Review of Allocation of Advances by Foreign Banks operating in India to Exports Small Scale Sector (SSI) during 2006-2010

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Abstract:-This research paper provides an overview of the performance of Foreign Banks' (FBs) with reference to allocation of advances to Exports/Small Scale Sector (SSI) during 2006-2010. The paper analyses the trends in lending and target achievement as set by Reserve Bank of India for Foreign banks operating in India. The target for priority sector lending during the aforesaid period was 32% out of which 12 % is covered for export sector and 10% for SSI sector. This was with a view for securing a better adaptation of the lending system to the needs of economic planning and it is playing a more active role in aiding sectors like export and SSI sector.

This study is based on the parameters like lending to aforesaid sector by foreign banks, targets achieved by foreign banks group NPAs (Non-performing assets), while lending to these sectors. On the basis of these parameters, the study concludes that foreign banks have achieved the SSI lending and export credit and overall target. The performance of foreign banks in lending has improved year by year during the period 2006-10, although substantial variations have been observed in the performance of various foreign banks as also in meeting the sub - targets within the these sectors. The paper also discusses the problems or issues which arise due to providing advances to these sectors and also suggest some ways to sought out these issues. All the parameters have been analyzed for the period, 2006 – 2010 (Five years).

Key words: Advances by Foreign Banks, Export Sector Lending, SSI Sector lending targets, Finance, Advances.

Introduction:-

Availability of credit is a major concern for all, particularly for exports, small, medium enterprises. From the point of view of foreign exchange earnings & foreign trade balance, the export/SSI activities have national importance and have been assigned importance and priority for development. Rajesh K.Pillania (2008) comments that Indian economy and foreign trade are on a growth trajectory and Indian exports have come a long way in value terms from the time of gaining independence in 1947. During the financial year 2013-14 India's exports amounted to US$ 334 billion and imports amounted to US$ 480 billion.

Appropriate lending as per needs & wants of export and SSI sector reflects the effort to synchronize the lending activities of each financial institution with the national priorities.

Thorsten Beck (2008) in his research paper, finds that institutions perceive the SME segment to be highly profitable, but perceive macroeconomic instability in developing countries and competition in developed countries as the main obstacles. R.Gandhi (2014)) in his key note speech "Structure of Foreign Banks for Emerging Nations-Indian Case" ASIFMA Annual Conference November 2014, emphasizes need of the positive support of FBs for lending to export and SSI sector in India.

Direct finance to small scale industries (SSIs) includes all loans given to SSI units which are engaged in manufacture, processing or preservation of goods and whose investment are in plant and machinery (original cost) excluding land and building. Small business/service enterprises, the export and SSI sectorial advances from financial institutions have undergone several changes, with incorporation of several new areas like pre-shipment or post shipment credit and finance for import substitute/deemed export or export market development.

During the period 2006-10, for foreign banks, SSI advances aggregating to 10 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever was higher falls under priority sector financing. During the period 2006-10 although export credit is not a part of priority sector for domestic commercial financial institutions, for foreign banks (FBs) 12 per cent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever was higher falls under priority sector financing which was utilized by foreign banks to meet priority sector lending target as set as per prevailing RBI guidelines during aforesaid period.

Prior to financial year 2012, only foreign banks have to disburse 12 per cent of their credit under the priority sector to export companies. Other domestic financial institutions keep aside 40 per cent of their net loans for the priority sector, which includes micro, small & medium enterprises, education, housing, weaker section and agriculture, but not exports. The share of Indian financial institutions' export credit to total exports was on the decline.

