Banks are not providing adequate foreign exchange at market rates to small firms, despite being reprimanded by the Reserve Bank of India (RBI).

The situation is somewhat better with public sector (PSU) banks. But private and foreign banks are charging their small and medium enterprise (SME) customers exorbitant rates, with no scope of negotiation, said several SMEs and currency consultants. Executives at the SMEs didn't want to get identified as they are heavily dependent on banks for financial needs.

SMEs at large do not understand foreign exchange and the concept of hedging, which banks often take advantage of.

In April 2015, the RBI's then executive director G Padmanabhan had warned banks against charging high rates from SMEs.

"Not only there appears to be a wide variation amongst the banks in the charges levied on smaller customers, there also appears to be complete lack of transparency regarding information on the charges levied," Padmanabhan had said.
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PSU banks largely became reasonable after that. But private and foreign banks have reverted to their old practices.

In 2014-15, the RBI made it semi-mandatory to hedge every foreign exchange transaction, in the absence of which loans commanded a higher risk weightage for banks. Lenders started arm-twisting clients to hedge, but at a rate offered by banks. Otherwise, the other line of rupee credit was also getting choked.

Banks no longer care to ask clients to hedge unless the foreign exchange transaction involved is substantial. However, the root problem of exorbitant rates, almost at par with retail, has not been addressed.

"SMEs are indeed charged very high commission on forex conversion. While large companies pay quarter to half paisa, small companies pay anywhere between 5 and 250 paise. Whereas, the reasonable amount for their size should be 2 to 6 paise," said Samir Lodha, managing director of QuantArt Markets Solutions.
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According to an executive with a company engaged in building machines for converting pulps into papers, nobody in the firm has any knowledge about foreign exchange, but have to engage in such transactions regularly and banks exploit that.

"There is no one to handhold us, so we go by whatever banks offer us. We know the rates we see on websites are what we will get, but nobody explains why we are charged more. We don't want to antagonise banks by challenging the quotations," said the official.

In case of exporters, who generally have a better understanding of foreign exchange than importers, the situation is equally bad.

“Quite often banks offer us rates (to buy dollars from the exporter) much below market rates. We cannot sell foreign exchange somewhere else, as most transactions happen through banks,” said an executive of an export-oriented SME.

Ajay Sahai, director-general and CEO of the Federation of Indian Export Organisations (FIEO), agreed that small firms are at disadvantage in meeting their foreign exchange needs.
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“There is no cap on how much a bank can charge interest on foreign exchange loans or products. Banks treat SMEs as riskier clients than large corporates, even as NPA numbers point out the opposite, and this results in SMEs getting a rough deal on exchanges,” said Sahai.

Bankers say it won’t be right to blame them for the differential. They say the fixed cost remains the same, no matter the size of the loan.

“So, the smaller the foreign exchange need, the higher the cost in relative terms. When seen in isolation, rates look exaggerated vis-a-vis a large firm’s rates. Unfortunately, we cannot change this unless there is a separate structure mandated specifically for SMEs,” said a private sector banker.