RESERVE BANK OF INDIA
1979

REPORT OF THE STUDY GROUP ON THE FORMATION OF A CONSORTIUM OF INDIAN AND FOREIGN BANKS

Reserve Bank of India

Report of the Study Group on the Formation of a Consortium of Indian and Foreign Banks

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Bombay,

April 26, 1979.

The Deputy Governor,
Reserve Bank of India,
Central Office,
Bombay.

Dear Sir,

REPORT OF THE STUDY GROUP ON THE FORMATION OF A CONSORTIUM OF INDIAN AND FOREIGN BANKS

I have pleasure in submitting to you 3 copies of the Report of the Study Group on the Formation of a Consortium of Indian and Foreign Banks, appointed by the Reserve Bank of India in October 1977.

Yours faithfully,

Sd/-
(P.C.D. Nambiar)
Chairman.

REPORT OF THE STUDY GROUP ON THE FORMATION OF A CONSORTIUM OF INDIAN AND FOREIGN BANKS

The steady growth, increased resources and accelerated tempo of activity of the foreign branches of Indian banks in recent years had led to the more enterprising among them to spearhead the demand for the creation of a consortium of Indian and foreign banks. The idea was mooted in late 1976 by the Chairman of a leading public sector commercial bank with the submission of a tentative proposal suggesting the formation of a consortium of five prominent Indian banks with an equal number of reputed non-Indian banks - British, American, German, French and Japanese - for the purpose of medium and long-term lending to Indian industry, shipping, etc. Although the outlines of the proposal were somewhat vague, it was felt they needed to be discussed in greater detail by the Reserve Bank in consultation with other financial institutions. Accordingly, a meeting of the Chairmen of public sector banks having overseas branches was convened at Bombay by the Reserve Bank on August 20, 1977 to discuss the question of establishing a consortium of Indian and foreign banks.

The subject was discussed extensively at this meeting but in view of the divergent reactions of the participants to the idea of such an institution as also the need to examine the various facets of the proposal in greater detail, it was decided to set up a small Working Group to consider in depth the question of forming a consortium of Indian and foreign banks.

The following persons drawn from the public sector banks, the Government and the Reserve Bank of India were invited to serve on this Group:

1. Shri P.C.D.Nambiar,
   Chairman,
   State Bank of India.

2. Shri R.C.Shah,
   Chairman,
   Bank of Baroda.

3. Shri M.V.Subba Rao,
   Chairman,
   Indian Bank.

4. Shri Baldev Singh,
   Joint Secretary,
   Department of Banking,
   Ministry of Finance.

5. Dr. Vijay Kelkar,
   Economic Adviser,
   Ministry of Commerce.

6. Shri K.B.Chore,
   Joint Chief Officer (DBOD),
   Reserve Bank of India.

7. Kumari C.J.Batliwala,
   Director - Division of International Relations,
   Economic Department,
   Reserve Bank of India.

Although no specific terms of reference were given to this Group, the objective was that the Group should study the concept of multi-bank consortia, their organisational patterns such as ownership structure, objectives and typical activities and their long-term viability to determine whether the time was right for Indian banks to enter the arena of consortium banking;

in short, to assess what advantages a consortium of banks would offer which Indian banks by themselves cannot develop.

The Group met three times between March 1978 and November 1978. At its first meeting, the Group considered two papers: one - a specific proposal submitted by a public sector bank outlining the possible structure of a consortium bank with foreign and Indian interests (vide Annexure I) and two - a background note on the concept, evolution, growth and experience of consortium banking (Annexure II).

The thesis of the first paper was that in recent years operations of foreign branches of Indian banks had shown a sizeable increase and Indian banks with substantial international business had discovered how profitable international business could be and this realisation had now called for a greater diversification and entry of foreign branches of Indian banks into the more sophisticated areas of international banking business. While conceding that foreign branches of Indian banks have been able to finance all the short-term needs of India's foreign trade, the paper sought to point out that there was a gap in medium-term financing, and the 123 odd branches of Indian banks as presently organised were unable to finance the foreign exchange requirements of Indian industry in areas like shipbuilding, aircraft and exploration of natural resources. In the context of the country's large and increasing reserves, the proposal was that the time was ripe for Indian and foreign banks to join hands in equal

partnership to form a banking consortium with the object of providing medium-term funds to viable Indian projects. Partnership with foreign banking interests, it was felt, would provide the needed financial muscle for Indian banks to enter the area of wholesale banking. The paper went on to cite a number of advantages of a consortium bank to India, as also the advantages of such an arrangement to the foreign partners (vide paragraphs 4 and 5 of the paper). Availability of large medium-term loans at a lower cost as also increased profits for Indian banks resulting from the contacts and expertise which could become available through association in a consortium with some of the giants of the international financial world were the obvious advantages claimed for such a venture. To the foreign partners, involvement in the development of a stable economy with a large potential producer and consumer base was the key advantage.

Having outlined the need and rationale for a consortium bank which would make billion-dollar project financing of Indian industry a reality, the proposal sets out briefly, the structure and modalities of such a venture.

1. The Bank would be incorporated in London, as easy access to Euro-currency funds and flexible methods of banking control would be the main determinants for its logical location, even though from the tax angle, it is not the most attractive centre.

2. There would be ten shareholders - five Indian banks and five foreign banks - one each from the USA, the UK, West Germany, France and Japan. The total paid-up capital would be £ 10 million and the ten shareholders would contribute £ 1 million each, with 50% shareholding resting in the hands of the Indian Government through the nationalised Indian banks who would have the controlling interest.

3. Each bank would nominate one director, and as the Government of India would be holding 50% of the equity, it would be entitled to appoint five directors and could, in addition, suggest the appointment of an Indian as Managing Director. The Board would thus comprise of 11 directors, with administration and veto power in the hands of the directors representing Indian banks.

4. The Bank of England would permit such a Consortium Bank to borrow upto fifteen times its paid-up capital i.e., £ 150 million. Borrowing of this order would be considered feasible, particularly when the Bank has as its shareholders five leading banks of major industrial countries.

5. The Bank of England rules would require an unequivocal guarantee from shareholders in the Consortium that they would each be jointly and severally liable for all the liabilities of the Consortium. In effect, the maximum liability of each shareholder under this proposal would be pinned down to £ 16 million - £ 15 million by way of working resources and £ 1 million by way of share in the equity. Even without remitting capital from India, the Indian banks in the Consortium could easily provide the equity capital out of the profits of their overseas branches.

6. Para 18 of the paper provides a fairly detailed calculation of income, expenditure and profitability of such a bank in the first five years of its operations. According to this reading, from inception, a consortium bank of this nature could easily make profits and thereby guarantee dividends to its shareholders. The Bank would borrow short-term funds at slightly higher than the London Inter-Bank rate (LIBOR) for six month deposits and it is envisaged that it could lend them at $\frac{3}{4}$% over the LIBOR. This would yield a clear profit. In addition, the Bank would issue performance bonds and letters of guarantee, income from which would be substantial. It is assumed that establishment costs and expenditure on salary, would not be too high as it would require a small but technically competent qualified staff.

The message which the paper seeks to unquestionably convey is: the economic strength and stability of the Indian economy, its large industrial base, its strong foreign exchange reserves position, the strength of the Indian rupee are factors that place Indian banks in a particularly favourable position for entering into long-term financial partnership with their foreign counterparts. At no time in the past could the Indian economy operate from such a position of strength in international financial and currency markets - and therefore, it is imperative that Indian banks should seize the opportunity to enlarge and strengthen their operations by entering new areas of financing with foreign participation. An important premise of this analysis is that despite the strides forward made by foreign branches of Indian banks, they are unable to finance medium-term foreign exchange requirements of Indian projects firstly, because of their preoccupation with short-term foreign trade financing and secondly, they do not have the banking strength or size to raise large medium-term loans.

While the first paper pencilled the outlines of such a financial enterprise, the second paper was a more general one giving a short historical sketch of the evolution, growth and experience of consortium banks and the role consortia have played in the international sphere, to enable the Group to take a hard look at the facts, figures and issues involved in this type of activity.

To begin with, it may be useful to point out that there is no precise definition of a consortium bank. According to the Bank of England, 'a consortium bank is a bank which is owned by other banks but in which no one bank has more than 50% ownership and in which, atleast one shareholder is an overseas bank'*. The period 1968-1972 was the heyday for consortium banks when the Euro-currency market was in its most dynamic period of expansion, but thereafter, as brought out in the paper, there has been a slackening in the formation of consortia and new entrants have been few and far between.

Consortium banks cover a broad spectrum of banking types vastly different from each other. The differences stem from ownership pattern, capital structure and the areas of activity. The financial resources too, of consortium banks vary widely. There are the leading giants like the Orion Bank commanding assets in the neighbourhood of £ 1 billion, and the Midland and International with assets aggregating £896 million. In contrast, there are regional consortium banks like the Intermex and Libra, with a much smaller capital base (vide Table I.1). Although they are all children of the Euro-markets the main difference among them, in essence, lies in the nature of their activities.

Despite the enormous diversity of structure and activity presented by the consortium banking community, four areas of

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* This definition applies to consortium banks headquartered in London.

activity are discernible. Firstly, those consortium banks devoted primarily to medium-term lending in the Euro-currency market like the MAIBL, and the International Commercial Bank; these banks were designed to cater primarily to handle large financial flows of the multinational corporations or the Governments. Through the syndication principle, they offer their shareholders a higher return on their international operations. The sheer size of their assets and high profitability ratios have placed these banks in a commanding position in the international financial world.

The second variety of consortium banks is the multi-purpose institution which combines under one umbrella a broad range of banking activities encompassing medium-term Euro-currency lending as also merchant and investment banking. Project financing, international mergers and acquisitions, specialised financial services in the capital market field are all areas in which they operate - in short, their activities are similar to merchant and commercial banks - with this difference that the scale of their operations is much wider. They thus offer stiff competition to their parent species - the merchant bank.

The third type of consortium bank has essentially grown out of geographic consideration - participation in regional development being the compelling force behind its creation. A good number of well known consortia like the Libra Bank in Latin America, Eurobraz and Intermex concentrating on Brazil and Mexico and the UBAF in the Middle East are all examples of regional motivation.

Coming to the fourth category, the principal force urging its creation is the desire on the part of the oil surplus nations to participate in international money and capital markets both as lenders and borrowers. It is a form of vertical integration prompted by the desire of the surplus rich but less developed nations, not so ably equipped with financial expertise to join their financial counterparts in advanced industrial countries to undertake financial operations suited to their own requirements.

A classification asset-wise, ownership-wise and activity-wise of London based consortia is presented in Table I.2 of Appendix II. Such a classification reveals the following features:

1. Asset-range of these consortium banks varies from a low of £ 21 million to a high close to a billion pounds.

2. No single bank in the consortium partnership has a controlling interest, but it is possible for a group of banks belonging to the same country to have a controlling voice in the enterprise.

3. Activity-wise, a third of the London-based banks were regional oriented, whereas another third were preoccupied in the business of medium-term lending and investment management. Consortium merchant banks were few, and fewer still were specialised banks.

Over the years, the working of consortium banks has indicated some trouble spots. These appear to have resulted from an overlap in areas of operation between the parent bank

and its offspring, with shareholding banks increasingly finding themselves in competition with their offshoots for lending business. Often the business objectives of a consortium are deliberately left vague to impart the needed flexibility. This has posed operational difficulties. Another area of difficulty that has arisen is on the question of the shareholders' interest and obligations in this kind of a loose joint venture. This question surfaced in 1973-74 during the period of currency uncertainty, when anxieties were expressed in the financial world, whether consortium banks would be able to ride out of the currency storm and if not, would shareholder banks be prepared to bale out their offspring. The banking crises of 1973-74 revealed that they were able to survive only by the skin of their teeth. Difficult conditions in the Euro-currency markets, low margins and rising interest rates had reduced profits of a number of consortium banks. The rough experience had rattled many a shareholder bank to question the long-term viability of the consortium bank concept and several Japanese and American shareholding banks turned cold to the idea. It would be fair to point out that the American bankers had never bought this idea of working together in a consortia with any great enthusiasm. They were not prepared to underwrite the risk of their partner members in a consortia. Their management style and the pressure of the American investment community to demonstrate solid earnings acted as a constraint to their being involved in a consortium type of

activity. They were never enamoured by a partnership that extended to too many masters trying to pull the strings and pipe different tunes. This explains the biggest shake-out that has taken place among US banks, a number of them pulling out of consortium operations or taking over full control in order to develop their own in-house international merchant banking capacity. For instance, Bank of America which in the earlier period was actively participating in collaboration arrangements has in the last two years sought to unwind its involvements and to concentrate on its own international banking business. Further, unlike the British and European banks, US banking law requires US banks to seek official clearance before making an overseas investment.