Present export sector lending scenario:-

From the financial year 2012, export credit was delisted from priority sector lending list even for foreign banks. This move of RBI was strongly resisted by FBs operating in India on account of non-availability of credit worthy projects in other areas & difficulty in meeting priority sector lending targets for FBs operating in India. As per K.R. Srivats(2013) , export credit can be revitalized if it is reinstated as a separate priority sector category for financial institutions, especially for foreign banks. This could lead to FBs operating in India expanding their lending to the export sector, thereby having a positive impact on India's exports and GDP, as per the study titled 'Reprioritizing priority sector lending in India', Nathan Associates Inc.(2013). Export sector lending has played a critical role in stimulating exports. However, credit supply to exporters needs to be increased further, says the study conducted by Nathan Associates Inc. Following the 2012 revision in guidelines for priority sector lending, foreign banks with more than 20 branches are not required to lend to the export sector. This is expected to have had a dampening effect on the growth of India's exports, as the revised guidelines required large foreign banks (with over 20 branches) — Standard Chartered, Citibank India and HSBC — to direct credit to agriculture but not exports. The study concludes that this dried up export credit to export-oriented sectors, thereby affecting exports and GDP. It is estimated that a 1 per cent fall in lending to the export sector will reduce the export GDP by 0.76 per cent. As per this study “India is facing a rising current account deficit and an export-led growth strategy could help it reverse the trend; reducing credit available to the export sector will only thwart the solution” .

RBI action:-

The Reserve Bank plans to include export finance under priority sector lending category, with certain riders, Deputy Governor H R Khan said on 13th January 2015. He said that a specially constituted internal group is working on this aspect and its inclusion would be over and above benefits granted to financing Micro, Small and Medium Enterprises (MSMEs). A decision on this aspect was expected in the final report, which was scheduled to be submitted in two months. One of the suggestions which this group was looking at now, is whether up to a particular level of export advance limit, and linked with some turnover of that party, whether there can be incremental amount which can be computed for the purpose of priority sector lending.

Proposals from Foreign Banks (FBs) and Indian Financial Institutions (IFI):-

There have been continuous proposals from FBs & IFI in the form of demand to include new areas such as economic interest rate for financing purpose on case to case basis plus infrastructure related to export/SSI within the ambit of financing of these sectors. There have also been suggestions that the focus on the needy export/SSI sectors of economy should not get lost because of opening of Indian economy plus so called globalization after 1990. In December 2004, it was decided that direct advances by financial institutions like foreign banks covering to export/SSI sectors will be encouraged, thus beginning a phased withdrawal of eligibility in special bonds of specified institutions. A list indicating the type of advances which would be eligible for compliance with the lending targets for these sectors was sent out by RBI to the financial institutions. For small scale industries, no separate guidelines were issued, but it was indicated that direct loans granted to road transport operators would qualify for compliance with lending targets along with small scale industries.

Without parallel reforms in financial sector, economic reforms in the real sectors like export and SSI sector of Indian economy fail to realize their full potential. The removal of impediments to financial sector’s long term developments and a general improvement in the functioning and efficiency of the financial system as a whole refers to reforms in financial sector. There is a shift in the focus related to financing, from quantitative to qualitative growth as a result of financial sector reforms and financing in India today, is subjected to prudential norms of operations and competitive environment and the deregulation, the vital component of the financial sector reforms, has increased the overall profitability of the financial system. Financing in India now, has undergone a very rapid transformation in the past decades. There is a sea change in the financing of export and SSI sector in the post financial sector reforms. The scope and extent of export and SSI sector lending has undergone a significant change in the post-reform period with several new financing schemes. As per an internal working group which was set up in the Reserve Bank in 2004 (Chairman: Mr. C.S. Murthy) to examine the need for continuance of export/SSI sector lending prescriptions, to review the existing policy on lending, the guidelines were revised and export/SSI sector have been retained as priority sector in the revised guidelines, which came into effect from 30 April, 2007. As per C. Bhujangrao (2014) the performance of FBs in export/SSI sector has improved in recent years with vast improvement in the gross and net performing assets and asset quality has been improving over the years.

Commercial financing, itself, has undergone numerous changes all over the world, during the last five decades. Now, the present day financing does not restrict itself to traditional deposit collection and money lending, encompassing a wide sphere of financial activity; lending still remains the primary activity. Most credit needs of the society, for carrying commercial activities are fulfilled by the financial institutions. The conventional credit from the financing system to the commercial sector comprises loans and advance in the form of term loans, demand loans, cash credit, overdrafts, inland and foreign bills purchased and discounted as well as investments in instruments issued by non-government sector.

