International Journal of Trade and Commerce-IIARTC
July-December 2013, Volume 2, No. 2
ISSN-2277-5811(Print), 2278-9065(Online)

Wholesale Banking in India: A New-Fangled Mutation

G.V. Chalam[1*] Ch. Kiran[2]

[1]Department of Commerce & Business Administration, Acharya Nagarjuna University, Nagarjunanagar-522 510. Andhra Pradesh.
E-mail: chalam.goriparthi@gmail.com
[2]Department of Commerce & Business Administration, Acharya Nagarjuna University, Nagarjunanagar-522 510. Andhra Pradesh. saykiran@gmail.com

Abstract

Wholesale banking in India is set for an epoch of spiky growth. Revenues from wholesale banking activities are likely to be more than double over the next five years as infrastructure investment, expansion by Indian companies overseas, and further "Indianization" of multinational businesses amid other trends impel new businesses. The future growth of wholesale banking is indeed intriguing by considering the growth of Indian economy and globalisation of Indian corporate. The competition amongst banks will only intensify in future to reap the income arising from this potential. The main aim of this paper is to present the trends underlying the expected echelons of growth, and then tackle the key issues and priorities from the viewpoint of foreign institutions and their domestic counterparts.

Key Words: *Wholesale Banking, Retail Banking, Indianization, Small and Medium Enterprises (SMEs), Foreign Institutional Investors (FIIs).*

PAPER/ARTICLE INFO

RECEIVED ON: 23/05/2013
ACCEPTED ON: 16/11/2013

Reference to this paper should be made as follows:

G.V.Chalam & Ch. Kiran (2013) "Wholesale Banking in India: A New-Fangled Mutation" *Int. J. of Trade and Commerce-IIARTC*,
Vol. 2, No. 2, pp. 300-308

*Corresponding Author

1. INTRODUCTION

The concept of Wholesale banking explains the provision of various banking services, which are offered to government agencies, pension funds and other institutional customers with sound financial statements. Most of these services include cash management, large-sum loans, merchant banking and trust services. It also refers to borrowing and lending of funds amongst banks in the inter-bank market, involving very large sums of funds. Thus, the wholesale banking deals with government and larger institutional customers, whereas the retail banking focuses more on the individual or smaller business customers. It also provides services to other banks or large corporations.

2. DIFFERENTIAL FEATURES

The following are the main differential areas between wholesale banking and other banking and their priorities:

(i) The retail banks pact with large number of small transactions, while wholesale banks pact with a small number of large value transactions. The retail banks are mainly cater the needs of the individuals, whereas the wholesale banking provides services to government and its agencies and institutional transactions.

(ii) The revenues for the wholesale banking activities are likely from the infrastructure investment, expansion of Indian companies overseas, "Indianization" of multinational businesses, etc. The foreign banks and domestic banks, however, will find themselves in a hard-hitting commercial environment and must trounce a range of challenges, if they are to uphold or presume a leading position in the market.

(iii) With the widespread branch network and retail customer franchises, the domestic banks are able to deploy a large deposit base in their lending. However, they are not able to build strong lending relationships to expand into non-fund-based businesses, such as transaction banking, foreign exchange, and treasury and capital markets.

(iv) The wholesale banking products are more global as Indian companies expand their international operations and new regulations facilitate international capital rising. In fact the foreign banks are strong in base to dominate these markets because they have international credit rating. But the growing demand from Indian corporate for access to non-rupee funds in the form of external borrowings both in India and globally, domestic banks can respond by building appropriate funding and distribution capabilities to serve customer needs.

(v) Foreign banks are capable to pay a higher remuneration and perceived brand value to attract and retain quality employees in areas, such as, treasury, investment banking and relationship management. They have the talent base to attend cross-border transactions or create exotic derivatives for their clients. Their Indian counterparts will have to acquire these capabilities, if they are to compete. A few private-sector domestic banks have done so, but most struggle to develop an appropriate value proposition to attract and retain talent people.

(vi) Technology is a key differentiator, particularly in scale-intensive wholesale businesses, like transaction banking, particularly trade finance, cash management, foreign exchange and equities. For instance, most large corporations are now looking for secure online trade-finance and cash-management that are integrated with their core enterprise-resource-planning systems. While several private-sector banks have cutting-edge technology and can compete with foreign banks, others will need to make significant investments to catch-up with their peers.

