



**Knowledgeable Research**

ISSN 2583-6633

Vol.02, No.10, May, 2024

<http://knowledgeableresearch.com/>

## “ROLE OF FOREIGN BANKS IN INDIAN ECONOMY”

Dr. Rajeev Shukla

Economist at The State Trading Corporation of India Ltd, New Delhi  
 (A Government of India Enterprise)

Email: [rajeev2october@gmail.com](mailto:rajeev2october@gmail.com)

\*\*\*\*\*

### Abstract:

*A perusal of the history of banking in India indicates that foreign banks had been operating in an organized form in our country since the beginning of 19th century. Majority of the foreign banks had been merely agencies of large banking companies having their registered offices in foreign countries. These banks were primarily called upon to contribute a lot to the development of foreign trade in India. In fact, these banks are still expected to play significant role in the country's foreign trade. With normal ups and downs due to business vicissitudes, these banks have been varying in number over the period and at present, there are twenty-nine foreign scheduled banks operating in India.*

**Keywords:** *Commercial Banking, Organization (WTO), New Economic Policy, Hitherto, India, private capital, global economic environment, Trade policy.*

\*\*\*\*\*

### INTRODUCTION

Banking system is transforming very fast in recent years in tune with changes taking place world over. Legal; Organizational and Market changes are occurring in India and facilitating to evolve a highly competitive banking field. Liberalization, Privatization and Globalization principles adopted by Government of India in the early nineties with Financial Sector Reforms are having direct bearing on all the types of banks in India since the year 1993. Indian banking industry comprises of a good blend of 27 Public (including 8 of State Bank Group), 30 Private (21 Old and 9 New), 31 Foreign, large number of Cooperative, 196 Regional Rural Banks (RRBs) and 4 Local Area Banks (LAB's). There are also other players like (a) Development Finance Institutions (DFIs), (b) Non-Banking Financial

Author Name: Dr. Rajeev Shukla

Acceptance Date: 11.05.2024

Publication Date: 28.05.2024

Comparries (NBFC's) and (c) Post-Office/Small Savings Scheme in the four-pillared Financial System.

Commercial Banking in India has undergone dramatic changes in the three decades. Some experts divided the working of the banks into three phases-viz. (1) Pre-Nationalization period up to July 1969 (2) post-Nationalization and up to Financial Sector Reforms in June 1991 and (3) post Reforms era and onwards. Opening of new Private Sector and inviting of more Foreign Banks (FBs) did impact the working of the entire banking industry. Several remedial steps like deregulation of interest rates were taken to bring back profitability and productivity in the system. Balance Sheets of Banks are more transparent now. Introduction of new products and services including Credit Cards, ATM, s Electronic Clearing System, Electronic funds Transfers, Bancassurance, Mutual Funds, Dematerialization, Retail Banking, Venture Capital Funding. Securitization, Asset Management /Asset Reconstruction Companies, Portfolio Management Service, Private Banking, Internet Banking, etc. by FBs is adopted simultaneously by Public and Private Sector Banks too in a highly competitive environment. While there was a conscious policy of branch expansion of RBI for public and Private Sector banks, FBs enlarged their operations in a moderate way. FBs has their origin from countries like USA, UK, France, Belgium, Germany, Netherland, Scotland, UAE, Bangladesh, Ceylon, Japan, Malaysia, Indonesia, Singapore, Hong Kong Bahrain, Muscat, Oman, Mauritius, etc.

World Trade Organization (WTO) came into existence on January 01, 1995. WTO regime opened up business opportunities among member countries and moving towards competition and globalization. With certain relaxations to the member countries, after the Financial Service Agreement in 1997, the share of FBs in All Scheduled Commercial Banks (ASCBs) in India has increased substantially under all the parameters.

## **STATEMENT OF PROBLEM**

The world market is now enlarged and changed several such developments have taken place in the recent past. Some of these important developments were the collapse of the communist regimes in Eastern Europe and the opening of their markets. Rise of Japan as a world technological leader, emergence of four tigers in East Asia namely Republic of Korea, Hong Kong, Singapore and Taiwan in addition to Thailand, Malaysia and Philippines as successful and leading exporters. Similarly, the efforts have made by China to modernize its economy and double its GNP by the year 2000. The trend towards increasing economic interdependence and globalization of markets in another important development in the international market environment.