Likewise, after the currency debacle of 1973-74, the trend of Japanese banks looking for foreign partners to form a consortium has receded to a trickle. As a regulatory measure, the Japanese banks were prevented from acquiring a controlling stake in overseas joint-bank ventures. Tokyo Bank's involvement in a Brazilian investment bank failure, led the Japanese authorities to frown on banking ventures with minority Japanese participation. The trend now is to encourage Japanese banks to join forces to set up their own consortia.

Against the backdrop of developments in consortium banking over the last decade, the paper has attempted to sketch the present scenario for the creation of new consortium banks.

The highlights of the present scene are that the whole concept of consortium banking is in a state of flux, and considerable soul-searching is underway by its shareholders. Some have left the consortium fold while in others, changes of shareholders and capital shares has taken place. Some have reduced their stake by increasing the number of partners. London-based merchant banks' type of consortia have been hardest hit following the sharp decline in sterling in 1976-77. For this reason, some of the British merchant banks have sold out their shares and quit the consortium bank scene. In short, a crisis of identity has been in evidence.

The recent moves highlight the marked changes which have been taking place in the character of international banking as an increasing number of banks have gained experience and self-confidence to undertake worldwide operations in their own right rather than relying on partnerships and relationships with other banks. On the other hand, it would only be fair to point out, that not all such ventures have run into difficulties. The stronger among them have achieved considerable success - particularly the regional variety. But even among them, the consortium concept is likely to continue to have a role which may include a growing trend towards specialisation and advisory services. Medium-term lending activity would be somewhat reduced to fee generating activities and short-term commercial business. Some of the larger banks are strengthening their corporate finance activities in the areas of public issues,

private placement and syndicate loans. The push of a few other moderate-sized ventures is in the direction of leasing business.

Recent developments show that the number of consortium banks, particularly in London, has been significantly reduced. Given the new climate of banking, it appears unlikely that there will again be a move to set up older type of consortium group aimed mainly at providing a vehicle for participating in the Euro-currency markets. Nevertheless, the consortium concept is not likely to fade or die out. As indicated, it will take on a specialised hue. However, for this type of creature to remain in business, it must be ahead of the market and in the teeth of intense inter-bank competition must take correct and timely decisions. To do this means the relationship between shareholders and the management of the consortium bank must be smooth as the strength or weakness of this relationship would significantly affect the working of the consortium.

It would appear that a financial instrument like the consortium for 'playing on the world stage' has undergone a radical change in the last two years and individual foreign banks are queing up in London and New York to set up shop there and get a share of the international banking business. Moreover, many of the banks coming to London are relatively small by international business standards. A few years ago, these would have relied on correspondent relationships with other banks or on consortium arrangements rather than attempting to go it alone.

The need for co-operation and assistance from other banks for setting up in international markets was one of the principal reasons for the fashion, a few years ago, for creating consortium banks. This fashion has become out-moded and in the changed environment the debate has been revived over the rationale of consortium banking. To begin with, some consortium banks turned out to be not all that profitable - in others, shareholders have become increasingly reluctant to share profits that are made with others. Many of the shareholding banks feel that they no longer need to rely on joint ventures in order to develop their international business. After the shocks of 1974, some international banks thought it prudent to shorten sail. The period 1976 to 1978 was marked by a liquidity glut and like the rest of the international banking community the consortium banks felt the effects of the difficult market conditions. Competition had seldom been tougher and this renewed the squeeze on profit margins in the lending business. The period also witnessed the growth of worldwide branch banking which clearly provides evidence of the trend towards building up the required individual representation.

Thus, recent events project the diversity rather than the similarity of consortium banks - the only common denominator being that it is owned by the group of banking shareholders. The more prosperous among them, notably the Orion & European Banking Company have created an image of their own and are ready to ignore their consortium tag. In the face of intense competition big national banks are polishing up their services to multinational

corporations. London-based consortium banks would thus be called upon to face new pressures and diversify their activities in the coming years, as established banks move to make their individual presence felt on the world stage.

Against this overview of the developments in consortium banking, the background paper raised certain questions for the Study Group to consider before arriving at its recommendations.

Taking note of the strong external payments position, the Study Group examined these questions in order to reach an answer, whether there was need for the setting-up of a consortium bank of the type envisaged in Annexure I. The view of the Group was that a consortium bank with five Indian and five foreign banks, each enjoying one-tenth interest, was not a feasible proposition and would pose more problems than it would solve in its day-to-day working. The considered view of the Group was that any partnership with foreign banks, who would inevitably demand a controlling interest, should be eschewed to avoid the kind of difficulties and problems existing consortia were faced with. True, some foreign banks had shown interest in joining hands with Indian banks but it was felt the move was motivated by the fact that India was accumulating foreign exchange reserves and was a lender in the Euro-markets. The Group noted that domestic banking institutions in the Middle East were also trying hard to win a measure of independence from the banking giants of the West. If, experience was any guide a

financial entity of the kind envisaged was likely to face friction, particularly when half the shareholders were foreigners. In the case of a number of consortium banks, shareholders who are <u>not</u> in the first rank of international banks have found the functioning of the consortium not all that smooth. In the Indian case too, past experience to set up a merchant bank in collaboration with a US bank was not a happy one, and negotiations, although at an advanced stage, broke down when the Indian counterpart discovered that it was a ploy on the part of the foreign bank to get a footing in India.

It was recognised that the proposal to form a consortium of Indian and foreign banks had as its genesis the need to provide medium-term finance to Indian projects, particularly in the context of the increasing number of Indian joint ventures and turnkey projects in foreign countries. It was also recognised that at this stage with a strong external payments position, raising medium-term finance was no longer a problem. In fact, in the last two years a few nationalised banks had demonstrated their ability to raise fairly large loans in the Euro-currency market at attractive spreads over the LIBOR.

In the light of the above, it was the unanimous view of the Group that the participation of foreign banks would create unavoidable problems of administration, arising out of conflict of interest between the Indian and foreign banks and that the idea of the inclusion of foreign banks in any consortium arrangement should be given up.

The Group, however, recognised that not all banks had the technical expertise to operate in the Euro-currency market and to fill this lacuna, the Group also went into the question of the need to set up a consortium of major Indian banks who could jointly operate in the foreign exchange field - a wholly Indian-owned consortium bank modelled on the Japanese pattern. On this, the thinking of the Group was somewhat divided. Some members of the Group felt that in view of the satisfactory foreign exchange position there is no need for immediate urgency for creating a formal institutional arrangement of the consortium type. They, however, conceded that if there was a drastic change in domestic or international liquidity conditions, creation of such an entity could be considered. There were others who suggested that even though there was no immediate need, if at all it was to be set up, this was the right time to start thinking about it from a position of strength.

The rationale advanced by the proponents of this idea were:

1. Indian banks at present are unable to finance medium-term advances simply because their deposits are of a short-term character and they do not have the necessary financial muscle to borrow short and lend long without running into liquidity crisis. Nor are these banks by themselves *in a position to borrow large sums in the Euro-currency* markets or set up full international representation of their own. In these cases, the consortium would fulfil this special role.

2. Not all Indian banks have the technical expertise or financial strength to launch out in the Euro-currency markets on their own and a consortium would fill this gap.

3. Since the consortium bank will command a higher credit rating than any one individual Indian bank, the cost of raising funds will be cheaper.

The Group examined each of these points. In the course of the discussion complete agreement was not in evidence on the point that Indian banks were unable to meet the demands for medium-term advances. It was argued that the fact that aggregate loans so far raised by Indian banks abroad on a medium-term basis formed a miniscule of international lending operations, did not by itself prove the lack of capability of the Indian banks in this field. The extent to which loans can be raised depends on a number of factors including the policy of the Government of India. There was hardly any instance when Indian banks were unable to raise medium-term resources when required or called upon to do so. SBI alone had participated fairly actively in the Euro-currency markets.

Although it was undisputable that the present was most opportune time from the point of liquidity and foreign exchange resources to set up such an institution, some apprehension to set up an Indian-owned consortium bank stemmed from the lull in investment activity within the country. It was stated that one of the important validity tests for the proposal would be the availability of data regarding the extent of market loan exposures necessary for the country's foreign trade - present and projected, juxtaposed with the aggregate operating potential of Indian banks through their foreign operations. Such an exercise alone would indicate whether

Indian banks were capable of raising funds of that order in the next four to five years, before coming to the conclusion that the existing organisation of Indian banks was inadequate to meet the need. Given the present level of reserves and foreign aid, the key question is: would India need to enter the Euro-currency market in a big way in the coming years or could the same well be achieved by syndication of loans ? Already some of the Indian banks with a good network of branches had earned a high rating in overseas markets and had successfully arranged for syndicated loan financing.

It was pointed out that there might be some truth in the belief that the cost of funds would be lower if the banks operated as a consortium than in their own rights as individual banks. However, other factors that determined the cost of funds were market conditions, and the rate, more often than not, depended on the political and economic outlook of the borrowing country and the financial viability of the project for which resources were raised. What is more, the creation of a consortium bank might affect the development and profitability of the existing Indian banks.

In short, these members argued that India has not reached a stage in its foreign trade where capital goods exports and joint ventures call for the organisation of an expensive new edifice like a consortium bank, the projected requirements could very comfortably be serviced by Indian

banks operating internationally; may be with some capital funds support to these banks which would be less expensive, would help them take on larger transactions than they are now in a position to finance.

It was recognised that these were important factors that had to be reckoned with if the Group was to endorse the wholly-Indian bank consortium proposal. At the same time, it was conceded that there were other aspects of the proposal that also merited some consideration.

On the point that Indian banks have and can raise medium-term resources as well as a consortium might be able to do, the counter argument advanced was that, in practice, a consortium bank concentrating on corporate finance activities had demonstrated that it can operate with greater professional skill in medium-term borrowing, operation in the capital markets, portfolio management and other specialised services. Further, a consortium bank concentrating on specific areas could promote profitable business whereas commercial banks with multifarious activities were unable to devote singular attention to term-lending operations. The ability of Indian banks to raise term resources was limited. Customer base for Euro-term deposits of Indian banks is not known to be large. It is widely known that persons of Indian origin settled abroad have sizeable currency deposits which at present are with foreign banks. When an Indian bank borrows medium-term from a foreign bank, it exposes itself to some measure of surveillance by the foreign bank.

This could be avoided, if Indian banks are in a position to raise large Euro-term deposits either through their branches or by floating instruments like certificate of deposits or floating notes. The latter would be possible only if an internationally reputed foreign bank could lend support to such issues. Given the narrow capital base of Indian banks on their own, the Indian banks would find such an operation difficult. A consortium bank with equity capital denominated in convertible currency would fare much better in foreign markets than an Indian bank with a narrow capital base denominated in rupees.

Currently, Indian banks have 123 branches overseas in some 24 countries. In order that they gain international stature, their operations should not be limited to retail business but they should venture into wholesale activities and should extend to Euro-currency dealings in a sizeable manner. This would be possible through a consortium bank with a sound foreign currency capital base. Incidentally, the capital investment in the consortium would be a fruitful avenue for long-term deployment of the country's reserves. To the extent that Indian banks operate through the help of foreign banks, Indian banks generate profits for foreign banks. This could be avoided if a wholly Indian-owned consortium bank were to directly handle the transactions. The idea is not that a consortium bank would supplant foreign branches of Indian banks but would supplement and strengthen the international banking structure of Indian banks.

Branch banking has its limitations given the narrow base of owned funds. Overseas branches of Indian banks because of inadequacy of medium term sources of finance are constrained to concentrate their activities on short-term lending, even though medium term lending has several strong attractions like low servicing cost and higher mileage in terms of image and lucrative ancillary business. The profitability of Indian banks' overseas branches would remain unaffected if the consortium bank directed its energies to medium term lending. Further, the comparative capital strength and financial stature of consortium type organisation would provide a better access to international markets than many an overseas branch. Fears of errors of performance or lack of technical expertise, it was stressed, should not deter the taking of the decision to set up wholly owned Indian bank consortium.