OBJECTIVES AND RESEARCH METHODOLOGY

Objectives

1) To study and analyze the export/SSI sector lending by various Foreign Banks (FBs).

2) To analyze targets achieved by various Foreign Banks (FBs).

3) To study the issues and prepare strategies to enhance the export/SSI sector advances.

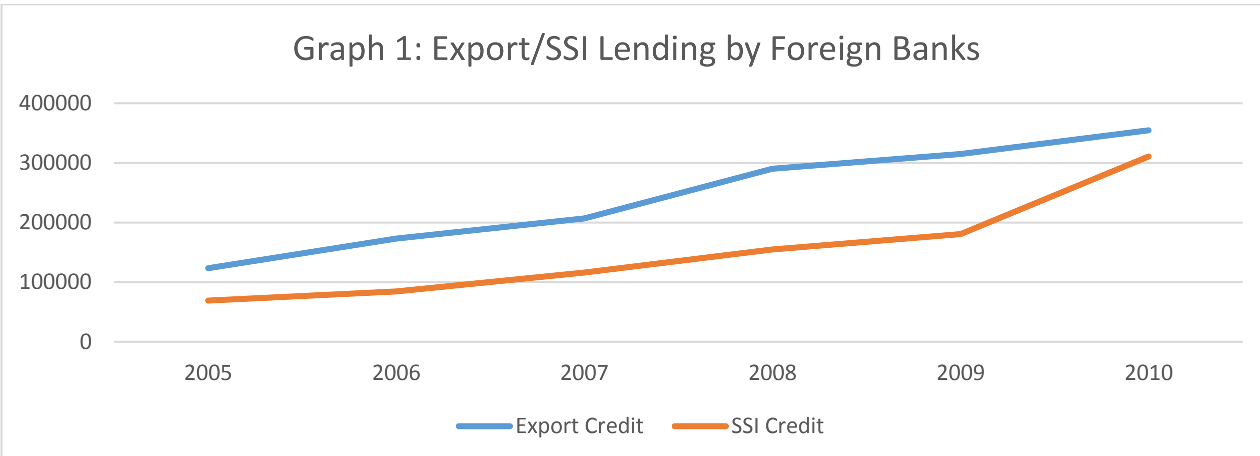
Research methodology

The research design of the study is export/SSI sector advances of various Foreign Banks (FBs). RBI has given several targets to FBs to enhance loans in export/SSI sector but out of these targets, FBs have been succeeded to achieve only a few targets. Lending to export/SSI sector has created the fear of NPAs among the FFIs. Profitability of the FBs has also been adversely affected by the export//SSI sector advances, because of low rate of interest on the sector advances. The universe of the present study is FBs operating in India. The study attempts to accomplish its objectives by making analysis on the basis of following parameters:

1) Lending by FBs to Export Sector
2) Lending by FBs to SSI Sector
3) Targets Achieved by FBs while lending to Export Sector
4) Targets Achieved by FBs while lending to SSI Sector)
5) NPAs while lending to Export/SSI Sector

All the parameters have been analyzed for the period, 2006 to 2010

Results & Discussion



Graph 1 indicates increasing trend of lending by foreign banks to Exports/SSI sector 2005-2010

Table No.1:-Export/SSI Lending by Foreign Banks (FBs):-

(Amount in INR million as on 31st March)

Year	2005 Amount	2005 Percentage of Net Bank Credit	2006 Amount	2006 Percentage of Net Bank Credit	2007 Amount	2007 Percentage of Net Bank Credit	2008 Amount	2008 Percentage of Net Bank Credit
Export credit	12,3390	18.3	17,3260	19.6	20,7110	18.3	29,0070	22.8
Small-scale industries	6,9070	10.2	8,4300	9.5	11,6370	10.3	15,4890	12.2