(vii) The domestic players to expand their business activities, they need to adopt best practices in account management, including key account planning. They must also use a management information system that highlights individual client profitability and maps clients with relationship managers and product specialists. The wholesale banking market is poised for new growth on the back of the rosy prospects for India's companies. The foreign and Indian players are at different starting points, given their capabilities and market shares. But the opportunity is huge for those that make the right choices and execute their strategy well.

(viii) The foreign banks' branches are concentrated mostly in metro and tier-1 cities because of the restrictions on the number of bank branches they can open. Thus, the foreign banks struggle to serve Midcorporate and SMEs outside these cities. As a result, foreign banks have focused on large corporate. However, they faced with growing competition and margin erosion in their large-corporate businesses, foreign banks must develop cost-effective ways to serve profitable Midcorporate and SME segments.

(ix) Foreign banks in India are limited by the size of their rupee balance sheets. As Indian banks start flexing their muscle and demanding a higher share of non-fund-based business by exploiting their lending relationships, foreign banks must find ways to overcome this disadvantage, perhaps by offering clients unique structuring, lines of credit and off-shore products.

(x) The foreign banks have created high-cost, soloed units in corporate and investment banking. While domestic banks leverage their corporate banking capabilities and relationships to make inroads in investment banking, foreign banks can use their superior investment-banking capabilities and relationships to make greater headway in corporate banking.

There are three key priorities for foreign banks reaching out to the midmarket, overcoming their lack of domestic balance-sheet muscle and leveraging synergies in corporate and investment banking.

(i) Improve distribution to reach mid-corporate and small and medium enterprises (SMEs).
(ii) Overcome rupee balance-sheet disadvantage.
(iii) Leverage synergies across corporate and investment banking.

Aforementioned to the economic crisis, the wholesale banking practices could be grouped into the following models to achieve its business targets:

(i) Global banks, which have wholesale banking divisions that cover the entire world and have momentous franchises in most wholesale banking activities.
(ii) Global Investment banks, which have broad way franchise in investment banking business.
(iii) Challengers, who are globally competitive in a given set of wholesale banking products.
(iv) The regional players, who pilot in regional markets, but is not a global player.

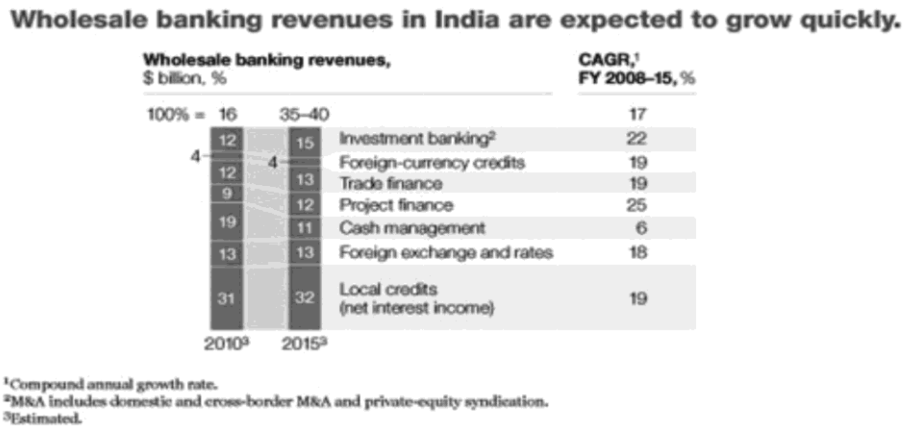
(v) Local wholesale banks, which provide a full range of wholesale products and services in their home markets, typically with an emphasis on corporate banking.
(vi) Wholesale banks, which ponder only on trade related financing and some structured finance.

3. DYNAMICS OF WHOLESALE BANKING

Wholesale banking in India is set for a period of sharp growth. The revenues from wholesale banking activities are likely to be more than double over the next five years as infrastructure investment, expansion by Indian companies overseas, and further "Indianization" of multinational businesses, among other trends drive new business. Foreign players and the country's domestic banks, however, will find themselves in a tough commercial environment and must overcome a range of challenges, if they are to maintain or assume a leading position in the market.