Further a consortium bank could aid the export of our banking skills and improve the country's invisible earnings and also aid in the marketing of projects and capital goods abroad. On the last mentioned points the majority view was that the kind of expertise India possesses is basically of the development banking variety; expertise in international banking and merchant banking is not worth exporting. While the idea of improving invisible earnings is laudable, this objective could not be achieved by incorporating a consortium bank and exposing it to the sophisticated markets and giant internationals.

In the context of the creation of a wholly owned Indian consortium bank, the Group considered at some length, the various alternative models for creating the capital structure of such a bank. One proposal was that bigger banks with a cluster of foreign branches could co-operate to merge their foreign operations while continuing to compete in the domestic market. This suggestion was based on the premise that branches of individual banks by themselves in the coming years may not have the financial muscle to be able to borrow and lend large sums for undertaking turnkey projects in third countries and a consortium of banks would be a way out to get banks involved in this type of business. As a whole, the Group was not in favour of this proposal as it would result in the existing banks losing their identity which had been built up over several years. The Group saw little merit in 14 public sector banks merging into an entity to conduct operations abroad. A monolithic organisation of this type would present insurmountable operational difficulties.

Another variation which, too, found lukewarm support was that the State Bank and its subsidiaries

could possibly form one consortium and some of the other public sector banks could get together and form another consortium, each taking a lead in different areas of activity. It was pointed out that such an arrangement would not lend added operational strength to the State Bank as term export finance operations of associate banks was negligible - in any event the requirements of the associate banks were well taken care of by the State Bank. In the case of the other banks, the more successful among them would be reluctant to join hands with their weaker counterparts.

Yet another variant was that large Indian banks with sizeable foreign operations could be invited to form a consortium with 51 per cent holding and the remaining 49 per cent could be distributed among non-residents of Indian origin residing abroad. The merit of the proposal would be that it would draw in surplus funds of non-resident Indians; however, such a proposal would lead to fragmentation of holdings, since a large number of Indians would be holding shares in the consortium and would militate against its acceptability and credibility in foreign markets. The presence of powerful pressure groups among the shareholders could also come in the way of timely and correct decisions.

Having broadly surveyed the consortium terrain from all angles, the Study Group reverted to answer some of the questions raised in the background paper (vide pages 24 and 25 of Annexure II).

The Group noted that consortia of the merchant banking variety were on the decline. In Euro-credit and Euro-bond markets they had suffered the usual fate of pioneers. New pressures continued to elbow them out of established areas of activity into newer fields demanding increasing specialisation. Over the last few years important changes have taken place in market mechanics which have duly led to changes among lenders and borrowers. International credit markets have been extremely liquid and a persistently large US current account deficit and capital outflows have injected huge amounts of dollars into Euro-markets. Banks are bursting with liquidity and spreads have dropped drastically. This has encouraged borrowers to refinance their former debts on the basis of lower margins and longer maturities. In other cases, improvement in the balance of payments of various countries has allowed them to prepay loans originally raised to finance previous debts. Increased prepayment is plaguing Euro-bankers who do not like to face prepayment because their returns could be lower if the loan is refinanced, or their portfolio is unbalanced if the loan is simply repaid. Prepayment clauses in syndicated Euro-dollar loans are causing problems for

the international banker and expectations are that the syndicated Euro-loan market is likely to face a continued avalanche of prepayments for some time to come. In this environment, the Group felt a consortium of wholly Indian owned banks with a relatively small capital base, doing limited merchant banking business and trying to raise funds for Indian projects would hardly be able to make a dent on the international financial scene and would not be a viable proposition.

As a vehicle for promoting capital goods exports from India, the Group while recognising that among the LDCs India had built up a respectable capital base, also noted that the volume of capital goods exports on deferred basis was not sizeable. The volume of deferred credit exports, by itself, is still very small, relative to total exports and current projections are that it is not likely to show a spectacular rise. At the end of the current Plan 1982-83 when engineering exports reach a level of Rs.1,500 crores, the share of deferred exports would at best be Rs.260 crores allowing for the initial down payment. This is based on the premise that not more than 20 per cent of the engineering exports will be on credit terms. It is true the pattern of Indian export trade has shifted from primary products to industrial goods but the weight of light industrial goods and textiles in Indian export trade is rather large and these exports are on cash basis. Some shift in trade pattern has taken place, with the export basket including items like rolling stock,textiles, cement plants and transmission towers, but as yet these form a

modest proportion of total exports. The Group foresees a long-term growth trend for exports of heavy machinery on deferred payment terms but compared to the volume of world business transacted in heavy machinery, the Group's reading is that the microscopic Indian share does not warrant the creation of a formal consortium.

Further, in considering such a formal organisation, it had to be ensured that the activities of the consortium in no way impinged on those of already established foreign branches of Indian banks. The question was: would the consortium support or supplant existing Indian banks abroad ? The majority view was that looking to the business scope for the consortium in the medium-term finance area, the danger of its supplanting the foreign branches of Indian banks could not be overlooked. But the minority in the Group saw a gradually increasing scope for such an organisation, provided it catered for a whole package of financial and non-financial services required in the execution of projects. Its activities could embrace merchant banking and offshore banking in third countries. To this, the point was made that normally such financing is heavily loaded in favour of the country that draws up the project. India, a late entrant on this scene, with a small capital base would find the going pretty rough in the teeth of stiff international competition. More so, in the present environment in which there has been sharp decline in margins banks charge on syndicated loans - as low as half a percentage point over LIBOR for

borrowers who had to pay $1\frac{1}{4}$ per cent over LIBOR three years ago - accompanied by a stretching of maturities to up to 15 years compared to seven-year maximum a few years back.

At the same time, the size of loans has increased sharply. Such margins, it was felt were hardly sufficient to cover banks' needs to finance capital and reserves. Unless the volume of business was sufficiently large, lending at so narrow a spread would merely dilute the capital and earnings of the consortium bank.

The Group noted the view that while the State Bank had the financial ability to compete on its own for international business, with the enlarged scale of international operations the other banks with their limited owned resources were handicapped for such a task. For this, a formal wholly owned Indian consortium was not the immediate answer. After giving due weightage to divergent views that had surfaced in the discussions and taking note of the international and domestic banking scenario, the Group's recommendations are as follows:

1. It recognises that collaboration with foreign banks, the plank on which the whole idea of a consortium was initially mooted, is a proposition subject to severe weaknesses and conflict areas and therefore, totally impracticable in the Indian context.

2. The Group, however, recommends that joint ventures with foreign interests should not only be permitted but also encouraged in countries where entry of Indian bank branches is prohibited or made difficult by the law of that country and where the formation of a joint venture is in the interests of the development of the country's trade and international relations.

3. The Group recommends that for the time being Indian banks may continue to evolve consortium type arrangements to meet specific needs of individual projects or proposals on an _ad hoc_ basis. For instance, two or three banks could combine to pool their resources to undertake merchant banking or financing company type units. The same bank, if considered feasible, could be a member of more than one such arrangement. The smaller among the Indian banks that are keen on participating in term lending and in financing capital goods exports, could utilise the umbrella of the larger banks, to the extent this is feasible on a transaction-by-transaction basis. The recommendation has the merit of flexibility and could be regarded as a stepping stone to greater diversification and specialisation of Indian banking overseas.

4. The recommendation, however, does not mean that the Group has thrown overboard the proposal for the formal creation of a consortium bank. It has, after a thorough examination, decided that at this juncture, it is better to wait at the crossroads and not rush to be on the consortium map. Based on the experience gained from the working of *ad hoc* consortium arrangements, as described in recommendation (3), if the volume of business warrants and throws up the necessity of a formal banking institution on a continuing basis, a group of Indian banks could enter into a consortium bank. In forming such an institution, banks which have been operating in the regions concerned may be accorded a leadership role; other banks need not, however, be shut out. If found necessary, there could be more than one such consortium. All the nationalised banks need not be included in one such institution, nor should it be confined to the State Bank and its subsidiaries, but could by mutual consent comprise three or four public sector banks who would primarily cater to the needs of Indian projects or India's foreign trade. These consortia need not impinge on the business of the existing branches of the Indian banks operating in these areas who would continue to operate in the retail banking business. These consortia would concentrate their activities in the area of wholesale banking with an accent on merchant banking or project financing.

In short, the Group recommends that there could be a number of consortia with such combinations as may be suitable to a group of banks operating in a particular area. The merit of the recommendation is the flexibility of approach and freedom for like-minded banks to come together with a view to encouraging the gradual evolution of an institution that would meet the emerging needs of the country in the context of its international trade and economic relations. In this connection, the Group recommends that the Reserve Bank of India could extend stand-by support to these consortia to enable the latter to operate confidently in the Euro-currency market, free from liquidity constraints. The comfortable external reserves position should not make the extension of such support difficult. The medium-term credit needs of Indian industry and Indian joint ventures operating abroad have risen sharply in recent years and if the proposed banking institutions are to become viable, financial support of this nature would be desirable.

5. The Group does not rule out that a time may come when overseas branches of Indian banks may have to sink their individual identities and operate by joining hands to set up a public sector corporation of the consortium type to handle all wholesale business. The advantages such an arrangement would offer are enlarged resources, economies of scale and equitable distribution of available technical and professional skills. Such a development, if at all considered, would entail considerable ramifications in the banking structure and existing arrangements for operating abroad, which are beyond the scope

of the Report. For the time being, till the thinking on the consortium approach crystallises and action is initiated, within the confines of the existing set-up, an ad hoc and flexible approach is endorsed.

6. While one member of the Group (Shri Subba Rao) has signed the Report, to bring out the totality of his views on the subject, he has requested the Group to append his note (vide Annexure III).

Sd/-

(P.C.D.Nambiar)

Sd/-

(R.C.Shah)

Sd/-

(M.V.Subba Rao)

Sd/-

(Baldev Singh)

Sd/-

(Vijay Kelkar)

Sd/-

(K.B.Chore)

Sd/-

(C.J.Batliwala)

ANNEXURE I

NOTE ON AN INTERNATIONAL CONSORTIUM BANK FOR PROVIDING MEDIUM-TERM FOREIGN EXCHANGE LOANS TO INDIAN INDUSTRY, INDIAN SHIP-BUILDING AND OTHER INDIAN PROJECTS REQUIRING MEDIUM-TERM FOREIGN EXCHANGE FINANCE

In the three years 1974, 1975 and 1976 there has been a very sharp increase in the business of the foreign branches of those Indian banks which have sizeable foreign operations. Working funds, deposits and advances of the foreign branches of Indian banks rose from Rs.506 crores, Rs.352 crores and Rs.253 crores in 1974 to Rs.1,137 crores, Rs.866 crores and Rs.485 crores at the end of 1976. With the increase in business, profits remittable to India increased from Rs.5.38 crores in 1974 to Rs.9.02 crores in 1976 and at the latter level the profits of the foreign branches contributed substantially to the profits of the parent banks in India. Indian banks doing substantial international business were finding out at first hand how profitable international banking business could be and with this realisation their operations have become diversified and more and more sophisticated.

2. The increased resources and activities of the foreign branches of Indian banks have meant that they have, in conjunction with their Head Offices and occasionally in conjunction with foreign correspondents who have provided credit lines of a short-term nature, been able to finance all the short-term aspects of India's foreign trade. Hence today there would be no need for an international consortium bank to finance the

short-term needs of India's foreign trade. However, as far as the medium-term foreign exchange requirements of Indian industry, agriculture, shipbuilding, aircraft and exploration of natural resources are concerned the foreign branches of the Indian banks have not been able to help at all and my contention will be borne out by the fact that out of the 94 branches abroad of Indian banks at the end of 1976 scarcely half a dozen would have loans of this nature on their books and the total number of such loans would be very small in relation to both the resources and the volume of business handled by the foreign branches of the Indian banks. It is in this context that I feel the time has come to seriously examine a proposal for a consortium of Indian and foreign banks formed with the primary objective of providing medium-term funds to Indian projects, and in a subsequent paragraph when I examine the advantages that I believe would accrue to India and the Indian banks from the proposal, I shall touch upon the reasons for the inability of the Indian banks abroad to finance medium-term projects.

