

## CHAPTER - 1

### EVOLUTIONS OF INTERNATIONAL BANKING

#### INTRODUCTION

Nowadays finance acts as the life blood for an economy specifically for its trade, commerce and industry. The banking sector acts as a backbone of any modern economy. The effectiveness of any economy is well reflected by the banking sector that exists in the economy.

Banks are intermediaries which accept deposits and lend money to the industrial and personal borrower. Bank earns spread which is the difference between deposit interest rate and lending rates. Spread is the recovery of cost and profit. International banking includes all activities and services that facilitate the movement of goods and services and fund from one country to another country.

International banking is the process in which financial institutions render their services to foreign clients. International banking involves the transactions relating to the acceptance of deposits and loans anywhere in a currency other than that of the country in which the bank is located. The global banking system is a network of interconnected nodes each depicting a specific location

The oxford dictionary defines a bank as "an establishment for custody of money which it pays out on customer's order".

Banking is an industry that handles cash, credit, and other financial transactions. Banks provide a safe place to store extra cash and credit. They offer savings accounts, certificates of deposit and checking accounts. Banks use these deposits to make loans. These loans include home mortgages, business loans, and car loans.

Banking is one of the key drivers of the U.S. economy. It provides the liquidity needed for families and businesses to invest for the future

The term banking is derived from the word "banco" means "a bench". The term banking has undergone tremendous change over the years. The traditional and commercial banking activities of accepting deposits and lending has been replaced by the concept of universal banking and now international banking.

### **History of International Banking**

The Old Testament book Ecclesiastes says "**There is nothing new under the sun.**" The last four decades of international expansion by banks controlled from head offices in the economically most powerful countries is merely another chapter in a centuries old story. International banking →hearkens back at least to the second millenarian before the Common Era, when Babylonian temples under the code of Hammurabi safeguarded the idle funds of the population and extended loans to merchants to finance the movement of goods. Likewise during the period of Greek ascendancy in the ancient world (roughly 500 to 300 BC) "banks" regularly advertised interest for deposits and loans, and routinely handled foreign money payments.

Under the Roman Empire a variety of financial instruments were legalized, such as bills of exchange, to promote regional (international) trade. During the Dark Ages, most of such activity disappeared. But with the coming of the Renaissance international banking again emerged as a powerful force on the landscape.

In more recent history the Florentine banking houses of the fourteenth and fifteenth centuries - the Bardi Peruzzi and the Medici Slip streamed in the wake of the growth of international trade in wool cloth and silks and at their perihelion, had branches, subsidiaries and offices throughout Europe. The Bardi and the Peruzzi collapsed as a result of defaults on extensive loans to monarchs such as Edward I and Edward II of England and Robert of Aujon, king of Naples. Malun describes these loans as the first instance of international lending by the forerunners of modern banks to the forerunners of modern governments. Similar fate befell the Medici Bank which had lent four times its capital resources to Edward IV.

During the nineteenth century, British and European bankers lent to the "new world". The economic development of the United States, from the colonial periods throughout the nineteenth century was financed in large part by capital from London and European centers. British merchant banking houses-notably Barings, Hamros, and Rothschild - sponsored, underwrote and held issues of foreign bonds. Many of the foreign bonds issued were acquired in the traditional way by private investors through the London Stock Exchange.

Others were issued "internationally" much like the Eurobonds are placed now a day. Led by British institutions banks in the 19th century, promoted two different types of international lending which are **trade financing**

and **investment banking**. The former, short term commercial lending on the traditional basis of bills of exchange was typically used to finance commodity exports and imports or to deal in foreign exchange. The latter, a pioneering development of the era consisting of the placement of long-term funds of fixed interest securities on an agency or undertaking basis was used more for Infrastructural and industrial investment.

Trade financing was only a relatively small part of the story in the nineteenth century. Far more important was the development of investment banking which accounted for the great bulk of the international lending, where, financial houses acted primarily as agents or underwriters for the placement of long-term debt or equity issues with the broader investing public rather than as lenders on their own account. Risk was borne by the tens of thousands of individual savers who invested in the capital market, rather than directly by the shareholders or partners of bank themselves.