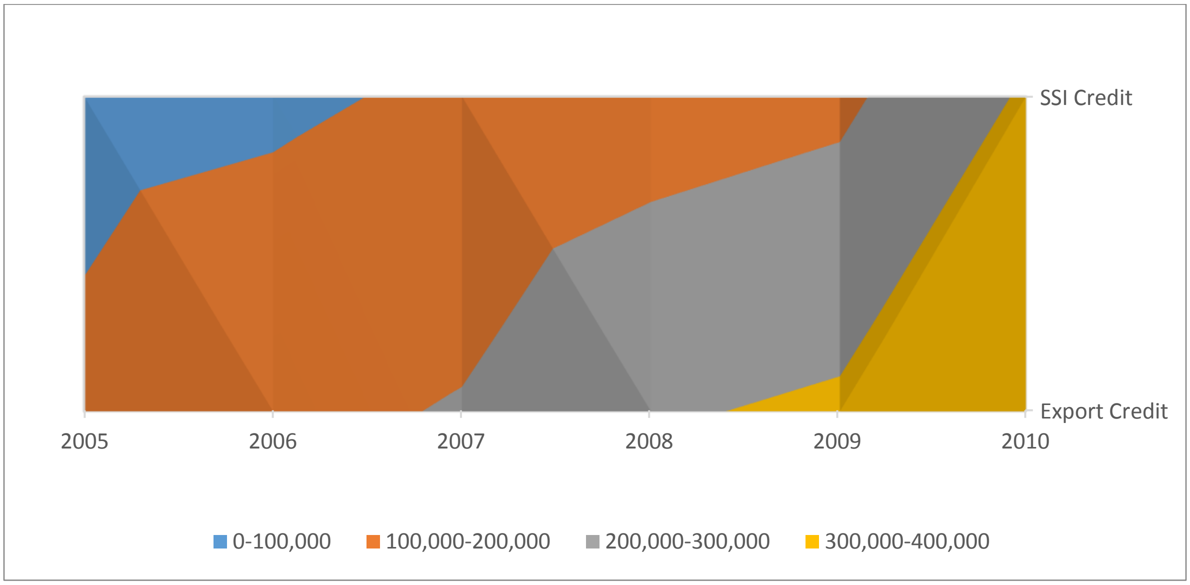
Table No.1 –Continued Export/SSI Lending by Foreign Banks (FBs):- (Amount in INR million)

Year	2009 Amount	2009 Percentage of Net	2010 Amount	2010 Percentage of Net

		Bank Credit		Bank Credit
Export credit	31,5110	19.4	35,4660	20.6
Small-scale industries	18,0630	11.2	21,0800	12.2

(Source for table no.1:- Report on Trends and Progresses of Banking in India 2006-07, 2007-08, 2008-09 and 2009-10)

Graph 2 below indicates spread of export/SSI lending by foreign banks from 2005- 2010



FBs operating in India as a group, have achieved the targets for lending to export/SSI sector. Also there is an increase in quantum of lending year wise for both export and SSI sector.

NPAs:-

SSI Sector: -

Table No.2: - Distribution of FBs

	2005	2006	2007	2008	2009	2010
No. of FBs	29	29	29	29	31	32
Up to 2%	24	24	23	24	24	23
2 to 5%	1	1	2	2	2	2
5-10%	2	1	1	1	2	2
Above 10%	2	3	3	2	3	5

Export sector: - Table No.3: - Distribution of FBs

	2005	2006	2007	2008	2009	2010
No. of FBs	29	29	29	29	31	32
Up to 2%	17	17	17	20	21	21