NATURE OF CONSORTIUM BANK'S BUSINESS

3. The consortium bank would mainly grant medium-term loans of up to eight years' duration to projects in India or to projects outside India being handled by Indian companies of construction engineers, architects and builders and all ancillary business connected with the granting of such loans, such as issue of guarantees, performance bonds and letters of

intent. It would not do short-term commercial business that would cut across the short-term business of the Indian or foreign partners of the consortium and it would also not do retail business in the interest of maintaining an economic staff structure and avoiding duplication of services which the Indian and foreign partners of the consortium would provide. In the circumstances there should be no conflict of interest between the consortium bank and its partners, particularly the Indian partners, a point on which I believe there is some anxiety among the Indian banks with branches abroad and particularly in London.

ADVANTAGES OF CONSORTIUM BANK TO INDIA AND INDIAN SHAREHOLDERS

4. The question is often asked whether a consortium bank of this nature would really confer on India any special advantages not presently available and whether it would benefit the overseas banking operations of Indian banks. To my mind it seems the advantages would fall under the following main heads:-

a) At present the overseas offices of Indian banks are unable to finance medium-term advances, mainly because their deposits are of a short-term nature. In the absence of a lender of last resort, they have wisely chosen not to get involved with medium-term finance as, in the event of a drying-up of short-term lenders in the Euro-currency markets due to political or other considerations, the foreign branches of Indian banks could have faced a liquidity crisis requiring a massive rescue operation by the Government of India. Hence the consortium bank would be able to do what the foreign branches of Indian banks are unable to do.

b) Individual Indian banks just do not have the financial muscle to be able to borrow large sums in the Euro-currency markets to finance the medium-term needs of India's economic development. A consortium of Indian banks, i.e. in effect the Government of India and some of the world's largest banks would be able to do this with a degree of ease.

c) A consortium bank would be able to provide a pool of ready funds for any viable medium-term project in India which required medium-term foreign exchange finance. At present any company which requires such funds has no assurance that firstly, such funds would be available and secondly, the cost of such funds - in the past several foreign banks have driven very hard bargains at the cost of Indian companies.

d) A consortium bank would be able to provide Indian companies with cheaper medium-term foreign exchange funds than are available at present. I would visualise that a bank of this kind would be able to provide medium-term funds at ¾ of 1% over the 6 month LIBO rate, whereas the best that India has been able to manage for a very large project has been the recent 1% over the 6 month LIBO rate, done for a loan of U.S.$50 million. In the past, smaller projects have had to pay anything between 1½% - 2% over the 6 month LIBO rate and in addition there have been several hidden extra costs.

e) Indian companies and banks dealing with foreign banks other than the consortium bank would have an indirect fall-out advantage from the very fine rates which the consortium bank would charge, as the banks they dealt with would not be able to charge a rate much higher than the consortium bank would charge. In fact, I believe that the consortium bank's activities in this direction would lead to a reduction in interest rates over the whole spectrum of India's borrowing, whether government or private.

f) At present the entire profit on loans raised abroad by Indian companies goes to foreign banks. In the case of the consortium, the Government of India through the medium of the Indian shareholding banks would hold 50% of the equity and therefore would receive 50% of

the dividends, so that in effect a part of the interest which Indian borrowers would pay to the consortium bank would come back to India as her share of the profits of the consortium bank.

g) I believe that the Indian banks, who were members of the consortium, would get the benefit of both contacts and expertise through being associated in the consortium with some of the largest banks in the world.

ADVANTAGES OF CONSORTIUM BANK TO FOREIGN PARTNERS

5. While the advantages of a venture of this nature for India and the Indian partners of the consortium are fairly obvious, the question may be posed - what are the advantages to the foreign partners, would they wish to be involved in a consortium of this sort devoted entirely to the development of India's economy and, if so, why? From informal discussions with leading British, European and American banks over the last three years, I believe that the response from at least one leading bank from each of the five foremost industrial nations of the Western world - the USA., the U.K., Western Germany, France and Japan - would be both positive and enthusiastic. The reasons for this response appear to be as follows:-

a) The leading banks of the world see the long-term advantages of participating in Indian economic development with India's potential consumer and capital markets of several hundred million people.

b) A consortium bank of this kind between themselves and the Indian banks virtually representing the Government of India seems to them a very desirable way of participating in Indian economic development,

as they would have a certain measure of control with a bank incorporated in London and with the foreign banks holding 50% of the equity.

c) They feel that with the foreign banks providing the financial muscle for raising the resources required and the Indian banks providing credit-worthy borrowing projects, this bank would operate at very good margins of safety of funds.

d) While all the foreign banks emphasised that their major interest was long-term involvement in Indian economic development, they were aware that a bank of this nature could, in the short-term, provide a very reasonable return on capital invested and also an opportunity for the use of their surplus funds.

LOCATION OF CONSORTIUM BANK

6. In locating a bank of this nature, the most important single aspect is easy access to Euro-currency markets and London is still unquestionably the world's largest centre for Euro-currency finance. All the major consortium banks set up during the last decade have been incorporated in London with its extensive Euro-currency market, its pragmatic approach to international banking and its relaxed methods of banking control. In the case of the consortium contemplated between Indian and foreign banks, London seems to be the most logical place of incorporation as all the world's leading banks have offices in London and so have seven of the leading Indian banks. The only difficulty London presents is its relatively high tax rate on profits and dividends - but the alternatives of tax-free havens like Luxembourg and Lichtenstein with their separation from Euro-currency markets and their relative

obscurity as international financial centres appear to me to be untenable. There is also the other angle that even if a bank of this nature were to be incorporated at a centre other than London and a branch was to be established in London, all profits made at the branch would be liable to corporation tax on profits at the rate of 52%

CAPITAL STRUCTURE AND SHAREHOLDERS

7. It is suggested that the consortium should have 10 shareholders - five Indian banks to be selected by the Government of India and five foreign banks, one each from the U.S.A., the U.K., West Germany, France and Japan. The five foreign banks would be invited to participate by the Government of India who would inform the foreign banks about the objectives of the bank and the aims and purpose for which the bank was being set up. If the foreign banks initially invited did not wish to participate then alternatives could be sought. However, it seems to me that certain foreign banks work very closely with Indian banks and a reasonable response might be obtained from the following banks - the list is only given as a suggestion and is by no means exhaustive -

U.S.A.	- Manufacturers Hanover Trust Company.
U.K.	- National Westminister Bank *or* Barclays Bank International Ltd.
West Germany	- Deutsche Bank.
France	- Societe Generale.
Japan	- Bank of Tokyo.

8. Each bank would hold paid-up capital to the extent of £1 million so that the total paid-up capital of the consortium bank would be £10 million, of which the Government of India would hold £5 million through the medium of the five participating Indian banks. Each bank would nominate one director and as the Government of India would be holding 50% of the equity it would be reasonable that the Indian banks should suggest an Indian as Managing Director, who would sit on the Board in addition to the five representatives of the Indian banks. Accordingly, the Board would comprise of 11 Directors, a Managing Director, five representatives of the five Indian banks and five representatives of each of the foreign banks. The staff would be entirely professional and would be recruited in the open market, with perhaps a leavening in the initial stages of expert staff seconded from the shareholding banks, who would help to get the new consortium bank going.

9. The question may well be asked - why could the Indian banks not form a consortium of this nature on their own without the participation of the foreign banks? The answer is that a bank of this nature depends almost entirely on its capacity to raise funds in the London market and that capacity is largely dependent on the strength and financial size of the partners in the consortium. The Indian banks operating in London would not have enough muscle to raise short-term funds and to roll them over to finance medium-term advances. It may also be felt that, in the present position where there is a

surfeit of liquidity arising from oil funds, India would be able to raise medium-term funds on its own without the intervention of a consortium bank. The answer to that must surely be that the present position will not contihue indefinitely and the consortium bank must be thought of as a long-term project to help Indian dev lopment particularly at times when the money markets do not suffer from the present surfeit of liquidity. Secondly, it is axiomatic in international banking that a country should borrow from a position of strength in order to get the best terms and India's present economic strength and stability and strong foreign exchange reserves will make it easy to get strong partners for the consortium bank and for the consortium bank to raise funds for Indian development in international Euro-currency markets.

RESOURCES OF CONSORTIUM BANK AND THEIR UTILISATION

10. The consortium bank would not accept small retail deposits from casual customers which would bring it into conflict with the interest of the partners of the consortium, but it would accept larger deposits for fixed periods (say U.S.$100,000 and over for periods of 6 months and over) and would also maintain current accounts for its borrowing customers. Despite these deposits I would anticipate that the largest portion of the resources of the consortium bank would come from borrowing in the London, New York, Singapore and Hong Kong inter-bank markets. The utilisation of the

resources would come in the shape of medium-term loans for Indian economic development, though it would be up to the consortium bank and its partners to decide at a later date whether 100% of the loans should go to Indian companies or whether they would prefer that a percentage of loans should be made to third countries who might be tied to Indian projects, say as buyers of goods and services.

11. The Bank of England normally permits consortium banks to borrow up to fifteen times their paid-up capital although it is possible that in the initial stage the permission might be to borrow only a smaller multiple of the paid-up capital. Similarly, once the bank is considered to be well established and its paid-up capital and management expertise are thought to be adequate, the Bank of England is not averse to permitting a consortium bank to borrow twenty to twenty-two times its paid-up capital. However, as the money borrowed has also to be lent out in creditworthy ventures, I have used a very conservative yardstick and project the following figures of resources with the maximum permitted figure of fifteen times the paid-up capital being reached only at the end of the fifth complete year of operations.

RESOURCES

(In millions of £ sterling)

	Complete years of operation				
	1st	2nd	3rd	4th	5th
Paid-up capital	10	10	10	10	10
Deposits and borrowings from banks	10	40	70	100	150
Total resources	20	50	80	110	160

It might be mentioned here that in return for permission to borrow in inter-bank markets, the Bank of England will insist on an unequivocal assurance from all the consortium partners (in the case of the Indian banks this would virtually be the Government of India) that they would be responsible for all debts of the consortium bank. This is a usual condition laid down on all the partners of consortium banks and all large foreign banks involved in consortium banks are aware of the condition.

12. Apart from working balances by way of cash on hand and with banks and funds to meet the liquidity and credit control requirements of the Bank of England, I would hope that all the balance funds would be lent out and hence a separate projection of utilisation of resources is not being made, although figures regarding income in the subsequent paragraph take into account the fact that a certain portion of the funds representing working balances would not earn any interest and a further portion of the funds which are maintained for liquidity and credit control requirements would earn interest at lower rate.

13. INCOME, EXPENDITURE AND PROFITABILITY OF CONSORTIUM BANK

(£ sterling - 000's omitted)

INCOME

COMPLETE YEARS OF OPERATION

	1st	2nd	3rd	4th	5th
Interest on paid-up capital (a)	540	540	480	420	360
Interest differential on loans (b)	75	300	525	750	1,125
Commission and Exchange Earnings (c)	25	100	175	250	375
Total earnings	640	940	1,180	1,420	1,860

(a) From the paid-up capital, allowance has been made for interest-free working funds of £1 million in the first and second years, £2 million, £3 million and £4 million in the third, fourth and fifth years, respectively. Interest has been calculated at 6% p.a. on the balance of the working capital which, in view of the present strength of sterling, seems a reasonable rate at which to expect returns on funds which have to be kept at relatively short periods to ensure liquidity.

(b) Here the figure is shown as a differential between interest earned and interest paid so that no item will appear on the expenditure side on account of interest paid- the differential is reckoned at ¾% p.a. in view of the intention to make loans at ¾% over the six month LIBO rate, with the cost of borrowing funds being reckoned at the six month LIBO rate, although a sharp dealing department could reduce this cost by taking deposits for periods shorter than six months.

(c) It is impossible to quantify exchange and commission earnings at this stage. However, as one of the main functions of the consortium bank will be to issue performance bonds and letters of guarantee for international obligations, the income should be substantial. Similarly the consortium bank will, I hope, be maintaining an active

foreign exchange dealing department. The commission and exchange earnings have been reckoned at only £25,000 in the first year rising up to £375,000 in the fifth complete year of operations and the latter figure does not seem unduly high when viewed against our London Office's commission and exchange figure of about £450,000 during 1976.