In the 1920s, New York, rapidly supplanted London as the center of global finance, and American banking institutions came to dominate the market for international lending. England and France declined notably as sources of new funds and Germany hamstrung by its my moth reparations burden was transformed into one of the biggest borrowers. The United States found itself in, undated with requests for funds from Europe and elsewhere. In absolute magnitude the sale of foreign investment by Americans during the euphoric Roaring Twenties transcended even the records set by Europeans in the previous century.

World War I changed little in international finance; the elements of continuity were strong. For once, investment banking continued to account

for the bulk of overseas lending, likewise, sovereign loans continued to dominate overall lending tallies.

The international banking system became one of the main victims of the Great Depression after the Second World War. A rash of bank failures, default and violent contractions in international trade and investment shattered confidence in international lending.

An Overview across national borders ground to a halt in the early 1930s and really did not resume until after the Second World War .The machinery of private international finance spent twenty years in cold storage. The establishment of the Bretton Woods monetary system restored confidence in international trade and investment, establishing a new set of rules governing trade, finance and exchange rates that formed the basis of the postwar world economy. With a secure financial framework in place multinational business blossomed and revolutionized economic life by creating a global shopping center.

The practical business requirements of running a global shopping centers eventually led US banks to create history is first global money market. Ultramodern communications and information technology soon bound banks together in a single global financial market. Perhaps the most remarkable development that the financial industry has experienced since the end of the world War II has been the internationalization of banking.

This development was commenced by the major commercial banking institutions located principally in Western Europe and the Western hemisphere. The banks that took the lead and embarked on multinational

banking were individual institutions from such foreign banking oriented countries as Canada, France, Germany, Switzerland, UK & USA and Japan.

Undeterred by geographical barriers, these banks embarked upon the creation of worldwide networks of outlets and became actively engaged in international operations. The international expansion of these banks has brought about the effective linkage of national financial markets and the increasing integration of worldwide banking systems. Despite apparent differences in the patterns of their international expansion these banks have become multinational set of competing financial institutions.

International banking has become one of the dominant features of the international monetary and financial system since the first oil crisis in 1973. The main factors in this development have been

- (a) The unspent oil receipts of the low absorber oil - exporting countries, which were mainly deposited with US and European banks, and
- (b) The increasing financial needs of non-oil Less Developed Countries, which were mainly covered by loans from those banks. On the purely technical side, the development of the market has been greatly facilitated by technological progress in the telecommunications sector.

## **Functions of International Banking**

### **1. Opening Non-resident accounts.**

International banks provides various services to nonresident of the country helps them in making or receiving the remittances from abroad and also keep the deposits in foreign exchange e.g. FCNR. The 3 main types of

account are opened for nonresident are nonresident external (NRE), nonresident ordinary (NRO), and foreign currency nonresident (FCNR).

## **2. Export financing :**

International banking provides easy credit facility to finance the export for the exporters. This pre-shipment finance is termed as **packing credit**. It facilitates them by providing credits at low rates or concessional rates enabling them to get raw material and other necessities required for exporting of goods to different countries. Banks also provide loans for packing and shipping of goods called as **post-shipment credits**.

## **3. Imports financing :**

International banks also provide facility of import financing just like the import financing commonly by the use of **letter of credit**. Letter of credit is a secured mean of payment. In modern world it is not possible for the buyer and seller to meet each other face to face and most of the traders are done through electronic media giving rise to credit risk or default risk.

## **4. Issuing Guarantee:**

As a part of international banking function, banks provide guarantees favoring the beneficiary at the request of its customer. Bank issues guarantees for making the payment to the beneficiary in case of default by the borrower.

## **5. Loan in Foreign Currency:**

With the view of integration and globalization of the economies, the corporate are able to raise foreign currency loan from overseas lenders. The

foreign currency loan are normally denominated in currencies namely dollar, pound.