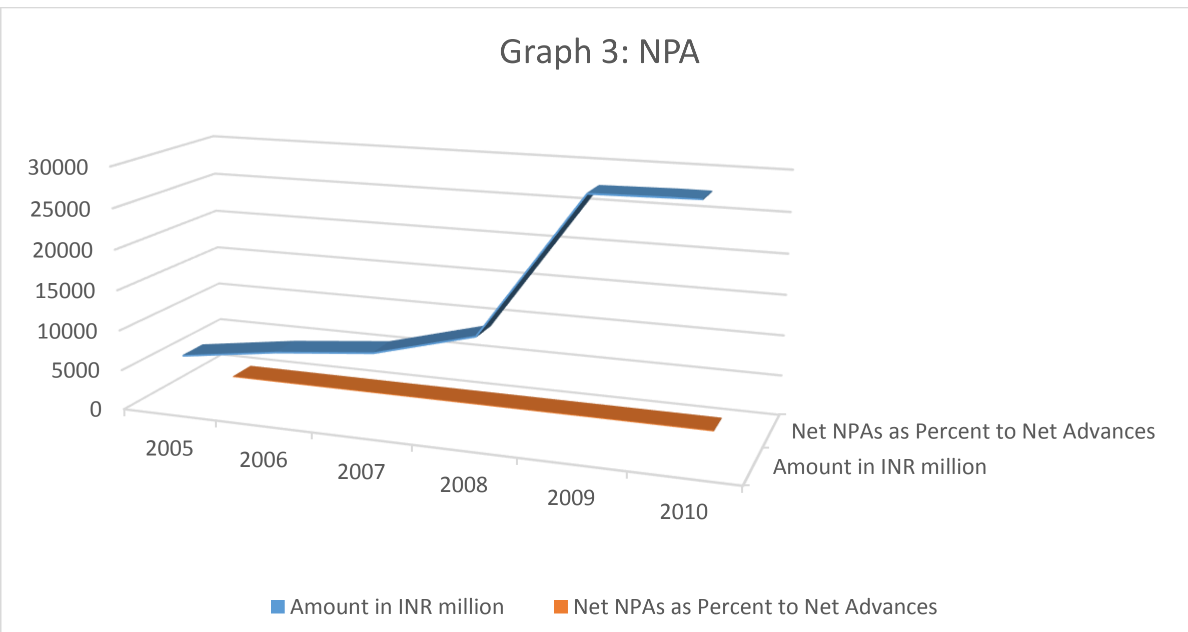
2 to 5%	2	2	2	1	2	3
5-10%	3	2	2	1	4	0
Above 10%	7	8	8	7	4	8

FBs operating in India faced problem of controlling level of NPAs in both SSI and Export sector.

Table No.4: Ratio of Net NPAs to Net Advances (Covering FBs total advances):-

(Amount in INR million)

Year	Amount	Net NPAs as Percent to Net Advances
2005	6390	0.80
2006	8080	0.80
2007	9270	0.70
2008	12500	0.80
2009	29730	1.81
2010	29960	1.82



FBs operating in India as a group, have maintained level of NPAs at 0.7 to 0.8 during 2006 to 2008. For the next two years level of NPAs increased to 1.81-1.82 mainly because of global slowdown.

Table No.5: Distribution of FBs:-

	2005	2006	2007	2008	2009	2010
No. of FBs	29	29	29	29	31	32
Up to 2%	21	25	27	26	24	25
2 to 5%	2	-	1	2	6	6
5-10%	2	-	-	1	1	1
Above 10%	4	4	1	-	-	-

(Source for table no.1, 2, 3, 4, and 5:- Report on Trends and Progresses of Banking in India 2006-07, 2007-08, 2008-09 and 2009-10)

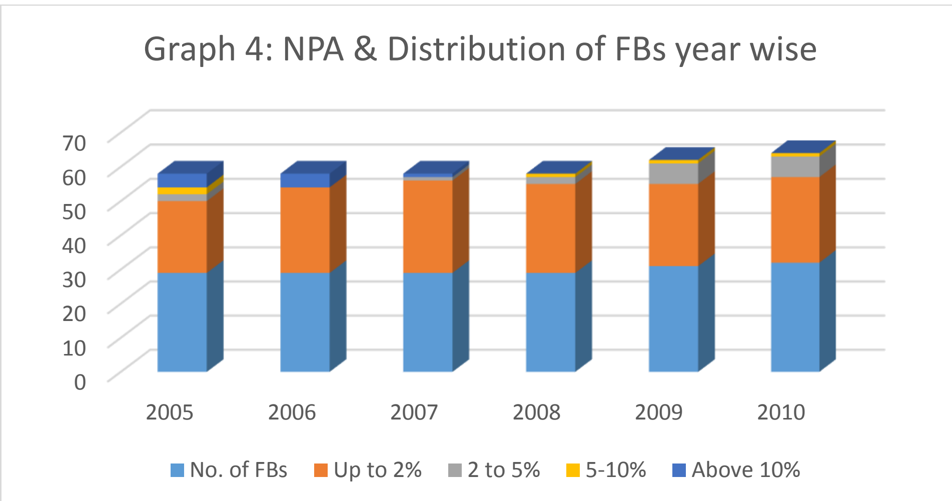


Table 5 & Graph 4 shows that majority FBs managed to maintain NPA level below 2%.