14. EXPENDITURE

(£ sterling 000's omitted)

COMPLETE YEARS OF OPERATION

		1st	2nd	3rd	4th	5th
Rent	(a)	100	110	120	130	140
Miscellaneous Expenditure	(b)	100	120	140	160	180
Salaries :-	(c)					
Managing Director		21(1)	22(1)	24(1)	26(1)	28(1)
Senior Staff		40(4)	44(4)	60(5)	78(6)	98(7)
Medium-level Staff		30(5)	49(7)	72(9)	88(11)	117(13)
Junior Staff		45(15)	72(18)	90(20)	110(22)	132(24)
		136(25)	187(30)	246(35)	302(40)	375(45)
Ancillary Staff Costs	(d)	27	37	53	60	70
Total Expenses		363	454	559	652	765

(a) Rent has been calculated on the basis of £10 per square foot for 6,000 square feet on upper floor premises in the City of London - this space should meet requirements for five years including future expansion when the staff is expected to go up to 45. The balance £40,000 provided under "Rent" is for rates and service charges, which would increase over the five-year period, although rent would remain static as most leases are for five years. Hence, escalation for rates and service charges is provided between the first and fifth years.

(b) Miscellaneous expenditure will cover heating, lighting, postages, telegrams, telephones, telex, law charges, repairs, travelling and entertainment expenditure. The figure provided is identical to the amount expended by our London Office in 1976, its thirtieth year of operation. As a bank of this nature would have high expenses in respect of telegrams, telex, telephones, travelling and entertainment expenditure, the escalation provided between the first and fifth years is on the generous side.

(c) A bank of this nature does not require a large staff as it will only do wholesale banking; but the highly expert nature of its work does require a highly trained staff and one has to pay high wages in the City of London to obtain such staff. In the figures for staff expenditure projected above the number of staff at each level is shown in brackets against the cost. A staff of 25 is visualised in the first year comprising of 1 Managing Director, 4 Managers of Departments, 5 medium level staff and 15 juniors going up in the fifth year to 45 comprising 1 Managing Director, 7 Managers of Departments, 13 at medium level and 24 juniors. Provision has been made in the figures not only for the increase in the number of staff but also for increases in salaries with increase in years of service and increase in the cost of living.

(d) Ancillary staff costs such as pension fund, social security costs, luncheon vouchers, staff housing etc., have been calculated at 20% of the salary bill and from the experience of our London Office I would say that this is a fair estimate.

15. PROFITABILITY

On the basis of the figures for income and expenditure projected in paragraphs 13 and 14 the profitability of the bank for the first five complete years of operation would be as follows:

Complete years of operation	Profit
1	£ 277,000
2	£ 486,000
3	£ 621,000
4	£ 768,000
5	£1,095,000

These figures would mean that the shareholding banks would receive a pre-tax interest on investment ranging from 2.77% in the first complete year of operations to 10.95% in the fifth complete year of operations. It is possible that the results would be even better if the Bank of England permitted the consortium bank to borrow more than 15 times its paid-up capital.

16. PRELIMINARY EXPENSES

It is difficult to quantify detailed preliminary expenses at this point, particularly as they are not an important consideration in view of the large paid-up capital of £ 10 million contemplated for the consortium bank. However, working on a rough rule-of-thumb basis, repairs, renovations, painting and fitting-up of premises should cost £15/16 per square foot making about £100,000; furniture and equipment should cost a further £100,000 making a total of £200,000 in respect of preliminary expenses, although a lot would depend on the condition of the premises, the standard of decorating and furnishings required, etc., and the accounting systems to tb be used.

17. SUMMING UP

I summarise below the main points of this note:-

a) Despite the strides forward made by the foreign branches of Indian banks they are unable to finance the medium-term foreign exchange requirements of Indian projects firstly because of the essentially

short-term nature of their deposits and secondly because they do not have the banking strength or size to be able to raise large medium-term loans.

b) A consortium bank, having Indian and large foreign banks as shareholders, would be able, by virtue of the strength and size of its foreign partners, to raise funds in the Euro-currency markets and lend them on a medium-term basis to Indian projects, industrial or otherwise.

c) The consortium bank would have a pool of ready funds for any viable medium-term project in India - at present no such pool exists and projects are never assured that loans would be available when required.

d) The medium-term funds provided by the consortium bank to Indian projects would be <u>cheaper</u> than the best rate available at present - a rate of ¾% over the 6 months LIBO rate visualised. As a result of the cheaper rates charged to India by the consortium bank there would be a reduction in interest rates over the whole spectrum of India's borrowing.

e) The Government of India, through the shareholdings of the Indian banks would receive 50% of all dividends paid by the consortium bank, so that in effect a part of the interest which Indian borrowers would pay to the consortium bank would come back to India as her share of the profits of the consortium bank.

f) The Indian shareholders of the consortium would get the benefits of both business contacts and expertise through being associated with the world's largest banks.

g) As far as the foreign shareholders of the consortium are concerned they see long-term advantages in particular in Indian economic development with India's potential consumer and capital markets of several hundred million people. They also see a consortium bank as a development where they can have a certain measure of control with 50% of the equity and regard the bank as a safe and profitable project which would give them an interest in Indian economic development. It would also provide the foreign shareholders in the short-term with a reasonable return on capital and also an opportunity to use their surplus funds.

h) As access to the Euro-currency markets is the major aspect, London is unquestionably the most profitable centre for location of a consortium bank.

i) I would envisage that the bank should have a paid-up capital of £10 million - £1 million subscribed by each of the Indian banks and £ 1 million subscribed by each of the foreign banks. To give the widest geographical spread and financial strength, the five foreign banks should, in my view, come from the five leading industrial countries of the Western world, the U.S.A., the U.K., Western Germany, France and Japan. Each of the banks would be amongst the world's largest banks.

j) The Indian banks would have the capital resources to form a consortium on their own but, without the foreign partners, would not have the financial strength to raise short-term funds in the Euro-currency markets and to roll them over for medium-term lending to Indian projects.

k) The consortium bank would not do any short-term business that would cut across the business of the Indian or foreign partners of the consortium.

l) The consortium bank would accept large deposits for fixed periods (say U.S. $100,000 and over for periods of six months amd over) and would also maintain current accounts for its borrowing customers.

m) However, the major portion of the consortium bank's resources would come from borrowing in Euro-currency markets - at present the Bank of England permits borrowing up to 15 times the paid-up capital and there have been instances where in the first five years they have permitted borrowing up to 20/22 times the paid-up capital.

n) All the funds borrowed would be lent out to Indian projects for medium-terms after taking account of working funds and funds required for credit control and liquidity purposes.

o) In return for permission to borrow the Bank of England would insist on a guarantee from the partners of the consortium that each one of the partners would be responsible for all borrowings of the consortium.

p) From the viewpoint of staff and establishment costs the consortium bank would have the advantage that it would be able to work with a small highly trained staff and would require limited space.

q) A detailed working of income expenditure and profitability has been worked out in the report on the basis of our Bank's experience in London over the last few years and the figures of expenditure have been on the basis of the first half of 1977 from which it will be seen that the ~~consortium from which it will be seen that the~~ consortium bank would make a profit of £277,000 in its first complete year of operation going up to £1,095,000 in its fifth complete year of operations. At the latter level all partners of the consortium would get a pre-tax profit on capital invested of 10.95% which, in terms of international finance, is today a very good rate.

r) As the consortium develops after five years of operation, the return of 10.95% would considerably improve.

s) As the paid-up capital is a large one of £10 million, preliminary expenses are not a major consideration although I reckon it would cost £200,000 to set up the bank - £ 100,000 by way of renovation and fitting-up of premises and £100,000 by way of furniture, fixtures and equipment.

18. CONCLUSION

With foreign exchange resources at a very high level and India operating from a position of strength in international financial and currency markets I am convinced that the time is right for setting up a consortium bank on lines detailed in this report. Detailed features of the proposal would of course, be a matter for discussion between the various parties involved.

Bank of India

ANNEXURE II.

Background Note on Consortium Banking

At the meeting of bankers convened on August 20, 1977 at the Reserve Bank, it was decided to set up a small working group to consider in depth the question of forming a consortium of Indian and foreign banks. Although no specific terms of reference have been given to this Group the objective is that the Group should study the concept of multi bank consortia, their organisational patterns such as ownership structure, objectives and typical activities, and their long term viability to determine whether time was right for Indian banks to enter the arena of consortia banking; in short, to assess what advantages a consortium of banks would offer which Indian banks by themselves could not develop. The purpose of this Note is not to provide a case for or against consortium banking; it will be the task of the Group to take a hard look at the facts, figures and issues involved in this type of activity and then come to its own evaluation and conclusion. The main purpose of this Note is to present background material on the evolution and growth of consortium banks and the role they have hitherto played in the international sphere.

According to the Bank of England a consortium bank is a bank "which is owned by other banks but in which no one bank has more than 50 per cent ownership and in which at least one shareholder is an overseas bank".* Currently, about 30 London-based banks fall into this category (see Table 1.1) but the growth rate in terms of numbers in the recent years has decelerated. The period 1968-1972 was the heyday for consortium banks. At end-1973, they numbered 24, but thereafter new additions have been few and far between. The definition, too, is only operationally meaningful - for it would appear that a disparate group of financial institutions have been clubbed under the consortium umbrella for reasons of statistical convenience. The inadequacy of the term consortium banks becomes much more apparent when one considers the size, function and management objectives.

Consortium banks, as they exist today in the principal centres, cover a broad spectrum of banking types vastly different from each other. To begin with, there are substantial differences in ownership pattern and capital structure. The European Banking Company, for example, has seven shareholders each with 14.3 per cent holdings whereas the Euro-Latin American Bank (Eulabank), established in

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* This definition applies to consortium banks headquartered in London. Source : The Banker,

1974, has as many as 19 shareholders with shareholding interest varying from 6 per cent to barely 1 per cent and with 5 per cent of the balance of the share capital at present unallocated. In Midland and International Bank, two British banks control nearly two-thirds of equity interest with a Canadian bank and an Australian bank holding respectively 26 per cent and 10 per cent. There are others like the Manufacturers Hanover where the controlling interest, as high as 75 per cent, lies with the US bank, the British, Italian and Japanese banks enjoying only a minority participation.

The financial resources of consortium banks, too, vary widely. At the upper end of the ladder is the giant Orion Bank commanding assets in the neighbourhood of £ 1 billion, with the Midland and International Bank - the first consortium bank set up in 1964 - ranking second with total assets of £ 896 million. In contrast, there are the regional consortium banks like the Intermex, with a capital structure of £ 165 million, Iran Overseas Investment Bank (£ 113 million) and Libra (£ 274 million). Clearly, these are much smaller entities meant to serve regional needs and hardly comparable in stature to the MAIBL and Orion or the Banque Europeene

de Credit and International Commercial Bank. Although all bear the label of consortium banks and most of them are children of the Euromarkets; disregarding even the substantial differences which exist in ownership pattern and capital structures, the main essence of difference lies in their typical activities.

The late 1960s and early 1970s was the peak period for consortium bank creation, when the Eurocurrency market was in its most dynamic period of expansion. Consortium banks sought a wide array of combinations to gain tactical and strategic advantages. Small banks with business acumen sought to combine with large banks with lending power, regional banks sought associations with international banks and North American banks sought transatlantic partnership with European banks, while merchant banks sought associations with clearing banks.

Many a consortium bank was set up with a particular objective in view, but the tempo of developments often drove it to grow in an adjacent but somewhat different direction. In many cases the business objectives of a new consortium bank were specifically left vague by the founding shareholders, leaving it to the management

of the bank to evolve its own distinctive strategy. Even where particular objectives were specified, eventual evolution of activities turned out to be very different from the pattern originally envisaged by its shareholders.

Despite the enormous diversity which exists within the consortium banks community, it is possible to identify four clear cut areas of activity. First and foremost are those consortium banks devoted primarily to medium-term lending in the Eurocurrency market. The largest and oldest of consortium banks, such as MAIBL, Bank Europeene de Credit and International Commercial Bank belong to this category. These banks were initially conceived as specialist institutions designed to cope with the considerable demand for medium-term Eurocurrency credit that was being generated by multinational corporations, Governments and other international borrowers during the sixties and early seventies. Such consortium banks provide a degree of gearing to their shareholders' lending capabilities. Through the syndication principle, they offer their shareholders an opportunity to earn a higher return on international operations than they would on

domestic activity. Equally, they provide a specialist service in the generation and processing of medium-term loans and are generally able to monitor international medium-term situations more efficiently than a regular commercial bank. As a whole, banks in this category have achieved considerable status in the international banking community in terms of both total assets and profitability.