### **6. Syndication Of Loan:**

In view of the need for huge size of loans and multiplicity of bank and the short time of sanction, the banks facilitate the borrower by providing option of transferable loans commonly called as syndication of loan.

## **FEATURES AND BENEFITS OF INTERNATIONAL BANKING**

### **(1) FLEXIBLE IN NATURE**

International banking facilitates multinational companies by providing flexibility in dealing with multiple foreign currencies. The major currencies that multinational companies or individuals can deal with include dollar, euro, pounds, sterling, and rupee. The companies having headquarters in other countries can manage their bank accounts and avail financial services in other countries through international banking without any hassle.

### **(2) EASY ACCESSIBILITY**

It provides accessibility and ease of doing business to the companies from different countries. An individual or MNC can use their money anywhere around the world. This gives them a freedom to transact and use their money to meet any requirement of funds in any part of the world.

### **(3) ACCESS TO INTERNATIONAL TRANSACTIONS**

International banking allows the business to make international bill payments. The currency conversion facility allows the companies to pay and



receive money easily. Also, the benefits like overdraft facility, loans, deposits, etc. are available every time for overseas transactions.

#### **(4) GLOBAL ACCOUNTS MAINTENANCE**

Many multinational companies are able to maintain foreign accounts only because of international banking by helping them in keeping records of the account holders in a fair manner. All the transactions of the company are recorded in the books of the banks across the globe. By compiling the data and figures, the accounts of the company can be maintained.

### **TYPES OF INTERNATIONAL BANKING**

#### **1) Correspondent banks**

Correspondent banks involve the relationship between different banks which are in different countries. This type of bank is generally used by the multinational companies for their international banking. This type of banks is in small size and provides service to those clients who are out of their country.

#### **2) Edge act banks**

Edge act banks are based on the constitutional amendment of 1919. They will operate business internationally under the amendment.

#### **3) Off-shore banking centre**

It is a type of banking sector which allows foreign accounts. Offshore banking is free from the banking regulation of that particular country. It provides all types of products and services.

#### **4) Subsidiaries**

Subsidiaries are the banks which incorporate in one country which is either partially or completely owned by a parent bank in another country. The affiliates are somewhat different from the subsidiaries like it is not owned by a parent bank and it works independently.

### **5) Foreign branch bank**

Foreign banks are the banks which are legally tied up with the parent bank but operate in a foreign nation. A foreign bank follows the rules and regulations of both the countries i.e. home country and a host country.

## **TYPES OF RISKS**

### **1) Currency risk**

The common risk present for all types of international banking institutions is the fluctuation in the currency exchange rate. An international bank has to be familiar with the currency exchange rate while doing business internationally. The companies which choose to operate in a foreign country and at that time it has to deal with currency risk.

### **2) Political risk**

It is commonly seen the political risk do effect the working of international banks because business has to follow the rules and regulation of host country and each country has their political effect on the business. An unfavourable decision may have an inverse effect on the business.

### **3) Reputation risk**

A reputation risk means the potential loss in reputational capital based on either real or observed loss in reputational capital. A bank faces reputation risks like rumors about the bank, data manipulation, bad customer service, and experience. A bank's reputation is judged by the clients, investors, leaders, and critics.

#### **4) Systematic risk**

The systematic risk is not related to particular one bank but it affects the whole economy. A systematic risk is associated with failures of the big entity and it affects the whole economy

### **SUMMARY**

Banking transaction crossing national boundaries is termed as International Banking. International Banking as we experience today has evolved out of various stages. The bench banking got replaced with commercial/traditional banking, The traditional banking has been replaced with Universal banking (all under one roof) and Universal banking has got extended with international banking because of Effects of World War II, Collapse of Bretton Woods, Oil crisis and impact on US economy, integration of world markets Globalization of economies/Liberalization and euro markets'.

Globalization and growing economies around the world have led to the development of international banking facility. The world is now a marketplace and each business wants to exploit it. Geographical boundaries are no more a concern. With access to technology, banking facilities have grown vastly. One prime example of it is international banking. In the years to come, such banks would see higher growth and higher profitability. Big