An empirical study of international correspondent banking in Australia

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NOTE

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CHAPTER NINE: SUMMARY AND CONCLUSIONS

9.0 INTRODUCTION

This chapter summarizes and concludes the research by reiterating the original objectives of the research and drawing conclusions on their attainment in section 9.2. Implications of the findings in section 9.3 and the limitations of the research in section 9.4 will be discussed, and finally future research directions will also be identified in section 9.5.

9.1 OBJECTIVES OF THE RESEARCH

The starting point for this research was that in order to remain competitive in the increasingly competitive area of correspondent banking in Australia, banks would benefit from a greater understanding of what motivates individual banks to choose international corbanking to provide financial services and indeed why they do not choose other approaches such as foreign branches, subsidiaries, affiliates, consortium banks or joint ventures. Likewise, from a micro-point of view, why banks choose a corbank in particular destinations, and why they don’t choose another bank at other destinations.

Based on this starting point three major objectives were developed and clearly outlined in Chapter one. Each of these will be restated and concluding comments made on how well they were achieved:

Objective (i): Outline international correspondent banking in Australia, the Australian banking systems and payment systems, and summarise both modern and traditional correspondent banking.

This objective was achieved in Chapter two and three that provided background information for valuable insight into the historical development of international correspondent banking. Corbanking deals with a whole spectrum of bank-to-bank
relationships in the form of contractual modes for services to their own customers through
the use of another bank as an agent. Australian banks started to use corbanking services
for payments and trade finance from early in the last century through a small number of
corbanks concentrated in Britain. The widening of sources of commerce with the rapid
growth of overseas banks and their branches outside Australia led to establishing many
corbanks by early 1960s. The resurgence of correspondent banking overseas and within
Australia was due to adjustment of characteristics of corbanks from traditional to
contemporary view of correspondent banking as being a more strategic or core activity
rather than a routine operational task, a cost centre to a profit centre, reciprocity to fee-
based and commission, no interest to interest-payment on compensating balances and
non-specialist to specialist services. These changes were accompanied by rapid changes
and deregulation of the banking sector in Australia. In particular the opening of the
domestic market to foreign banks in the mid-1980’s. The rapid uptake of technology in
the banking sector and the introduction of real-time settlement between banks has brought
Australia to the forefront of international banking technology.

Objective (ii): review the existing theoretical and empirical literature in the area of
international correspondent banking, specifically in relation to factors for international
corbanking relationships and criteria for selection of correspondents overseas. However,
there is a scarcity of previous researches on international corbanking in the Australian
environment. A case study of an Australian bank and an empirical survey of international
correspondent banking were carried out, presented and interpreted in this thesis in order
to lay down the foundation for the theoretical modelling;

This objective was achieved in Chapters four to seven. Chapter four added further insight
into the determinant factors and selection criteria related to corbanking in terms of
previous studies, their results and their limitations. The dearth of correspondent banking
literature determined the scope of the literature review extending to international banking and general banking theory in which factors identified are: location, internalisation and ownership (Dunning’s Eclectic theory, 1979), customer driven factors (Sabi, 1988), transaction costs (Benston and Smith, 1976) and transaction-cost and Principal-agent factor (Williamson, 1979, Milgrom and Roberts, 1992).

The research methodology for Chapter six to eight was discussed in Chapter five which also provided the theoretical foundation of methodologies such as the multiple research strategies of the triangulation approach (Haque and Hopper, 1997, Neuman, 1997). The research design structured the exploratory research on seven banks and a major case study of Commonwealth bank of Australia. This was followed by an empirical survey of all banks in Australia and modelling in which the survey results were subjected to regression and factor analyses.

Chapter six described the corbanking in Commonwealth Bank of Australia (CBA), a user and provider of correspondent banking services. The case analysis provided valuable insights the international correspondent banking practices, management and business in CBA.

Chapter seven presented the results of the international correspondent banking industry survey of 43 bank groups and its ten sub-grouping by looking at banks in Australia as a corbanking provider and/or user, risk and relationships management of corbanking, and the future of correspondent banking. The findings revealed that many banks had modernised or were in the process to modernising their corbanking activity. Corbanking was generally regarded as a strategy issue, although many banks did not consider corbanking as their core business. In order to have an efficient corbanking system, many banks have started to rationalize their corbanking systems either concentrating on using key correspondents or outsourcing their corbanking services.
Objective (iii): develop and test the models of the determinant factors of international correspondent banking relationships and selection criteria of international correspondents specifically applicable to the decision process in selecting to build Australian international correspondent networks.

