Journal of the K.R. Cama Oriental Institute
ISSN: 0970-0609

UGC Care Group I Journal

A STUDY ON GLOBAL TRENDS AND DEVELOPMENT ININTERNATIONAL BANKING

Dr. Mayank Singh
Associate Professor, Lucknow Public College of Professional Studies
Mr. Rahul Kumar Singh
Assistant Professor, Lucknow Public College of Professional Studies

INTRODUCTION

Global banking is going through some profound changes following the global financial crisis (GFC). The crisis has led to large balance sheetsimpairments, notably for many banks in advanced countries. It has also led to a barrage of new regulations, tighter supervision and oversight, and some banks having to pay large penalties for past wrong-doings. And, to a significant degree, the crisis has sharpened market discipline, making investors and lenders more wary of banks' activities, including their international operations. Together, this has forced banks to adjust their balance sheets by deleveraging and raising new capital, and pare back cost structures by shedding activities and personnel, and adjusting compensation.

Other developments, including from new entrants in the industry spurred in part by advances in delivering financial services using digital means, are putting additional pressures on existing institutions. In addition, there has been a trend increase in the importance of emerging markets and developing countries in the world economy in general and in finance specifically, including through greater cross-border banking flows and direct foreign bank presence. As these changes continue to unfold and banks regroup, they are affecting the structure and industrial organization of global banking. In turn, they have consequences for the benefits and risks that global banking brings to financial systems and economies. As such, it is a useful moment in time to take stock of what has changed in the global banking system since the GFC, and to reflect on what developments underway may mean for (possible changes in) regulations, supervision and other policies, so to assure that the best balance is struck between benefits and risks, considering also countries' characteristics and circumstances.

GLOBALIZATION

Every age has its defining terms. In our day one of those terms is "globalisation". The prince among words blessed with the suffixation, is globalisation now in constant use in the context of financial markets and it has become the buzz-word of our times. National economies are undoubtedly becoming steadily more integrated as cross-border flows of trade, investments and financial capital increase. It represents the involvement of capital markets in different parts of the world with each other. By itself such a concept is not remarkable, because it is not new. Both money and those requiring it have crossed borders in search of one another for centuries without having been globalized. To become so requires two modern ingredients that have been missing until recently. The first of these must be that the border crossing not be just opportunistic smash-and-grab operation but involves a permanent institutional nature that is based on linkages between markets.

The second is that linkages result in a significant increase in the number of transactions between markets so that they begin to have some influence on the rate setting or pricing mechanism. As the process occurs those markets so linked become integrated initially to a limited extent but more so as volumes increase.

The study group of the Bank for International Settlement study group comments about global

Principal
Lucknow Public College of Professional Studies
Vinamra Khand, Gomtinagar, Lucknow

integration of financial markets, go a long way to define what we mean by globalisation.

"The roots of the present trend towards a global integration of financial markets go back to the 1960s, when the development of the Eurocurrency and Eurobond markets heralded the advent of truly international financial markets. However, owing to various regulations and exchange controls the links between international markets and individual domestic markets remained in most cases rather loose or partial. It was only in the course of the 1970s and particularly during 1981-86 that international and domestic markets have become increasingly integrated. This has occurred as a result of macro-economic developments, deregulatory measures, technological changes and financial innovations. Since these changes have been neither smooth nor uniform the outlines of what could be called truly global financial markets often appear as a patchwork of individually integrated financial instruments and channels of intermediation".

No sector of the economy seems to be more global in its orientation and operations than finance. As Stephen Kohrin of the Wharton Business. School has argued "The financial market is global in the sense that transactions are linked in an electronic network and borders and territoriality are virtually irrelevant. Drawing support for this view from such experts like the former Citicorp Chairman Walter Wriston and the consulting business guru Keniche Ohmae, Kohrin asserts that "government control over flows of funds and thus the value of currencies or monetary policy is very limited.

The data would appear to support the view that finance has gone global, operating outside the framework of nation-states. International hank lending grew from $ 40 billion in 1975 to $ 5560 billion by March 1998. Bond lending rose from $ 19 billion in 1975 to over $ 3882 billion in March 1998. Banks have placed branches worldwide and many now accumulate the bulk of their earnings outside their home country. By 1990, London was host to more than 500 foreign banks which held more than 87 p.c. of the international assets booked in that city. In addition the capitalization of foreign stock exchanges grew dramatically during this decade and a half, with major markets emerging in Tokyo, London, Paris and Frankfurt,

The foreign exchange market was the first to globalize in the mid-1970s as controls were lifted and new technology created new opportunities for arbitrage. It is the biggest and still the only truly global financial market. The bond market became integrated only during the 1980s and the equity markets have been much slower to go global being hobbled by internationaldifferences in accounting practices and restrictions on holding of foreign equities by pension funds.