Exhibit-1 shows the prospects for India's wholesale banking market during the period 2008-15. The Wholesale banking revenues, which in India account for close to 30 percent of total banking revenues, are expected to be more than double, from roughly $ 16 billion (2010) to $ 30-40 billion (2015). It can also be seen from the data that the corporate banking, including both lending and fee businesses, accounts for the lion's share of the wholesale market (85 percent). The revenues from this source are projected an annual growth of 19 percent, reaching $ 40 billion by the year 2015. One can estimate from these statistics that the revenue will rise from $ 1.8 billion in the year 2010 to $6 billion by 2015, thus an annual growth of 27 percent. During the same period the equities are expected to account for closer to 70 percent of this total, mergers and acquisitions for 20 to 25 percent, and debt capital markets and private-equity syndication for 5 to 10 percent. The recent rise in equity markets and the subsequent pick-up in merger and acquisitions are already being felt. It can be inferred from the financial variables of wholesale banking that there is a positive growth in its operations, and address the key issues and priorities from the perspective of foreign institutions and their domestic counterparts.

Exhibit-1

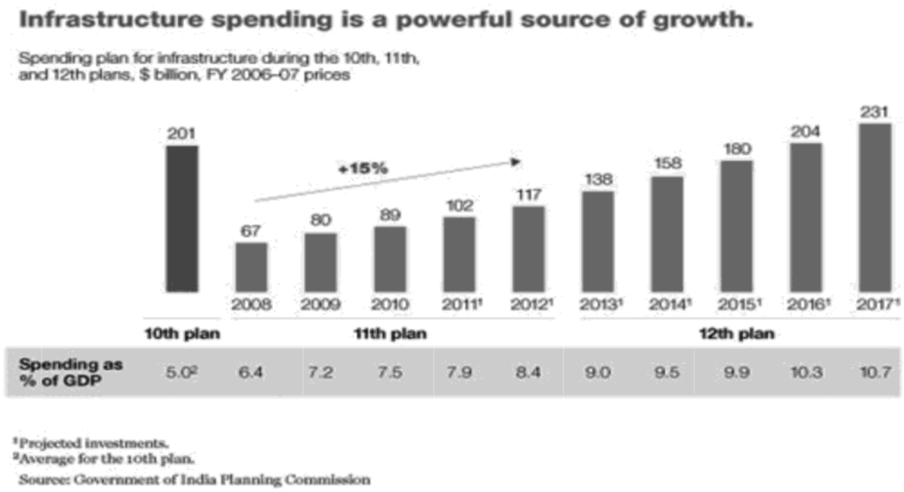


Thus, these trends will shape the evolution of India's wholesale banking markets and create new opportunities for foreign and domestic players alike: to create demand for additional banking products and services; continue globalization of Indian companies, bring the need for acquisition of expertise, trade-finance and treasury services, and cash-management skills. It also inspire a host of inbound merger and acquisitions and increased fund allocation by global managers. Further, increase the sophistication of products and solutions, driving higher margins. Finally, it continue the focus on midmarket companies with new banking requirements and regulatory change in bond and equity markets.

4. INFRASTRUCTURE INVESTMENT

Exhbit-2 shows the amount investment made on infrastructure development during the eleventh plan period and the projection during the twelfth plan period (2012-17). It can be seen from the data that there is average growth of 8 per cent during the eleventh plan period and it will rose to more than 10 per cent during the twelfth plan period. It can be said that there is a huge demand for core infrastructure, which will nevertheless likely outstrip the supply in the future. Therefore, in order to sustain the India's economic growth, the Planning Commission envisages that $1 trillion (about 10 percent of GDP) will be spent on infrastructure during the 12th plan, i.e., 2012 to 2017.

Exhibit-2



According to the Planning Commission, half of the investment during the XII plan period is likely to come from the private sector, implying a more than threefold increase in private-sector investment over the XI plan period. Another $250 billion is likely to be raised by the public sector through external financing. Meeting these investment needs could create annual wholesale banking revenues of $ 6 billion to $ 7 billion across lending, debt syndication, capital raising, and secondary markets. But banks must be willing to innovate, potentially becoming active developers in addition to operating through third parties, and they must also embrace more sophisticated products, such as project financing, through a mix of syndicated lending in foreign currencies, non-traditional structured-trade-financial instruments, and securitization of cash flows.

Managing asset-liability mismatches will be a key challenge that will require institutions to broaden the sources of funds for projects beyond bank financing. Services such as bond placements and credit enhancement should provide additional sources of revenue as the corporate bond market deepens and the regulatory framework for introducing longer-term sources of funds (for example, insurance and pension funds) is put in use.