This objective was achieved in Chapter eight. The models drew heavily on the literature reviewed in Chapter four, a case study in Chapter six and empirical survey in Chapter seven. There were two major models for each bank group, determinant factors of correspondent banking relationships and selection criteria of correspondents for decision making. Development of these models also allowed two hypotheses to be developed concurrently to test the models. A methodology to test the models was developed in Chapter five and eight, with the results, limitation and implication described in Chapter eight. In summary, models formed by stepwise regression were simple in the formats of one or two independent variables explaining a dependent variable. Each model of the ten bank groups was formed for determinant factors of international correspondent banking relationships and selection criteria of international correspondents. The findings by OLS regression and factor analysis were: the most important factor explaining why banks developed correspondent banking relationships was *bank size* and a less important factor was the location not physically present factor. The most important criterion for banks in choosing correspondents was *formal banking presence* and less important criteria were operational capabilities and location. The generalisation is according to counts on factors or criteria appearing in the models. Exploring by factor analysis, a consistent result for all banking groups indicates not physically present and bank size factors, which always co-exist for correspondent banking relationships. However, no strong criterion can be found attaching to formal banking presence.
9.2 IMPLICATIONS OF THE FINDINGS

Chapters six to eight have portrayed the current (1995-1997) international correspondent banking (corbanking) activities in Australia leading to determinant factors of correspondent banking relationships and selection criteria of correspondents. Implications of the findings are as follows:

(1) International and domestic integrated financial services. The conclusions in this research supports the idea that modern corbanking products and services have emerged because of structural changes in global and domestic banking sectors (as also reported by Jacques, 1997). A fundamental redefinition of the nature of banking is currently underway, driven by the deregulation of the financial services sector and rapid advances in information technology. The Australian financial services market will be opened to offshore competitors and also will be influenced by other global market trends. Therefore, banks need to adjust to such changes including emphasis on high-tech distribution channels and product innovation in tough competitive environments. Furthermore, new competitors like non-banks are emerging across a whole range of traditional banking services, which are forcing banks to develop a much clearer understanding of market segmentation and the profitability of customers and products.

(2) Benchmarking. Financial institutions are increasingly looking to the tool of benchmarking as a means of identifying best practice for improved efficiency. This research did not intend to benchmark for corbanking practices. Nevertheless, it reflects the current corbanking practices in the Australian banking market, which can be used as a platform for improving products, services and practices and benchmarking process.

(3) Bank Size. Bank size was the most significant factor in the modelling of establishing corbanking relationships. Larger banks can easily reduce risk by diversifying their business portfolio since they have resources and capabilities to be involved diversified...
financial services (McAllister and McManus, 1993). The results of this research imply that larger banks are more inclined to develop diverse strategies for expansion that includes the development of a comprehensive international corbanking network. Smaller banks are less inclined or less able to develop such networks. However, there are equivocal relations between bank size and efficiency which also involve mergers, competitiveness and cost savings (Wallis Inquiry Report, page 465, 1997). Mergers is a key issue of the Australian banking sector in particular between the four major banks. At the time of the study mergers were not be permitted among any of the four major banks and two major life insurance companies: the ‘six pillars’ policy. This is clearly a contentious issue based on frequently expressed public concern about the existing state of competition in banking markets and the conventional assumption that a reduction in the number of larger players could further reduce competition (Wallis Inquiry Report, page 472, 1997). However, senior bankers in Australia wanted the government to abolish the ban on mergers between major banks since large banks around the world are merging, and institutions are merging (Channel 9, Business Sunday, 8/2/1998). The global banking industry is in favour of mergers and larger size for banks. The wave of mergers is happening and or happened in United States, Britain, Japan, Europe, Australia, and Asian countries. Bank mergers in Indonesia, South Korea and Thailand are not for improvement of performance but for their survival as a part of banking reform particularly in the light of the Asian currency crisis (1997). Further implications on mergers of banks worldwide means a reduction in the number of corbanking relationships and corbanking concentration because of a reduction in the number of banks.

(4) Strategic Alliances. A few corbanking alliances such as StandChart and Westpac, StandChart and First National Chicago exist. There are more alliances in the areas of information technology and fund management, which are directly relevant to corbanking
in the Australian scene. In the banking world, strategic alliances are agreements by which banks will co-operate and form partnerships for clearly defined objectives. In this tough competitive environment, collaboration with competitor banks can be a good alternative to securing a competitive advantage via overview of corbanking marketing styles. That is, an alliance that involves perhaps a combination of outsourcing on the one hand, and integrated product development on the other. In other words, to create a partnership that exploits the executive strengths and scale economies of the global player while making the most of the domestic bank’s distribution clout. It would be wrong to view mergers as the sole means of staving off takeover and absorption by global bank players. A clear alternative is for domestic banks to forge a close-knit, co-operative alliance with a global bank since an alliance can integrate competitive advantages. Banks with alliances will be restricted to use other banks, which may supply some cheap and better services. Other banks may not use banks with alliances since they become a threat to them.