MAJOR ISSUES

RBI's guidelines to export/SSI sector advances resulted in various issues for the financing system which require some attention. Discussion related to such issues is as follows:-

1 Lending to export/SSI sector becoming non-attractive:-

Issues like increasing proportion of deposit resources under statutory liquidity pre-emption at lower interest, the shift of savers' preferences to long-term deposits and the incidence of non-performing assets lead to low profitability and lending becomes non-attractive. FBs' increasing involvement in providing mandatory credit entailing rigid target setting and the interest concessionality is an important reason for declining profitability.

2 Declining credit worthiness & dishonoring commitments:-

Individuals/firms borrowing term loan / cash credit from export/SSI sector, initially pay quarterly Equal Monthly Installments (EMI) covering principal plus interest on time. However over a period of time these commitments are not honored which increases non- performing assets leading to delayed working in disbursement of credit.

3 Stipulated time frame and compulsion to achieve targets:-

There is an erosion of the qualitative aspects of lending which have an effect on the viability of the lending on account of compulsion to achieve targets within a stipulated time frame. One of the major problems of FBs is that there is an indirect government interferes in the working of the FBs especially for politically favored export/SSI customers.

4 High operating cost:

The time element involved in handling large number of cases under export/SSI sector is very high which leads to high operating cost. Also the deficiencies in pre-sanction and bunching of applications at the last moment by the sponsoring agencies in the case of lending under export/SSI alleviation programs results in to additional problems for FBs operating in India.

Solutions Proposed: - Monitoring Non-Performing Assets (NPAs)**:**The internal audit system operating in FBs should make a qualitative pre-audit to verify credit worthiness of customer before approval and disbursement of term loan or cash credit. There is no point in making post mortem once the account turns to non-performing asset (NPA). Also FBs should give more emphasis on sensitivity analysis for the proposed lending considering changing domestic and international market scenario. The sensitivity analysis must cover basic acid tests and to some extent negative factors related to manpower, technology, finance, market & materials plus external environment factors pertaining to specific industry sector. Debt Recovery Tribunal should implement to recover the NPAs and FBs should be very careful in considering settlement compromise proposals.

Rate of interest: FBs should follow the specific guidelines of RBI and try to negotiate rate of interest on case to case basis within the frame work for the rate of interest; however where the default is due to genuine reasons, FBs should extend the period of loan or reschedule the installments under term loan. Once such a relief has been extended, the over dues become current dues and FBs should not compound interest.

More freedom to frontline work force: - FBs should give more discretionary powers to sanction proposals from export/SSI sector without interference of the government.

Deep analysis based on economic viability of proposal: - FBs should fix quantitative as well as qualitative targets based on deep analysis related to economic viability of proposal so that profitability of the FBs can increase.

Realistic analysis by RBI to make financing more attractive: - RBI must realize that every financial institution operates first for survival with grace by making more and more profit. Hence instead of making compulsion of financing export/SSI sector to FBs, more freedom should be given to FBs operating in India by way of participative administration of finance function based on give & take philosophy.

Areas of Possible Future Research: - Further research may be carried for finding out effect of financing from FBs operating in India on India’s foreign trade. Here, various models applied by FBs may be studied which are applied for financing purpose.

Conclusion: -Thus, the study concludes that export/SSI sector advances by FBs are gradually increasing. With a gradual increase in advances, FBs have achieved targets fixed by RBI. Lending to export/SSI sector creates many problems like lending to export/SSI sector becoming non-attractive, declining credit worthiness & dishonoring commitments, stipulated time frame and compulsion to achieve targets, and High operating cost. However, these problems can be overcome by monitoring Non-Performing Assets (NPAs), allowing more freedom to frontline work force, carrying out deep analysis based on economic viability of proposal, negotiating rate of interest within RBI guidelines and finally realistic analysis by RBI to make financing more attractive.

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