The second category of consortium banks is the multi-purpose institution which sets out to fulfil a broad range of international banking activities which include medium-term Eurocurrency lending but also encompass activities associated with international merchant and investment banks. Such institutions compete with traditional merchant banks. They also provide specialised financial services in the capital market field and also in other areas such as international mergers and acquisitions, project financing, corporate financial advice, etc. In these respects, the consortium banks are better placed <u>vis-a-vis</u> their competitors viz., merchant and commercial banks. Although the traditional merchant banking and investment houses have years of experience and traditions behind them, they are increasingly deficient in financial

resources, distribution capabilities and geographic representation. Commercial banks, on the other hand, have established networks of branches capable of reaching end-investors, benefit from more substantial financial resources and are able to sustain international representation through branches or other offices. The consortium bank venture, which is able to successfully exploit the combination of its shareholders' financial and geographic resources and the expertise in terms of management traditionally associated with merchant banks and investment houses produces a winning combination.

The third category of consortium banks is based on essentially geographic considerations, regional motivation being the driving force behind their creation. Certain markets with considerable potential cannot be successfully exploited except through a consortia approach. In many cases, local regulations and economic factors preclude market penetration on an economically viable basis, except through a form of international partnership. Take the illustration of the US. It is a highly competitive market, in which although European and

Japanese banks have managed to make a perceptible dent, it is generally recognised that consortium banks like the European American Banking Corporation and its affiliate European American Banking Trust, have made the most significant penetration of the American commercial banking market in the last couple of years. Such a consortium bank either acquires a major retail banking network or represents the interest of a number of international commercial banks in an area where local overheads often exceed local profitability potential for a period of years. A further permutation of the regional concept in consortium banking seeks to combine the medium-term lending capabilities of a group of banks with respect to a particular geographic area. The Libra Bank falls under this species. In this respect, risk sharing is confined not only to purely financial exposure but also extended to political, physical and other intangible risks, associated with banking activities in the developing world. Intermex and Eurobraz concentrating on Mexico and Brazil, Libra serving Latin America, UBAF and the United Bank of Kuwait in the Middle East are all illustrations of the regional motivation.

The fourth category of consortium banks represent a form of vertical integration. A number of countries, which rely heavily on international finance for their development, have realised that their own financial institutions should be more heavily involved in the international financial community which supplies the major proportion of their external investment. Client nations of the international money and capital markets are not only interested in recapturing a portion of the profit they provide to international banks but also seek to educate their own institutions in international banking methods, in order to better negotiate with the international market. Countries such as Brazil, Mexico, Iran and Saudi Arabia representing both major borrowers and major lenders on the international capital market have promoted, either through government-controlled domestic banks or private sector banks, the creation of consortium banks primarily in London, designed to specialise in financial operations focussed on their own requirements.

A broad classification of the 35 consortium banks operating in London at the beginning of 1977 shows that asset-wise only 5 of these had assets below £ 100 million while as many as 17 banks were in the asset-range of £ 100 to £ 400 million. At the other extreme, total assets of only two banks exceeded £ 800 million (Table 1 : 2).

Ownership-wise, total number of shareholders of these 35 banks aggregated 217. A little under half the number of shareholders enjoyed equity interest in the range of 5 to 20 per cent of the shareholding. While 30 banks had a minority interest of less than 5 per cent, barely 5 enjoyed a controlling interest of over 50 per cent or more. This clearly reveals that in consortia arrangements while any single bank may find it difficult to gain a controlling interest, a group of banks belonging to the same country could have a controlling voice in the enterprise, e.g., Associated Japanese Bank (International) operating in London has four equal shareholders, all Japanese.

Classification of the same 35 banks by type of activity indicates that 12 were principally regional oriented whereas 13 figured in short and medium-term Eurocurrency

business and international investment management. Consortium merchant banks operating in London numbered 8 and specialised banks were two - one in the field of energy and the other in agriculture. However, the dividing line between a merchant consortium bank and one engaged in Eurocurrency business is very thin. As one banker puts it: scratch a consortium bank and you will find a potential merchant bank not far below the surface.

Over the years, the working of consortium banks have indicated some problem areas. These relate to the likely conflicts of interest between shareholders and their consortium ventures. In most industrial and commercial fields, a fairly clear line separating the business objectives of the joint venture from those of the parent institution is drawn. In the case of consortium bank venture, however, an overlap exists between the parent and its offspring as the consortium banks are deliberately left with vague business objectives to impart the needed flexibility. This has often posed operational difficulties. Pleading that in international financial affairs

the dividing line between competition and collaboration is virtually invisible, conflicts of interest between consortium banks and their shareholders is stated to be confined to administrative difficulties for the middle management ranks. Decision-making management, responsible for the creation of consortium banks are, however, not terribly disturbed by this problem.

The most crucial question concerning the working of consortium banks centres around the capital structure of the consortium and the shareholders' interest and obligations in the enterprise. This problem surfaced particularly in the period of currency uncertainty in 1973-74 when anxieties were expressed as to whether the consortium operations were strong enough to ride out of the financial storm, and if not, would their shareholder banks be prepared to bale them out.

The banking crisis of 1973-74 proved that the consortium banks were able to survive the storm but with considerable difficulty. During those years, difficult conditions in the Eurocurrency markets, including low margins and rising interest rates against a background of consider-able uncertainty, brought reduced profits to a number of

consoritum groups (for the first time) and in some cases there was a marked cutback in activity but the banks survived. However, the rough experience of 1973-74 did raise questions in the minds of many, about the long-term viability of the consortium bank concept and shareholders in a number of countries began to think hard about the whole idea. This was particularly noticeable in the American and Japanese attitudes which turned somewhat cold to the idea. American bankers have, it would appear, never shared the European enthusiasm for working together in a consortia. It is for this reason that US banks as a whole are poorly represented in the Arab consortia.

In addition, it was necessary to take steps to reassure the soundness of the consortium banks which the American banks were obviously not willing to underwrite. They prefer to run their own show and are not over-zealously keen to become involved with a long list of shareholders, whose many and varied interests have to be satisfied in a joint venture. Apart from differences in temperament and management style, the American attitude to

consortium ventures has hardened perceptibly in very recent years. Mainly it is a question of profitability. American banks are under considerable pressure from the investment community to demonstrate solid earnings. For instance, a few US banks which had invested in the sterling capital market of London consortium banks, may have to write off part of their investment following the 1975-76 slide in sterling. Apart from reduced profitability of the investment, they have become aware in the past few years, that their involvement in a consortium bank can sometimes entail them in assuming more than their share of the risk if a consortium bank runs into trouble. Their not-all-too-happy-experience in the past has prompted the US regulatory authorities, unlike the British and European banks, to insist that US banks seek official permission before making an overseas investment.

In considering the application, the Fed takes into account the possibility that the joint venture might need additional financial support and that this support could be larger than the bank's original equity investment. The applicant's ability to meet any additional demands put upon it, in the form of extra financial managerial support, also comes under scrutiny.

Although it is difficult to pull out of a consortium bank, there have been few cases of US banks pulling out of joint ventures overseas. Morgan Guaranty is reported to have disposed off its 51 per cent stake in its Italian affiliate and the Bank of America to have sold off all but 5 per cent of its stake in Rabomerica International Bank. The number of banks interested in joining the existing consortia also have decreased. What is more, small banks have found that they could participate as effectively in the Eurocurrency markets through their London branches, while the larger banks were unwilling to allow their consortium partners to cream off the lucrative international business. Against this background, the lukewarm attitude of the US banks to the consortium approach is understandable.

The same appears to be the case with Japan. The flood of Japanese banks seeking to join the international consortium banking community has receded to a trickle after the 1973-74 currency debacle. In fact, to dissuade the Japanese banks from looking

for overseas partners, the Ministry applied brakes, in that, it decided, in principle, not to approve any proposals by Japanese banks to acquire a controlling stake in overseas joint-bank ventures. Even among the pending application plans, it took the line of screening applications for acquisition of stakes of less than 50 per cent more closely. Further, all Japanese banks were instructed to submit detailed reports on the working of their joint ventures. The controls stemmed from Tokyo Bank's involvement in a Brazilian investment bank failure, in which the Japanese Bank had a 30 per cent stake. One of the main concerns of the Japanese Finance Ministry was that consortium banks relied heavily on short-term external borrowings to fund long-term lending commitments. Experience indicated that Japanese banks with minority stakes in consortium banks was not always a happy one. It is also reported that Japanese banks have often found it difficult to abandon their unique Japanese operating practices in favour of alien methods imposed by their partners. Anticipating friction, as also to simplify surveillance, the Ministry has encouraged banks to join forces by setting up their own joint ventures modelled

on the Associated Japanese Bank (International) Ltd.; in which four Japanese banks in equal proportion hold the entire equity. Among the more notable recent Japanese joint banking ventures is the Nippon European Bank set up in Brussels with four European banks owning 40 per cent and Mitsui Bank the remainder. The other is a 50 : 50 joint venture, also located in Brussels, capital being shared between Mitsubishi Trust and Banking Corporation and Schroders.

Against this backdrop of developments in consortia banking over the last decade, what is the present scenario for the creation of new consortium banks ? Available literature suggests that change in ownership of several of the existing consortium banks is on the cards and the upshot of this is a reappraisal of the role of the consortium banks by its shareholders. The most obvious examples of this reassessment are the London Multinational Bank and Canadian American Bank. Both these banks have left the consortium fold. Likewise, consortium banks have had one or more of their shareholders change in the last year. This, however, is not to suggest

that all such ventures have run into difficulties and there are drop outs everywhere. In fact, some of them have achieved spectacular success particularly the regional variety. Others have broadened their shareholdings by adding new partners, e.g., Eulabank, the consortium bank that caters for Latin America, took on Chile as a shareholder. The Nordic Bank enlarged its capital by accepting Copenhagen Handelsbank of Denmark as its fourth equal footing shareholder.

Another noticeable trend has been for the merchant banks to pull out of consortium banks. At a time when merchant banks were fighting for overseas business and the decline in sterling had eroded the capital base, their first call on capital was the home balance sheet. For this reason, some of the British merchant banks sold out their shares and made an exit from the consortium bank scene. As a result of this, London Multinational Bank has become a wholly owned subsidiary of Chemical Bank.

Yet another interesting development worth noting took place at Intermex. It not only decided to increase its capital but also to set up a holding company in Luxembourg to hold both Intermex London and a newly formed consortium bank,

Intermex International Bank, Nassau. Similar moves on the part of some other banks is also on the cards. The move to shift the headquarter location from the financial hub of London to places like Luxembourg and Nassau and merely opening offices in London is apparently dictated by tax-haven considerations. The outlook for new consortium banks, particularly of the merchant banking variety, to be set up in London is somewhat dim.

Changes in shareholders and capital funds were not the only signals indicating that consortium banks were suffering from a crisis of identity. A number of bankers appear to be chary of the 'consortium' tag and are at pains to re-christen their ventures as pure and simple 'International Merchant Banks'. The label 'Consortium Banks' has been tarnished by the happenings at the Italian International Bank and the Western American Bank. The deepest soul searching has no doubt occurred among international merchant bank consortia.

Even among the bigger and better-known and managed consortium banks, a radical

shift in the type of business handled is under way. To illustrate, United International Bank has moved out of medium-term lending and is concentrating on expanding its short-term commercial business and fee generating activities. It handles interbank money deals and specialises in Eurobond market and investment management with plans to handle OPEC investment business in a big way. Orion, on the other hand, is flexing its muscles by strengthening its corporate finance activities in the area of public issues, private placements and syndicate loans. Libra Bank is keen to forge ahead and has set up a department to handle corporate finance and has a team of bankers working in close association with exporters around the world, interested in tapping the Latin American market. Another area of operation that has attracted several banks is the business of leasing. International Commercial Bank and Nordic Bank are making thrusts in that direction.

Recent developments, therefore, are a pointer that the concept of consortium banking is by no means outworn. However, for this kind of an animal to remain in business, it must stay ahead of the market and be swift and nimble in its decision making. It is a game where what you

gain on the swings, you may loose on the roundabout, so flexibility, feel of the market and of things to come, is a must to be able to survive. Although such an enterprise needs a complex bureaucracy, it must not result in too many masters trying to pull the strings and pipe different tunes. This means that the relationship between the shareholders and the management becomes very crucial and discordant notes in this relationship could affect its smooth working. This is a sensitive area, and human material being what it is, the strength or weakness of this relationship will differ from bank to bank.