A noteworthy challenge during the last five years or so in wholesale banking is that an increased fraction of international trade taking place intra-firm and so requires very modest by way of trade finance activity from banks. The corporate house are also now involved in trading with low-risk countries, like, North America, EU and Asia, who make - up more than 85 percent of trading destinations. Since trading partners fetch less jeopardy, corporate house are now opting for open account scheme of financing, as the condensed risk outweighs the fact that this is much less sheltered than traditional methods.

Approximately 70 percent of international trade is done on open account basis. In a just-in-time world, corporate are now managing their supply chains very well and a reduced inventory necessitates smaller, more recurrent international shipments - too low in value to authorization a trade finance deal. Now, the multinational corporations have very good knowledge of the countries, where they are trading and so are much less reliant on banks to provide this expertise.

5. INCREASED PRODUCT SOPHISTICATION

Trade finance accounts for about 12 percent of corporate banking revenues and will likely continue at these levels. But while demand for traditional, low-return products will grow, demand for more sophisticated, bundled foreign-exchange and derivative structures will grow even faster. Leading players will continue to pursue areas such as factoring, supply chain finance and structured trade finance. Supply chain finance and factoring are already significant markets in their own right, with total revenues projected to exceed $ 1.6 billion by 2015. The annual growth of structured trade finance, particularly export-backed commodity financing is growing from 20 to 25 percent.

The share of Indian imports on open accounts is just 15 to 20 percent, in comparison with an average of 50 to 60 percent in the rest of Asia, companies will likely look to banks to provide an integrated working-capital solution. Wholesale banking for their part are moving to create integrated sales forces as well as technology platforms that straddle these two products.

6. MIDCORPORATE ENTHUSIASM

With intense competition and therefore lower margins from servicing large corporate customers in future, the midmarket will remain a critical area of wholesale banking. The typical corporate banking return on equity for serving mid size corporations in India is about one-and-a-half times that of the large-company segment.

Midmarket companies already represent a third of the overall wholesale banking market. But as their ambitions grow, these businesses will demand more sophisticated instruments, such as capital market products and derivatives, not just traditional products, such as lending and trade finance. Mid corporate will also grow more in private - equity deals in India, which currently around $ 38 million[3], which constituted about 25 percent of the $ 6.5 billion of private-equity syndication.

7. REGULATORY CHANGE

In most developed markets, corporate bonds represent a significant part of overall wholesale banking revenues. In India, however, the corporate bond and securitization markets are nascent, with total revenues of $ 34 million in 2012[4], compared with total equity capital market (ECM) revenues of $ 390 million. There are several regulatory issues, which are affected the growth of the market, notably the substantial disclosure requirements, limits on pension funds and insurance companies, restrictions on upfront profit booking of gains from securitization, and the introduction of a rupee-for-rupee capital requirement for both first - and second - loss credit enhancements.

Bond issues in the future will increase as liquidity tightens and banks face capital pressure following the implementation of Basel II; however, for the market to really take off, more regulatory easing will be required. As for equities, the Indian bourses must increase domestic retail and foreign investor participation. A draft of regulations focused on corporate oversight, enhanced investor protection and convenient participation is expected.

8. IMPERATIVES FOR SUCCESS

While corporate lending and trade finance account for about 80 percent of the revenues of Indian banks, particularly public-sector ones, foreign banks derive 60 to 70 percent of their business from treasury, capital markets, and investment banking. On the other hand, the public-sector banks dominate "balance-sheet-heavy" segments, such as corporate lending and plain-vanilla trade finance. These positions are by no means fixed and the picture is changing rapidly, especially post-crisis as Indian banks focus more of their energies on fee income to drive wholesale profitability.

Mergers and Acquisitions in India and Role of Wholesale Banking:

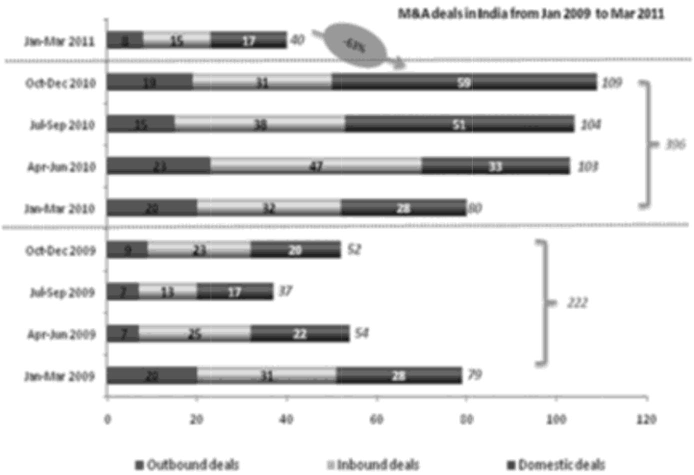


Exhibit-3 presents the trends in mergers and acquisitions in India during the period 2009 to 2012. It can be seen from the data that the amount of business in core investment banking has reached

