

Why are Indian banks curtailing their overseas operations?

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Over the past month, there were a spate of announcements about Indian banks downsizing their overseas operations – either closing down branches or foreign subsidiaries, or pulling out of some countries altogether.

All leading lights of the Indian banking sector are in withdrawal mode. SBI is reportedly pulling out of six branches in China, Sri Lanka, Oman, Saudi Arabia, France and Botswana. Canara Bank is to shut three foreign branches in the UK, Bahrain and Shanghai, and will also sell 50 per cent of its stake in a joint venture in Russia to SBI. Other banks closing branches are Bank of India and IDBI Bank.

Why pull out?

The immediate trigger for this pull back has been the poor performance of public sector banks during the past few years.

Mounting losses, the problem of bad loans, the need for fresh capital and tightening budgetary support with a number of strings, poor valuations at the stock market and the recent cases of huge frauds, have contributed to an environment where the government has had to crack down on banks. There are about 159 branches of Indian banks operating outside and about a quarter of them are loss-making.

Foreign operations cost a lot of money. First, there is a huge licence fee, or high capital requirement, to operate in many foreign domains. In some geographies, this was high enough to compel a couple of Indian banks to join hands and go there as a joint venture. Then there are infrastructure costs, including manpower expenses. High competition and razor-thin margins, especially in international financial centres such as London, Singapore, Tokyo or Hong Kong, have lengthened break-even periods.

Veteran bankers, who have handled overseas operations, say that it would take at least five years to start making profits abroad. Comparatively, the break-even period in India was between 2 to 3 years.

Profitability of even well-established overseas operations has never been substantial. Net interest margins for SBI's foreign book (which account for about 15 per cent of its total loans) is just 1.16 per cent against 2.61 per cent in its domestic operations.

Senior SBI officials have in the past pointed out that return on equity for foreign operations are usually around 5 to 7 per cent against 15 to 18 per cent in the domestic area. This pattern has remained broadly unchanged since they started operations outside.

The decision to go abroad was, therefore, always made selectively and cautiously. Indian banks were prompted and encouraged to expand abroad by ethnic business communities such as Gujarathis and Sindhis, who had business operations across continents.

These communities were often the 'anchor customers', offering a certain minimum volume of business to banks in order to open branches. Occasionally, branches were also opened for diplomatic and strategic reasons – either with the active backing of high commissioners, or to improve relations and trade with an ally (a recent example being Israel) or neighbour (China for example). The hope that Indian banks would go beyond this initial circle of customers (ethnic communities with an India connection) and operate a local book in foreign locations after some years has not been fully realised.

RBI's stand

Bankers recall that the RBI was very conservative in giving permission for banks to go abroad till about the year 2000. It was only later that the RBI relaxed its rules and banks could go abroad a bit more easily. This pace picked up in the next few years as many Indian business houses expanded their operations overseas particularly between 2005 and 2011.

Indian banks were urged by the Finance Ministry to help fund these ambitious expansion plans, especially in the aftermath of the global crisis. The current crackdown marks a conscious U-turn in that policy.

Interestingly, private banks have only a limited presence overseas. Given that returns have been low outside, they have been more careful with their capital deployment than public sector banks.