Against this overview of the developments in consortium banking the question may be asked - what are the advantages that emanate from the creation of a multination consortium bank ? The well-known advantages seem to be that for any bank, spearheading a consortium bank, it would facilitate the deployment of the country's surplus funds into medium-term lending. Secondly, it would provide the needed financial muscle for financing large and prestigious projects in its own territory and in

third countries. In turn, it could be an avenue for obtaining foreign currency loans at competitive rates. And, finally, participating banks would benefit from contracts and expertise of their collaborating partners. The object of this clearly is to make use of expertise in assessing the potential and risks of the markets in a chosen area, thereby giving the parent bank the opportunity of investment, which it might not have the size or resources to undertake alone.

These plus points have, however, to be weighed against the possible headaches and problems the commitment to such an idea might pose. The historical evolution of the concept and working of consortium banks reveals a perceptible slackening in the number of new ventures. As may be seen from the Table, an overwhelming proportion of consortium banks operating in London were born in the sixties to take advantage of the Eurocurrency loans business. Subsequently, a very few have been launched and those few have concentrated their activities in exploiting the petro-dollar rich Middle East, which region has been both a generator of surplus funds and - often in different parts of the area - a hungry user of loans. The scope for

large scale dealings in Eurocurrency markets is now rather less and any new bank venturing to establish itself will have to face keen competition, both in raising adequate resources and disbursing them to credit-worthy borrowers. Many of the financially well-known banks are already in this enterprise and in London financial circles, it is widely debated whether bigger banks will remain committed to the idea. And even if they do remain committed they will go off the beaten track into new lines of activity.

This leads us to the question of the rationale for the creation of a consortium bank. First is the regional motivation - a consortium bank serving the development needs of a specific area. These banks operate in a more specialised context - concentrating their activities in a specific region like Latin America and the Middle East. Another rare type of specialisation is according to the industrial character of the investment outlet - the International Energy Bank, which concentrates on the North Sea and other oil developments. The third is the merchant banking variety designed to get a share of the Eurocurrency business. Fourth is to derive economies of scale through joint operations as also to diversify risk.

The pertinent questions that need to be posed and answered are :

(1) In the context of the present uncertain international currency situation and wide fluctuations in foreign currency rates as also some measure of disenchantment, is it advisable for any LDC surplus country to toy with the idea of setting up a multi bank consoritum ?

(2) Would a consortium arrangement offer additional advantages which they could not develop by themselves ?

(3) What is the minimum capital base that would be needed to make the undertaking a viable proposition in the long run ? Is it worth venturing out on such an enterprise from a relatively small base ? In which case, would it entice other creditworthy foreign banks to come in ?

(4) To raise Euro-dollar loan, is it absolutely necessary to adopt a consortium approach ? Could not the formation of a syndicate of domestic banks achieve the same purpose ?

(5) What type of consortia would be aimed at ? Regional, merchant bank or other ?

(6) Where would it be located ? If London is chosen, the Bank of England Rules require that the parent bank and ultimately the central bank of the sponsoring country has to ensure solvency. For a less developed country this implies blocking up of much needed foreign exchange reserves without adequate returns.

(7) From the developing country's point of view, would it be more appropriate to deploy its surplus reserves in obtaining much needed planned imports of capital and wage goods or to utilise reserves in risky financial investment abroad ?

(8) At this juncture would foreign banks be interested in minority participation in a developing country ? Under existing laws, Japanese banks clearly would not be interested in such a deal.

The banking crises of 1973-74 revealed the considerable strain on consortium banks. These banks could survive because their individual resources were indeed large by all standards. Even so, they suffered reduced profitability and some incurred heavy losses. In these circumstances, newcomers have to be wary not to rush in where angels fear to tread, just to be on the consortium map.

At the same time by merely defaulting to think dispassionately about the idea and discarding it as impracticable, a developing country should not close the routes to its own development. At this juncture of the game, when shareholders of some consortium banks are parting company with their collaborators and others are waiting to pour in more funds, the question is : whether time is ripe for a developing country like India to gain membership on the consortium map or still wait at the crossroads without throwing its lot into a consortium pool ?

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Annexure III

Note on the proposed consortium of Indian banks for undertaking foreign exchange business outside India

There is a strong case for establishing a new bank as consortium of the major Indian banks for transacting foreign exchange business outside India. The reasons in favour of this proposal are :

(i) No Indian bank, including State Bank of India has a capital structure or capital and reserves in relation to its total liabilities, which is acceptable by international standards and the new institution, which will have no local liabilities in India or only negligible liabilities will be able to adhere to a debt-equity ratio in conformity with the requirements, which may be necessary for an institution aspiring to handle a substantial share of international business. (Indian banks individually cannot reach this standard and in their cases, the position is likely on the other hand to deteriorate every year).

(ii) The assumption that medium-term lending is the major unsatisfied need, for which a new institution is to be floated is unrealistic and unnecessary; an international bank can have a substantial turn-over of business, by undertaking all the other functions, which merchant banking houses, as distinguished from clearing banks in London or the Indian banks at home, are able to undertake, for example, providing financial advice, managing investment portfolios, arranging for Euro-credit, floating Euro-bonds, factoring leasing, hire-purchase finance and other related business. (Merchant banking internationally is highly profitable and Indian banks individually are not organised or equipped to undertake these functions).

(iii) The assumption that a consortium of Indian banks should be floated only for meeting the requirements of Indian industry and business is also untenable; there is considerable scope for lending in several parts of the world; to illustrate, in the Arab world, Indonesia and the Far East and by getting a share of this, India's foreign exchange earnings from invisible exports can be greatly augmented.

(iv) The new consortium bank need not incur any heavy risks, as a result of its lending operations, if it is able to get the benefit of the guarantee cover from the Inter Arab Investment Guarantee Corporation (IAIGC) and other similar organisations cover in respect of deferred payments from Government and quasi-Government organisations which now provide this facility to the exporters in a number of countries and any other cover which may be available.

(v) An Indian consortium is ideally suited to be an intermediary for handling the growing east-west trade between the communist countries and Europe and the U.S.A. because of India's contracts with the Communist countries and with offices in Moscow and Frankfurt, the new organisation may be in a position to handle and develop this business.

(vi) India is promoting a number of joint ventures abroad and the new consortium will be one of the natural lenders in collaboration with the banks of the countries concerned to all these enterprises.

(vii) International business is being handled more and more on the basis of ad hoc arrangements for consortium lending or by floating jointly-owned subsidiaries, with a view to sharing the risks and it will be easier for an Indian consortium to attract the ranking commercial banks of the world to collaborate with it, if it has the backing of several Indian banks, which will be sharing as members of the consortium, the residual risks, as allocated to it.

2. Apart from the reasons mentioned above, the following considerations will also have to be borne in mind :

(i) With the passage of time, it will be more and not less difficult for an Indian Consortium to get established internationally and there are therefore no advantages in postponing a decision.

(ii) Unlike other banks, belonging to other countries, the new Consortium may be able to get the benefit of the use of the foreign balances of the Reserve Bank of India to some extent for the time being, as the recent amendments to the Reserve Bank of India Act enable the Reserve Bank to maintain deposit accounts directly with the Indian Banks abroad.

(iii) The new Consortium, if it establishes offices in London, Paris, Frankfurt, New York, Singapore and Hong Kong will be in a position to act as an adviser to The Reserve Bank and also as its agent for handling the investment of the Reserve Bank's foreign balances, without passing the money through Consortium's own account.

(iv) In due course, after the new consortium is fully established, it may be able to borrow Euro-currencies in the form of deposits on its own credit-rating from the Bank for International Settlements, which has emerged in the last few years as the lender of the last resort in the Euro-markets and a liquidity problem may not therefore arise and the affairs of the new consortium are well managed.

3. Indian banks suffer certain inherent limitations in handling international business. Apart from the inadequacy of their capital base as mentioned at the beginning of this note, the lack of properly-trained staff, the low productivity of labour, absence of any computerisation (which will be unavoidable for handling any global business), excessive regulation of their lending and other business as a result of controls and the low priority, which is necessarily accorded to foreign business, by banks which are required to handle several other problems are bound to inhibit the growth of foreign business if it is handled individually by the banks as at present. It is not suggested that Indian banks should not try individually to increase their foreign business. But there will be a great deal of scope for additional business to be handled by a new institution, if it is promoted by all of them together and if it is ensured that it does not suffer from these limitations.

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Appendix

Table I : 1 CONSORTIUM BANKS OPERATING IN LONDON IN EARLY 1977

NAME	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
1) Al Saudi Banque +∠*	1977	3	-	1) Saudi Arab Finance Corpn.	75.0	Luxembourg
				2) Arab Finance Corpn. (Int) SA(Lux))		Luxembourg
				3) Banque de l'Union Europeene (Paris))		France
				4) Manufacturers Hanover International Finance Corpn.)	25.0	U.S.A.
2) Allied Arab Bank ∠*	1977	n. a.	-	1) Barclays Bank International	20.0	U.K.
						Luxembourg
				2) Al-Mubarakah Finance Holding Co.)		
				3) Altajir Bank)		Cayman Islands
				4) Alhamdoulilah Finance Foundation SA)	n. a.	Luxembourg
				5) Sanctuary Investments Ltd.)		Jersey
3) Allied Bank International@	1969	30		1) American Fletcher National Bank & Trust Co.	5.55	U.S.A.
				2) American Security & Trust Co.	5.55	U.S.A.
				3) Bank of the Southwest	5.55	U.S.A.
				4) Equibank	5.55	U.S.A.
				5) Fidelity Union Trust Co.	5.55	U.S.A.
				6) First Hawaiian Bank	5.55	U.S.A.
				7) First National Bank of Fort Worth	5.55	U.S.A.
				8) First National Bank of Memphis	5.55	U.S.A.
				9) First National Bank in St. Louis	5.55	U.S.A.
				10) First National Bank of St. Paul	5.55	U.S.A.
				11) Hartford National Bank & Trust Co. Ltd.	5.55	U.S.A.
				12) Liberty National Bank & Trust Co. Ltd.	5.55	U.S.A.
				13) Michigan National Bank	5.55	U.S.A.
				14) Trust Company Bank	5.55	U.S.A.
				15) United Bank of Denver	5.55	U.S.A.
				16) U.S. National Bank of Oregon	5.55	U.S.A.
				17) Valley National Bank of Arizona	5.55	U.S.A.
				18) Virginia National Bank	5.55	U.S.A.

NAME	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
) Anglo-Romanian Bank Ltd.	1973	14	88.8 (31.12.76)	1) Romanian Bank for Foreign Trade	50.0	Romania
				2) Barclays Bank International	30.0	U.K.
				3) Manufacturers Hanover International	20.0	U.S.A.
) Associated Japanese Bank (International) Ltd.*	1970	30	431.4 (28.2.77)	1) Sanwa Bank	25.0	Japan
				2) Mitsui Bank	25.0	Japan
				3) Dai-Ichi Kangyo Bank	25.0	Japan
				4) Nomura Securities Co.	25.0	Japan
) Atlantic International Bank Ltd.*	1969	36	121.9 (30.6.77)	1) Manufacturers National Bank of Detroit	41.6	U.S.A.
				2) Shawmut Bank of Boston	25.0	U.S.A.
				3) Banco di Napoli	16.66	Italy
				4) F Van Lanschot Bankiers	16.66	Netherlands
) Bank of Tokyo & Detroit (International) Ltd.*	1968	43	158.9 (31.12.77)	1) Bank of Tokyo	51.0	Japan
				2) National Bank of Detroit	49.0	U.S.A.
) Banque Francaise de Credit International*	1969	50	87.5 (31.3.77)	1) Banque Internationale pour l'Afrique Occidentale	50.0	France
				2) Credit Commercial de France	50.0	France
) Banque de la Societe Financiere Europeene +	1974	3		1) Algemene Bank Nederland	11.1	Netherlands
				2) Banca Nazionale del Lavoro	11.1	Italy
				3) Bank of America	11.1	U.S.A.
				4) Banque Bruxelles Lambert	11.1	Belgium
				5) Banque Nationale de Paris	11.1	France
				6) Barclays Bank International	11.1	U.K.
				7) Dresdner Bank	11.1	Germany
				8) Sumitomo Bank	11.1	Japan
				9) Union Bank of Switzerland	11.1	Switzerland

Name	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
0) European Banking Co.Ltd.	1973	108	307.5 (30.6.77)	1) Amsterdam-Rotterdam Bank	14.2	Netherlands
				2) Banka Commerciale Italiana	14.2	Italy
				3) Creditanstalt - Bankverein	14.2	Austria
				4) Deutsche Bank	14.2	Germany
				5) Midland Bank	14.2	U.K.
				6) Societe Generale de Banque	14.2	Belgium
				7) Societe Generale	14.2	France
1) Euro-Latinamerican Bank (Eula Bank)*	1974	26	142.0 (31.3.77)	1) Banca Serfin	6.0	Mexico
				2) Banco do Brasil	6.0	Brazil
				3) Banco de Colombia	6.0	Colombia
				4) Banco de Estado de Chile	6.0	Chile
				5) Banco de la Nacion Argentina	6.0	Argentina
				6) Banco de la Nacion	6.0	Peru
				7) Banco de la Republica Oriental del Uruguay	6.0	Uruguay
				8) Algemene Bank Nederland	5.0	Netherlands
				9) Banco Nazionale del Lavoro	5.0	Italy
				10) Banco Central	5.0	Spain
				11) Banque Bruxelles Lambert	5.0	Belgium
				12) Banque Nationale de Paris	5.0	France
				13) Barclays Bank International	5.0	U.K.
				14) Bayerische Hypothekenund Wechsel-Bank	5.0	Germany
				15) Dresdner Bank	5.0	Germany
				16) Oesterreichische Landerbank	5.0	Austria
				17) Deutsche Sud-Amerikanische Bank	2.0	Germany
				18) Banco Mercantil de Sao Paolo	1.0	Brazil

(The balance of the share capital at present unallocated)

Name	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
) European Arab Bank/*	1976	52	56.0 (31.8.77)	1) EBIC Group	) Shares held	
				2) Fuji Bank	) through Luxembourg	
				3) Industrial Bank of Japan	) holding company.	
					) European Arab	
				4) Arab Banks	) Holding S.A.	