Markets for short term credit have been integrated. to a large extent through the banking system. The spread between interest rates in the London interbank market and the US market for certificates of deposit has narrowed as never before.

Research shows that an increasing number of banks have more of their assets based overseas. In other words more banks are becoming more global. In its list of the Top 50 global banks (February 1999) 17 banks had more than 50% of their assets based abroad, 42 banks had more than 30% of the assets abroad.

Standard Chartered Bank, the UK based institution has most of its businessin Asia and the Middle East (74%) American Express Bank has 80% business abroad. The UK based HSBC Holdings and US based Citicorp have 65% and *63%* abroad. *704* of Citicorp's income came from outside the US. American Express Bank tops the income chart with 91.5% of the income coming from abroad while 84% of Standard Chartered's income comesfrom abroad. Republic National bank of New York has only 34.1% of jts assets abroad but 72% of its income is generated abroad. Bank of China has 23.6% of its assets placed abroad but these are said to account for a sizeable 61.4% of income. American Express Bank has 84% of its staff based overseas, Standard Chartered 89%, HSBC 65% Citicorp 58%, Banc

Santander *63%*, Banco Bilbao Vizcaya 58%.

According to the IMF's International Capital Market report, Foreign ownership of banks in the emerging economies increased dramatically during the 1990s In central Europe, for instance the share of total bank assets controlled by foreign banks has risen from less than 10% in 1994 to over 50% in 1999. In Latin America the 1990s saw a big increase in foreign control. Chile has the highest share of foreign control (54%) of its banking system, Argentina comes second with 49%. In Mexico, the share of assets under foreign control stood at 19% at the end of 1998 but during 2000 that total has increased to around 40%.

ORIGINS OF GLOBALIZATION

According to Mr. Wolfgang H Reinicke, the author of 'Global Public Policy', the most important element in defining globalization is that it originated and remains as a largely microeconomic process. This is in contrast to the notion of interdependence which is conceptualized and understood mostly in macroeconomic terms. Globalisation finds in origin in the changing pattern of "transborder operations of firms undertaken to organize their development, production, and sourcing, marketing and financing activities". Heightened competition at home and abroad has led not only to new developments in corporate and industrial organization such as flexible manufacturing, but also to the cross-border movement of increasingly intangible capital, such as finance, technology, knowledge, information and the ownership or control of assets.

These enable firms to establish a preserve in foreign markets, realize efficiencies and customize products for local markets. Globalising firmsacquire a much wider array of inputs and support services from abroad, allowing them to take advantage of the specialization and expertise available in other locations while at the same time acquiring the knowledge and expertise to produce in local markets.

Increased economic interdependence has narrowed the distance between sovereign states and regions, requiring closer co-operation in national macro-economic management. Globalisation, in contrast, represents the integration of an international dimension into the very organizational structure arid strategic behavior of companies. It allows companies to enhance their competitive position by creating an integrated, cross-border corporate network, a "global web" of interconnected nodes in which value and wealth are generated and distributed.

This represents a shift from what Michael Porter has called a "multidomestic industrial strategy, in which a company serves multiple independent local markets, to a global industrial strategy, which entails a vertical division of labour in the production of finished and intermediate goods. In a multidomestic industry competition in different countries is largely independent. Often the rationale for foreign operations is to overcome a variety of barriers, including tariffs and high costs in such areasas transportation and communication. In a global industry, however, afirm's competitive position in one-country depends significantly upon its performance in other countries, A global firm is not a loose aggregation of national firms, but instead is governed by a set of globally integrated strategies that rationalize the allocation of all resources across the multiple national territories but its geometry continues to change as companies adjust to changing economic and political conditions.

This form of cross-border activity allows corporation to enter new markets along the entire length of the product cycle and tins to exploit their technological and organizational advantages, reducing both costs and risks. To succeed in an increasingly competitive environment, corporations must widen 'and deepen their operations, to produce and sell goods across a wider spectrum of markets, customizing their products in each. AS a result, their international engagement becomes more complex going beyond arms length trade and traditional foreign direct investment (FDI) through new production facilities (so called greenfield investment). A global corporate presence implies the globalisation of almost all functional aspects *of* a firm management, finance, research and development **(R&D)** marketing as both the sources and the destinations of business operations expand.

Initially in the 1970s it was changes in the real economy in the form of multinational manufacturing

enterprises aggressively expanding their international presence that drove changes in the financial sector. Banks responded to these challenges by following their corporate customers abroad establishing overseas branch networks and expanding their cross- border banking capabilities. This was also the genesis of some early financial innovations, such as foreign exchange derivatives, which evolved out of multinationals need to better manage the exchange risks of operating overseas. More recently the causality of the relationship has reversed itself somewhat with the rapid globalisation of financial markets now driving many of the changes taking place in the real sector.