(5) Location not physically present. This was a factor in establishing corbanking relationships, which was statistically significant with respect to Australian majors and non-majors. A physical presence near to the customer will be rendered less necessity by improvements taking place in communications. Information technology gives local banks much wider scope to lock into a broader corbanking networks. However, despite these technological advances, physical presence remains highly important. Australian banks want access to important financial centers and the financial markets of major trading nations. Their inability to develop their own physical presence leads to the exploitation of corbanking relationships as proxy.

(6) Competitiveness. The competitiveness factor in establishing corbanking relationships was statistically significant with respect to Japanese banks. The factor indicates Japanese banks determined to be efficient and competitive by reforming their
financial system - the 'big bang or kinyu biggu ban'. Since Japan is a major trading partner of Australia, the soundness, security and efficiency of its banking system will facilitate trade flow between the two countries.

(7) Formal banking presence. This was a selection criterion of correspondents which was statistically significant in the survey with respect to All, American and European banks. This is the most important requirement related to licenses to function at certain locations or countries, however, This criterion as the principal obstacles to banks' operating on a wider geographical scale will be much diminished by technology. However, despite technology, a banking license in any particular economy requires physical presence. Therefore settlement and other operational aspects of corbanking depend on the physical presence of the corbank. In addition, complex corbanking services such as syndication lending require facilities, and some physical presence becomes necessary for corbanks.

(8) Cross Banking Group Relationships of Factors and Criteria. Regression modelling concluded that the most significant factor in establishing corbanking relationships for all banks and cross-banking groups was bank size with a less important location not physically present which, for the cross-banking group situation, were also confirmed by factor analysis including by visual ways in Figure 8.3. This implies that banks in Australia are using the two important factors in decision-making concerning the establishing of corbanking relationships. Nevertheless, regression modelling concluded that the most significant selection criterion of correspondent for all banks but weaker for cross-banking groups was a formal banking presence. This criterion for the cross-banking group situation was less clear and not consistent via confirmation by factor analysis in Figure 8.4. This implies that the formal banking criterion is still held for all
Chapter Nine

banks, but its application to the cross-banking group and growing situation should be treated with caution.

(9) Advisory Services. The provision of advisory services are seen by many banks in the survey as an important component of the package of corbanking products. These services are always rather flexible and broad in range from bank management to operation of services. The Asian currency crisis is an opportunity for banks in Australia to share their expertise with Asian banks in areas such as lending practices and debt management (DFAT, 1999). The ANZ bank provided rehabilitation to Sime Bank in Malaysia because of the Type II economic crisis (caused by outflow of capitals from Asian countries started from Thailand, Indonesia, South Korea, Malaysia and so on because of poor lending practices and at the booming economic during 1997 onwards) which centred on a failure of the financial intermediation process (Macfarlane, RBA Bulletin, 1997).

(10) Minimum Capital Investment. Many banks prefer corbanking mode since it is a way of providing international banking services and banking expansion with minimum capital commitment. This is particularly so in the wake of the Asian financial crisis where it is reasonable to assume Australian banks are reluctant to commit capital to invest in Asian banking market until clear signs of sustained recovery are evident. However, banks still need to have international transactions with Asia. This situation will increase the use of corbanking services with less capital investment.

(11) International Credit risk. Banks require to take certain credit risk in order to make profit in the case of corbanking involving international credit. Many banks in the population of banks do not manage their global country credit risk for each corbank in Australia in particular users of corbanking. Proper management and assessment of international corbanking credit limits granted to counter parties such as Stardchart and
Citibank will obviously improve corbanking profitability. This credit management proves to be more relevant for Asian banks during the period of the Asian currency crisis. For examples, prevention of loss caused by default of some Asian banks such as collecting payments of letter of credit and payment transaction from banks in Indonesian. This implies providing some credit limits for corbanking will increase corbanking activities on one hand, on the other hand, good international credit risk management will be reduced losses caused by changes of country risk.

(12) Reciprocity. In the past, banks felt some obligation to offer return business to those banks that directed business to them. In today's climate, this obligation is less powerful. Reciprocity is now used as a weapon or exchange condition to price business out of other banks as part of the marketing effort. Banks have to be reminded from time to time that their own corbanking business could suffer in the absence of sufficient reciprocity being offered, since reciprocity is no longer offered voluntarily on the basis of goodwill.

(13) Outsourcing. With profit margins continuing to tighten, and back-office processing increasingly by targeted for cost-savings, there are clear benefits in outsourcing to specialists the complex processing, e-commerce/business, computing and communication functions of banks. Outsourcing also anticipates better returns for shareholders as a result of lower capital investment in processing infrastructure. Therefore, financial outsourcing services are identified as a package or product including corbanking services for corbanking suppliers on one hand and cost saving services for corbanking users on the other. A few banks have moved to develop outsourcing business as a new profit stream. In the case study it was found that for strategic reasons Commonwealth Bank concentrates on information technology operations. Citibank is
on the other hand a good example of a bank that provides comprehensive outsourcing services (O’Riordan, 1998).

