely stated and also clearly poses disincentive for foreign entry, but is not yet implemented by India. Eventhough foreign banks are also subjected to priority sector lending requirements, they are by far less and distinct from that of domestic banks. As the sectors under priority lending prescribed to domestic and foreign banks are different, a mere quantitative increase in the requirement would not bring about non discrimination in resource allocation and continue to limit national treatment for foreign banks for their benefit.

Finally, entry limitation for new foreign banks is entered in the Schedule by stating that licenses for new foreign banks may be denied when the maximum share of assets in India both on and off balance sheet of foreign banks to total assets both on and off balance sheet of the banking system exceeds 15 per cent. Currently foreign banks possess around 7 per cent of the total commercial banking assets. But, given the immense rural penetration and large branch networking of domestic banks, a huge portion of banking assets lie well outside the boundary of areas in which foreign banks are located which is growing at a fast rate following the branching policies of the Reserve Bank of India. The entry limitation entered in the schedule thus translates into a very wide scope for foreign entry in commercial banking and subsequently to complex post entry operation and management issues. The fact that such foreign entry will increase the urban/metropolitan concentration, which will deprive opportunities for domestic banks to level out social costs borne by them, accentuates the concern. The serious implication in such a case would be a hindrance to rural-urban circulation of funds leading to sub-optimal outcomes.

The massive social banking needs faced by India, as more than 500 million in the country continue to have no access to financial services, are met almost wholly by domestic public sector. Still unattained goals of rural penetration and integration of regional financial markets require public intervention and increased sophistication in regulation of banks, India cannot do away with its restrictive banking regulatory policies. Future negotiations and subsequent commitments in the GATS are therefore to be addressed, keeping in view our need for retaining full domestic regulatory authority.

Inquiring into the corresponding foreign presence of Indian banks, it could be seen that number of branches of domestic banks abroad has drastically fallen owing to continuous loss making. While data on consolidated balance sheets of existing foreign branches also shows

consistent accumulated losses, most Indian banks are hardly equipped for acquiring international status. Like most other member countries, India has also opted for MFN exemption in terms of reciprocity. Opportunities for enhancing branches abroad for India in GATS are thereby largely dependent on this account. As reciprocity promote mutual and bilateral removal of entry restrictions, increasing multinationalisation of Indian banks would mean increasing entry of foreign banks into India as well. Crucial objective of entering into an international trade agreement like the GATS being to purse our own goals of making domestic banking internationally competitive, the question of how far that opportunity can be explored is still uncertain and not addressed properly in the Commitment Schedule of India.

# Appendix I

**Structure of Legal Text of GATS**

PART I SCOPE AND DEFINITION

| | |
|---|---|
| Article I | Scope and Definition – Definition of four modes of supply. |

PART II GENERAL OBLIGATIONS AND DISCIPLINES

| | |
|---|---|
| Article II | Most-Favoured-Nation Treatment |
| Article III | Transparency |
| Article III | Disclosure of Confidential Information |
| Article IV | Increasing Participation of Developing Countries |
| Article V | Economic Integration |
| Article V | Labour Markets Integration Agreements |
| Article VI | Domestic Regulation |
| Article VII | Recognition |
| Article VIII | Monopolies and Exclusive Service Suppliers |
| Article IX | Business Practices |
| Article X | Emergency Safeguard Measures |
| Article XI | Payments and Transfers |
| Article XII | Restrictions to Safeguard the Balance of Payments |
| Article XIII | Government Procurement |
| Article XIV | General Exceptions |
| Article XIV | Security Exceptions |
| Article XV | Subsidies |

PART III SPECIFIC COMMITMENTS

| | |
|---|---|
| Article XVI | Market Access |
| Article XVII | National Treatment |
| Article XVIII | Additional Commitments |

PART IV PROGRESSIVE LIBERALIZATION

| | |
|---|---|
| Article XIX | Negotiation of Specific Commitments |
| Article XX | Schedules of Specific Commitments |
| Article XXI | Modification of Schedules |

PART V INSTITUTIONAL PROVISIONS

| | |
|---|---|
| Article XXII | Consultation |
| Article XXIII | Dispute Settlement and Enforcement |
| Article XXIV | Council for Trade in Services |
| Article XXV | Technical Cooperation |
| Article XXVI | Relationship with Other International Organizations |

PART VI FINAL PROVISIONS

| | |
|---|---|
| Article XXVII | Denial of Benefits |
| Article XXVIII | Definitions |
| Article XXIX | Annexes |

**Classification of Service Sectors**

1. Business
2. Communication
3. Construction
4. Distribution
5. Education
6. Environment
7. Financial
8. Health

9. Tourism
10. Recreation
11. Transport
12. Other services (not included above)

**Sub-classification of Banking and other financial services (excluding insurance)**

GATS, Annex on Financial Services, Section 5(a):

(v) Acceptance of deposits and other repayable funds from the public;

(vi) Lending of all types, including consumer credit, mortgage credit, factoring and financing of commercial transaction;

(vii) Financial leasing;

(viii) All payment and money transmission services, including credit, charge and debit cards, travellers' cheques and bankers drafts;

(ix) Guarantees and commitments;

(x) Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:

A. money market instruments (including cheques, bills, certificates of deposits);
B. foreign exchange;
C. derivative products including, but not limited to, futures and options;
D. exchange rate and interest rate instruments, including products such as swaps, forward rate agreements;
E. transferable securities;
F. other negotiable instruments and financial assets, including bullion.

(xi) Participation in issues of all kinds of securities, including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues;

(xii) Money broking;

(xiii) Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial, depository and trust services;

(xiv) Settlement and clearing services for financial assets, including securities, derivative products, and other negotiable instruments;

(xv) Provision and transfer of financial information, and financial data processing and related software by suppliers of other financial services;

(xvi) Advisory, intermediation and other auxiliary financial services on all the activities listed in subparagraphs (v) through (xv), including credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy.

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