In addition to the consistent mutual reinforcement of trends in the globalisation of manufacturing and finance, a number of common factors have induced companies - financial and manufacturing alike - to adopt global strategies. They include: (i) the liberalization and deregulation of international economic activity, (ii) technology, among others.

CAUSES OF GLOBALISATION

1. DEREGULATION AND LIBERALISATION

Deregulation and liberalization of international finance centered primarily on the lifting of currency and credit controls that countries had erected to prevent damaging speculative challenges to the Bretton Woods system of pegged exchange rates. After the collapse of the Bretton Woods System in 1971 the logic for such controls gradually unraveled. Governments moved to dismantle barriers to capital flows both to facilitate the inflows that would allow them to fund deficit spending and to avoid the outflows that could result from capital moving to less regulated foreign markets.

In those countries, where change was slow in coming, multinationals increasingly adopted strategies of exit and evasion using their global presence to channel financial flows to other more favorable regulatory environments.

Deregulation of foreign exchange controls began in 1974 when the United States withdrew the ones that it had imposed during the 1960s to defend the dollar, the Interest Equalisation Tax and the Commerce Department's Foreign Direct Investment Controls. The dollar would now come and go as market forces dictated.

2. GREATER INSTITUTIONALISATION ABROAD

Increasingly the leading actors in the global financial markets are not banks or other financial firms trading for their own accounts (rather than actingas intermediaries), but large institutional investors such as pension funds, mutual funds and life insurance companies. Propelled by the gradual aging of industrialized country populations and their consequent higher levels of saving, these institutions have rapidly increased their share of household assets. Not only do industrial investors invest heavily in stocks and bonds but they also favour a geographic spread of their investment in order to reduce risk. Because many of these funds contain numerous relatively small contributions from unsophisticated investors who would not normally consider making overseas investments they play a key role in the internationalization of assets that would otherwise have been invested domestically.

3. SUCCESS OF EUROMARKETS

As institutions became more of a factor in the globalisation of markets, the markets, especially the Eurobond market, expanded. In the early years, Eurobonds were mainly denominated in Dollars. Investors were almost always from countries other than the US and therefore foreign exchange component of their incentive to invest had been a constant factor that differentiated them from US domestic bond market investors. During the period when the dollar was strong or perhaps more accurately when it w& not weak the Eurobond investors preferred dollars over other currencies and would on those occasions take a somewhat lower return than US investors in order to get hold of a dollar denominated bond of a well-knownAmerican company. But the investor, typically an individual whose money was being managed by a bank did not want to buy the bonds in the US, where it was

subject to a withholding tax on interest payment and where further, the bond would have to be registered in the investor's name for tax collector all over the world perchance to see. Eurobonds provided the same quality investments, but were offered on a basis exempt from withholding taxes and in bearer form (not registered by name but only as payable to the bearer of the security) assuring the owner complete and much preferred anonymity.

Today Eurobond investors are a more diverse group, which includes institutional investors from many countries whose knowledge of the market is exact and whose bargaining power with the market is considerable. The growth of the Eurobond sector in new issues and in secondary market trading has fathered similar developments in money market instruments such as Euro Commercial paper, note issuance facilities and floating rate notes in which a variable rate of interest based on the London Interbank Offered Rate (LIBOR now known as Euro Libor) is paid. It has also stimulated growth in the Euro-equities markets, which includes, transactions involving common stock, convertible debentures and debt withwarrants attached to purchase shares of the issuer.

4. INTEGRATION OF MARKETS

With increasing liquidity and turnover in both the market for new bond issues and the secondary market that develops after such issues become available for trading, the Euro market had become large and diverse enough to be able to attract a significant global daily volume of activity. International capital market activity involves a lot of arbitrage between market centers in addition to the traditional capital raising and investing ' functions. Arbitrage activities are the buying of a security in one marketand simultaneously selling the same security in another market at a slightly higher price.

5. TECHNOLOGY AND KNOW-HOW

In many accounts of financial globalisation, pride of place has been given to the "technological revolution" which made the growing sophistication of themarket place a function of bringing to the banking sector the latest in information technology, including telecommunications and computers. According to one scholar "one of the basic forces behind recent global financial revolution is technological change". Underlying the revolution in global finance is a revolution in communications and information processing which if anything may accelerate over time. This technological sea change, combined with the fact that banks and non-banks have become considerably more sophisticated in their operations, has promoted and encouraged the globalisation trend, Indeed according to Professor Michael Dertouzos of MIT "There are so many networks and networks ,. It could mean that there is no longer any meaning to international boundaries".

Without the silicall chip, world financial markets, like a lot of others, wouldnot be so active and globalisation and market integration would only be concepts, not realities.