Name	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
3) European Brazilian Bank Ltd.	1972	45	323.6 (30.6.77)	1) Banco do Brasil	31.9	Brazil
				2) Bank of America Group	31.9	U.S.A.
				3) Deutsche Bank	13.65	Germany
				4) Union Bank of Switzerland	13.65	Switzerland
				5) Dai-Ichi Kangyo Bank	8.9	Japan
4) First Boston (Europe) Ltd. ∠*	1973	50		1) The First Boston Corporation	66.66	U.S.A.
				2) Mellon Bank	33.33	U.S.A.
5) International Commercial Bank *	1967	44	505.0 (31.12.76)	1) Hongkong & Shanghai Banking Corporation	22.0	Hongkong
				2) Irving Trust Co.	22.0	U.S.A.
				3) First National Bank of Chicago	22.0	U.S.A.
				4) Commerzbank	12.0	Germany
				5) Credit Lyonnais	11.0	France
				6) Banco di Roma	11.0	Italy
) International Energy Bank Ltd. *	1973	35		1) Canadian Imperial Bank of Commerce	20.0	Canada
				2) Republic National Bank of Dallas	20.0	U.S.A.
				3) Societe Fianciere Europeene	20.0	France
				4) Bank of Scotland	15.0	U.K.
				5) Barclays Bank International	15.0	U.K.
				6) Banque Worms	10.0	France
) International Mexican Bank*	1974	42	166.7 (30.6.77)	1) Banco Nacional de Mexico	36.25	Mexico
				2) Bank of America NT & SA	27.5	U.S.A.
				3) Deutsche Bank	14.5	Germany
				4) Union Bank of Switzerland	14.5	Switzerland
				5) Dai-Ichi Kangyo Bank	7.25	Japan
) International Resources & Finance Bank SA ∠ *	1977	45	21.0 (31.8.77)	1) Bank of Montreal	30.0	Canada
				2) Arab-African Bank	10.0	Egypt
				3) Other shareholders	n.a.	

Name	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
19) Iran Overseas Investments Bank Ltd. *	1973	24	113.0 (30.9.76)	1) Industrial & Mining Development Bank of Iran	25.0	Iran
				2) Bank Melli Iran	25.0	Iran
				3) Barclays Bank International	6.25	U.K.
				4) Bank of Tokyo	6.25	Japan
				5) Bank of America	6.25	U.S.A.
				6) Deutsche Bank	6.25	Germany
				7) Industrial Bank of Japan	6.25	Japan
				8) Manufacturers Hanover International	6.25	U.S.A.
				9) Midland Bank	6.25	U.K.
				10) Societe Generale	6.25	France
20) Italian International Bank Ltd. *	1972	81	163.0 (30.6.77)	1) Banco di Napoli	25.0	Italy
				2) Banco di Sicilia	25.0	Italy
				3) Instituto Bancario San Paolo di Torino	25.0	Italy
				4) Monte dei Paschi di Siena	25.0	Italy
21) Japan International Bank *	1970	28	379.3 (31.12.76)	1) Fuji Bank	20.0	Japan
				2) Mitsubishi Bank	20.0	Japan
				3) Sumitomo Bank	20.0	Japan
				4) Tokai Bank	20.0	Japan
				5) Daiwa Securities Co.	6.66	Japan
				6) Yamaichi Securities Co.	6.66	Japan
				7) Nikko Securities Co.	6.66	Japan
22) Libra Bank *	1972	73	273.8 (31.12.76)	1) Chase Manhattan Overseas Bkg. Corpn.	23.6	U.S.A.
				2) Royal Bank of Canada	10.6	Canada
				3) Mitsubishi Bank	10.6	Japan
				4) Westdeutsche Landesbank Girozentrale	10.6	Germany
				5) Swiss Bank Corporation (Overseas)	10.6	Switzerland
				6) Banco Itau	8.0	Brazil
				7) Banco de Comercio	8.0	Mexico
				8) Credito Italiano	7.1	Italy
				9) Banco Espirito Santo e Commercial de Lisboa	5.9	Portugal
				10) National Westminster Bank	5.0	U.K.

Name	Established in	Staff	Total Assets £ m (As on	Shareholders	% of capital	Country
23) London Interstate Bank *	1971	23	63.4 (31.3.77)	1) First National Bank of Atlanta	20.0	USA
				2) Indiana National Bank	20.0	USA
				3) Keyser Ullmann	20.0	UK
				4) Maryland National Bank	20.0	USA
				5) Hamburgische Landesbank	20.0	Germany
24) London & Continental Bankers Ltd./*	1973	60	250.3 (31.3.77)	1) Deutsche Genossenschafts-bank	35.0	Germany
				2) Caisse National de	16.95	France
				Credit Agricole	16.95	France
				3) Central Robobank	10.76	Netherlands
				4) Genossenschaftliche Zentralbank	10.19	Austria
				5) Andelsbanken	5.12	Denmark
				6) Banque Federative du credit Mutuel	4.84	France
				7) S.G. Warburg & Co.Ltd.	3.17	UK
				8) Banca Nazionale dell Agricoltura	2.55	Italy
				9) Osuuspankkien KeskuspankkiOy	2.55	Finland
				10) Cera - Centrale Raiffeisenkas	1.78	Belgium
				11) Forenings Bankernas Bank	1.75	Sweden
25) Manufacturers Hanover Ltd./*	1968	107	117.0 (31.12.76)	1) Manufacturers Hanover Trust Co.	75.0	USA
				2) NM Rothschild & Sons	10.0	UK
				3) Riunione Adriatica di Sicurta	10.0	Italy
				4) Long-Term Credit Bank of Japan	5.0	Japan
26) Merrill Lynch International Bank Ltd./*	1972	56	114.0 (31.12.76)	1) Merrill Lynch Group	95.0	USA
				2) Brown Shipley Holdings Ltd.	5.0	UK
27) Midland & International Banks Ltd.* (MAIBL)	1964	99	895.6 (31.3.77)	1) Midland Bank	45.0	UK
				2) Toronto Dominion Bank	26.0	Canada
				3) Standard Chartered Bank	19.0	UK
				4) Commercial Bank of Australia	10.0	Australia

Name	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of capital	Country
28) Nordic Bank Ltd.*	1971	135	410.8 (1.7.77)	1) Copenhagen Handelsbank	25.0	Denmark
				2) Den Norske Creditbank	25.0	Norway
				3) Kansallis-Osake - Pankki	25.0	Finland
				4) Svenska Handelsbanken	25.0	Sweden
29) Orion Bank Ltd.	1970	250	998.0 (31.12.76)	1) National Westminster Bank	20.0	UK
				2) Chase Manhattan Corporation	20.0	USA
				3) Royal Bank of Canada	20.0	Canada
				4) Westdeutsche Landesbank Gironzentrale	20.0	Germany
				5) Credito Italiano Holding SA	10.0	Luxembourg
				6) Mitsubishi Bank	10.0	Japan
30) Saudi International Bank	1975	80	227.6 (31.12.76)	1) Saudi Arabian Monetary Agency	50.0	Saudi Arabia
				2) Morgan Guaranty	20.0	USA
				3) Bank of Tokyo	5.0	Japan
				4) Banque Nationale de Paris	5.0	France
				5) Deutsche Bank	5.0	Germany
				6) National Westminster	5.0	UK
				7) Union Bank of Switzerland	5.0	Switzerland
				8) National Commercial Bank	2.5	Saudi Arabia
				9) Riyad Bank	2.5	
31) Scandinavian Bank Ltd.*	1969	220	730.0 (31.12.76)	1) Skandinaviska Enskilda Banken	34.8	Sweden
				2) Bergen Bank	19.4	Norway
				3) Union Bank of Finland	19.4	Finland
				4) Den Danske Bank	14.5	Denmark
				5) Den Danske Provinsbank	4.8	Denmark
				6) Skanska Banken	3.9	Sweden
				7) Landsbanki Islands	3.2	Iceland
32) UBAF Ltd.*	1972	108	373.1 (31.12.76)	1) Union de Banques Arabes et Francaises	50.0	France
				2) Midland Bank	25.0	UK
				3) Libyan Arab Foreign Bank	25.0	Libya

Name	Established in	Staff	Total Assets £ m (As on)	Shareholders	% of Capital	Country
33) United Bank of Kuwait *	1966	150	364.4 (31.12.76)	1) The National Bank of Kuwait	19.7	Kuwait
				2) Kuwait Investment Co.	18.9	Kuwait
				Commercial Bank of Kuwait	16.7	Kuwait
				4) The Gulf Bank	16.7	Kuwait
				5) Kuwait Foreign Trading Contracting & Investment Co.	16.7	Kuwait
				6) The Alahli Bank of Kuwait	11.3	Kuwait
34) United International Bank *	1970	52	219.5 (30.6.77)	1) Banco de Bilbao	10.0	Spain
				2) Bank Mees & Hope	10.0	Netherlands
				3) Bank of Nova Scotia	10.0	Canada
				4) Banque Francaise du Commerce Exterieur	10.0	France
				5) Bayerische Hypothekenund Wechsel-Bank	10.0	Germany
				6) Credit du Nord et Union Parisienne	10.0	France
				7) Crocker National Bank	10.0	USA
				8) Privatbanken	10.0	Denmark
				9) PK Banken	10.0	Sweden
				10) Williams & Glyn's	10.0	UK
35) World Banking Corpn. +∠*	1969	20	582.00 (31.12.76)	1) Bank of America	-	USA
				2) Toronto Dominion Bank	-	Canada
				3) Banque Bruxelles Lambert	-	Belgium
				4) Banque Nationale de Paris	-	France
				5) Commerzbank	-	Germany
				6) Skandinaviska Enskilda Banken	-	Sweden
				7) F. Van Lanschot Bankiers	-	Netherlands
				8) Dai-Ichi Kangyo Bank	-	Japan
				9) Banco de Santander	-	Spain

\+ Representative Office.
∠* Consortium banks operating in London with headquarters outside London.
@ Branch.
* Member of Association of Consortium Banks.

Table I:2

Assets-wise classification of consortium banks operating in London

(£ m)

Total No. of Banks	100 & less	100 to 200	200 to 300	300 to 400	400 to 500	Over 500	N.A.
35	5	8	4	5	2	5	6

Ownership pattern of consortium banks operating in London

(Classified by % of Capital)

Total No. of Share-holders	5 & less	5 to 10	10 to 20	20 to 25	25 to 50	50 to 75	75 to 100	N.A.
217	30	63	54	31	17	2	3	17

Classification of consortium banks operating in London by main activity

Total No. of Banks	Servicing of specific geographic area	International financing/banking and Eurocurrency business	Merchant banking	Specific business
35	12	13	8	2

N.A. : Not Available.