(14) Innovative Distribution Strategy. International banking cannot function without effective and efficient delivery channels. While it is vital to evaluate the emerging distribution channels created by technological developments such as internet banking and electronic commerce or business it is just as important to leverage technology to create competitive advantages in the more traditional distribution channels. By combining these two strategies, it is possible to build extensive corbanking relationships through a comprehensive financial service distribution strategy. Technically, it is necessary to develop a technology-base distribution strategy to meet banker client needs; to leverage technology to distribution financial services including the internet, netting, smartcards, ATM, home banking and Interactive Voice Response Technology; to manage the integration of new and existing distribution channels; to establish strategic alliances for the distribution of financial services and to measure channel effectiveness in order to increase customer retention (International Quality and Productivity Centre, 1998).

(15) Future of Corbanking. The future of corbanking is expected to remain dependent on factors like the growth in international trade and payments, structural changes in the domestic and international banking sector, deregulation and developments in technology as was the case during the past decade and discussed in chapters two, six, seven and eight. Individual banks look at corbanking differently since they have different views with respect to available opportunities and threats. These are affected by the geographical spread of bank’s each branch network and their principal business specialisations. In addition, the competitive strategies currently being implemented by individual banks vary widely, with some banks still seeking to expand further into global business, while others are retrenching within their own domestic base. Therefore, it will be imprecise to
Chapter Nine

267

generalize the future corbanking strategy of the banking industry, other than the observe that growth in world trade is a key engine of corbanking business volume. We have entered a new age where corbanking continued is now seen as a more central or core activity that can have considerable strategic significant if a bank chooses to exploit it. The future is likely to see a greater appreciation of the strategic significance of well defined corbanking strategic.

9.3 THE RESEARCH LIMITATIONS

There are mainly three limitations of this research will be discussed: population/sample size, knowledge of interviewees and the inherent limitations of research methods.

One of the limitations is related to the population or sample size of the research. The population of banking groups in Australia was forty three (43) as at October 31 1996 and the whole population was used in the survey and modeling. The population was further classified into ten bank groups. The number of banks in each individual bank group was the population of their bank groups while the number of banks in total, and in some bank groups in particular, was low, the size could not be expanded beyond the total population. It is recognized that any findings elating to very small bank subgroups may have limited validity. However, the findings relating to the All bank group reflects the population at the time of the study. Owing to the rapid changes occurring in the banking industry, the bank population continues to change due to RBA granting banking licenses particularly to foreign banks and mergers and acquisitions are consolidating the domestic banks.

A second limitation common to this form of research is that the roles and responsibilities of interviewees may differ between organisations. In this research it was found that banks organise corbanking differently. The person(s) interviewed or who completed the questionnaire was a senior bank staff member with responsibility for corbanking.
Nevertheless, their level of corbanking knowledge and experience were difference and hence the opinions varied from bank to bank. There was also a danger that their opinions did not necessarily reflect the view of the bank.

A further limitation relates to the inherent limitations of research methods that use the case study method, empirical surveys and modelling by regressions and factor analysis as discussed in chapter five.

9.4 FUTURE RESEARCH DIRECTIONS

From the strategic perspective, banks these day seek to develop integrated, seamless services that touch on every aspect of the wholesale and retail markets and involve them in many more elements of the commercial cycle. Funding and financing, investing and managing risk, providing and processing all sorts of merchandising and transaction information, on a global basis are now as common a feature of banking as traditional settlements and payments. Banks must think of themselves as market access points, information providers and business facilitators in the widest sense. Success will be predicated on the ability to master a host of different competences and bundle them up in packages that not only add value to the client’s business but also demonstrate a commitment to ongoing investment and development. Traditional corbanking relationships do not provide the cross-product expertise - nor the commitment - necessary to win the confidence of clients in tomorrow’s marketplace. Alliance, or partnership banking, however offers scope for doing that. Many international banks are trying to devise a formula for providing them with market leadership or a niche position in key areas of banking. In fact correspondent banking is now seen as an integrated part of banking business, with the potential for operating economies that will continue to support large-scale investment in technology and a global product integration strategy. Every
bank must now devise a formula that suits its own shape and aspirations from which a form of partnership banking may emerge. The recommended future research, according to what have been discussed, could be in the areas of:

(i) How to provide services to the increasingly sophisticated needs of customers who expect better and faster service, and advice;

(ii) The development of global integrated financial services;

(iii) Strategic alliances or banking partnerships to sharpen the cutting edge of banking such as electronic commerce and outsourcing;

(iv) Reasons for the use of different selection criteria for correspondents by different banking groups.

This list should not be regarded as exhaustive as the issues raised in section 9.3 also raise many areas of potential research exploration.