6. SECURITIZATION

Securitization broadly describes the process by which financial intermediation has been moving rapidly from banks to capital market. In its earliest form, securitization referred simply to the issuance of debt securities as relatively close substitutes for bank credit. More recently, the term has become associated specifically with the process of converting cash flows from certain assets such as home mortgages or loans to foreign governments, into tradable securities. Today securities are not just alternative to bank loans but, in the case of asset and mortgage-backed securities, actually are bank loans that have been repackaged.

Securitization is important to financial globalisation because it drives the pricing and market availability of assets that were previously non-tradable. As these non-tradable are turned into securities, they become linked to the global pool of liquid capital and can then be freely bought and sold internationally. As a result it is now possible for a Japanese pension company to buy US residential mortgages, for a German insurance company to invest in corporate loans made by a British

bank or for a US investment bank to trade in pools of developing - country debt formerly held as bank loans.

CONSEQUENCES OF GLOBALISATION

One cannot capture the extent and impact of globalisation through quantitative measures alone. Rather one must also take into account changes in the organizational logic of companies and in corporate behavior. In manufacturing, the changing geographic concentration and composition of FDI (in mergers and acquisitions versus greenfield investment) and trade (finished versus intermediate products) and the rise of inter firm strategic alliances reflect such qualitative changes. In the financial markets globalisation is best captured by, the phenomenon of securitization which has fundamentally altered the nature of international finance. However, data on some of these indicators remain scant.

We shall, therefore, discuss the quantitative measures on which data is available.

1. INCREASED CROSS-BORDER INVESTMENT

The strongest evidence of the globalisation of industry comes from the rapid growth of FDI flows since the early to mid - 1980s. Between 1985 and 1990, worldwide FDI flows rose at an average annual rate of 31 percent, nearly three times faster than global trade or output. Over the same period the global stock of foreign investment also rose dramatically, from $ 700 billion to $ 1.7 trillion almost doubling as a share of world output. Estimates for 1994 put worldwide FDI flows that year at $ 35 billion. It is widely recognized today that FDI with its associated effects on international trade, international capital markets and the transfer of technology, knowledge, ownership and control has become the principal vehicle of the deeper integration of the world economy.

2. WIDER RANGE OF ALTERNATIVES FOR CLIENTS

An important positive consequence of financial market globalisation is the pooling together of market capacity around the world to provide a larger common financial marketplace that provides users around the world with a dynamic cost-effective environment for making selections among an increasingly expanding array of attractive financial alternatives.

3. THREE-MARKET CAPABILITY

London, Tokyo and New York are the three principal centers of the globalised market. Transactions between them are continuous and taking place in all types of debt, equity and foreign exchange linked securities. Market makers usually function as transactors within the domestic markets of their respective regions, as well as between the markets. When traders in London come to work in the morning, they look forward to having orders to execute at the opening that came in during the night from colleagues in Tokyo. Before retiring for the night, many New York traders discuss their positions with their counterparts in Tokyo. Day and night, traffic is heading in both directions on each of the three great financial roadways that connect the financial capital of Asia, America and Europe.

The three markets are 'inked across the hoard - in debt securities, foreign exchange commodities, equities, mergers and real estate. They are linkedby the transactions that are completed and by many that are no l completed but that were considered as the physical alternative to another transaction that was completed.

4. MANAGEMENT COMPLEXITIES

Senior managers of large investment banking institutions expecting to play a major role in globalised markets of the future must feel a little like the ambitious captain of an inland waterways vessel starting out on his first translantic voyage. —There's a lot of opportunity out there" he said, "but a lot of ocean too". There is a lot of opportunity for securities firms that can structure themselves to be effective competitors in the global markets, but the cost and complexity of setting up multiple product lines in Tokyo, London, New York and other promising places (e.g. Zurich, Toronto, Sydney, Hang

...ong, Paris and Frankfurt) is mind-boggling. Clearly, very few banks can do everything at once. For the rest, all of these possibilities are distracting temptations.

NEED FOR LARGER FIRMS

Between 1984 and 1987 many investment banking offices in London quadrupled in size. Such expansion was thought necessary in order for the firms to gear up to compete in the post Big-Bang environment in London.in which foreign firms would have access to all British markets for financial services. Those US firms participating in the UK market would have tolearn to be dealers and to be able to distribute British government securities ("gilts"). They would have to be able to make markets and provide brokerage and block trading services in British stocks. They would have to increase their calling activities on British companies including smaller ones that had not been covered before.

They would have to be able to offer UK merger and corporate financing advice. real estate services and pension fund assistance. All of this had to bedone in competition with not only their American investment banking rivals but their European, Japanese and US commercial banking competitors as well. Euro market activities were _expanding too and they had to be provided for.