$ 271 million during the last year. The wholesale banking market is undergoing an exceptional level of change driven by the recent financial crisis and longer term trends of cross border expansion, the liberalisation of banking regimes and at the same time superior regulatory requirements such as Basel-III.

Banking is now truly global business and banks are grappling with the opportunities and complexities this represents against a milieu of tighter precincts and more demanding and sophisticated customers in this segment. An added defy is that when foreign governments withdraw market prop-up which came into being due in the recent financial crisis and the de-leveraging of banks becomes a necessary condition under Basel-III, the return from corporate and Institutional banking will plunge further, if this segmental business is continued in the same mode, as hitherto done. A study on the performance of the top 100 banks', thr return on capital is likely to fall to something like 10 to 12 percent in the year 2012 from a level of 20 percent before the economic crisis. The study also indicates that even the global investment banks could see their returns fall to 14 to 15 percent by 2012- just half of their peak return in 2007.

The new wave will provide fresh deal-structuring, treasury and trade-finance opportunities. The foreign banks are aggressively leveraging global relationships to support international clients as they craft their Indian entry plans, but domestic players can use their domestic balance sheets to win a share of the action. At the same time, global institutional investors are increasing their allocations to emerging markets, including India. More foreign institutional investors are registering in India, while several top global private-equity and venture-capital firms have established offices in the country. For several of these players, India is among the top three or four global destinations outside their home market, where they have an on-the-ground presence. These enhanced interests in India are likely to stimulate primary and secondary equities markets in the coming years.

9. FUTURE OF WHOLESALE BANKING

Close to 60 percent of Indian companies suppose to amplify their share of overseas business over the next five years. This development, which will seize the form of better exports, enlarged international operations and expanded sourcing will generate three types of opportunities for wholesale banking players:

(i) *Acquisitions.* Outbound acquisitions by Indian companies in the first seven months of 2010 amounted to $ 22 billion, appreciably higher than the $ 8 billion recorded in the year 2009; it also exceeded the total in the year 2007, before the crisis. This acquisition binge looks set to continue, as global targets become cheaper and antagonism from international financial sponsors, such as private-equity and leveraged-buyout firms, diminishes.

(ii) *Trade finance and treasury.* As Indian companies swell trade with other countries, the need for services such as letters of credit, export insurance, structured foreign-exchange solutions, and receivables financing increases.

(iii) *Cash management.* Companies with global operations have to administer cash flows at a global level and consequently require more multifaceted and sophisticated solutions.

All these bring it in the form of greater exports, leading to possibilities of M&A business, trade finance and treasury business and cash management potential globally. Foreign banks are assertively leveraging global relationships to support international clients as they dexterity their

Indian entry plans, but domestic players can use their domestic balance sheets to win a share of the action. Simultaneously, global institutional investors are increasing their allocations to emerging markets, including India. As of January 2010, long-term funds among foreign institutional investors (FIIs) had invested around $ 81 billion in India, or about 25 percent of their chief emerging-market flows. More FIIs are registered in India, while several top global private-equity and venture-capital firms have established offices in the country. For several of these players, India is among the top three or four global destinations outside their home market, where they have an on-the-ground presence.

10. CONCLUSION

The Indian wholesale banking market is hovering for new growth on the rear of the blushing prospects for India's companies. Foreign and Indian players are at diverse preliminary points, pre-arranged their poles apart capabilities and market shares. But the panorama is enormous for those that make the precise preferences and execute their strategy well. Every player should persistently re-assess and espouse opposite strategies to face the competition. The domestic banks should further focus their attention on the definite challenges facing them and take measures and those who acquire proactive steps will benefit from the fruits.

REFERENCES

[1]. Wholesale Banking in India: Next frontier – Report March, 2011 by Mckinsey & Co.
[2]. Building India – Financing and investing in infrastructure. – Report by Mckinsey & Co.
[3]. Planning commission, Government of India - Eleventh Five Year Plan.
[4]. ISI Emerging Markets Database.