India is the largest country in south Asia and has a huge financial system Characterized by many and varied financial institutions and instruments. Indian Banking sector was well developed during the British rule that is, prior to her political independence in 1947. "There was significant presence of both foreign and domestic banks and well-developed stock market" (Bery, 1996, p. 245).

India's New Economic policy announced by the Government of India recently in 1991 emphasized on three things, Globalization, Liberalization and Privatization. Before the implementation of the New Economic Policy during 80's India had to face a highly on favorable balance of trade and had gone through a foreign currency crisis. But with the implementation of this economic policy, the economic environment in the country entirely changed when the three important components-globalization, liberalization and privatization were introduced in Indian economy. Following the recommendations of the **Narasimham Committee** on the financial system, the RBI with regard to allowing foreign banks to open offices in India either as branches or as subsidiaries emphasized on liberal banking policy. In this context, RBI issued the guidelines as on January 23, 1993 for the entry of new private banks including foreign banks to open offices. The foreign banks as guidelines stated, when permitted to operate in India should be subjected to follow the same financial organizational and functional conditions as are applicable to the domestic commercial banks. So, foreign banks are now brought to the same level as domestic banks in terms of Priority sector lending.

Hitherto, India's foreign trade was being financed mostly by foreign banks, owned and run by persons of other countries known as foreign exchange Banks. The main function of these banks tried to undertake this business through their agents but failed as got a little success. The Indian banks were not able to compete with the foreign banks which might have huge amount of funds iron the foreign market at the cheaper, secondly, Indian banks could not involve themselves in arbitrage and direct exchange transactions for the wants of their branches in the important foreign countries and lastly, they did not have surplus for financing foreign trade. Ultimately India now has 29 foreign banks with 270 above branches of which their majority of branches, say 89 percent are in the post and metropolitan cities. Ten percent in urban areas and only one percent in semi-urban areas as on June 30, 2008.

The year 2005 is witnessing celebration of bi-centenary year (200 years) by SBI with its long history while two other public sector Banks viz, corporation Bank and camera Bank have declared one hundred years of their service. Others like Punjab National Bank, Allahabad Bank, central Bank etc. in public sectors as well as Federal bank, Vysya bank and others in private sector have also been in existence for long year more and equally interesting is the functioning of FBs in India for over one hundred sixty years (since the year 1842) conforming to rigid business standards and complying with various regulations. In February 2005, RBI announced a '*Roadmap for Presence of Foreign Banks in India and guidelines on Ownership and Governance in Private Banks*'. FBs can now enter India via a branch or set up a wholly owned subsidiary (WOS). The minimum starts-up capital requirement for a WOS would be Rs. 3. billion (US\$ 68 Million). The WOS would also be required to maintain a Capital Adequacy Ratio of 10 per cent or as may be prescribed from time to time on a continuous basis, from the commencement of its operations. FBs applying to RBI for license of WOS must satisfy the RBI that they are subject to adequate prudential supervision in their home country. Other factors that will be taken into account while considering such application include economic and political relations between India and country of the FB as well as its ownership pattern. Looking at the above developments and the moderate market shares in deposits and advances the FBs had in India as well

as their varying numbers due to entry and exit in the last decade (post WTO era,) a question arises about their sustainability in Indian banking scenario.

### **Changing Global Economic Environment**

The world market and the entire global economic environment are today one of the most point of change. This has been due to several dramatic developments that have taken place in the recent past. These include the formation of united Germany a powerful economic and political entity which came into being in Oct 1990 the collapse of the communist regime in Eastern Europe and the opening of their markets, re-organization of user and the formation of commonwealth of soviet republics, use of Japan as a world technological leaders, emergence of four tigers in east Asia namely republic of Korea, Hong Kong, Singapore and Taiwan in addition to Thailand, Malaysia and Philippines as successful and leading exports and last but not the least the efforts being made by China to modernize its economy and double its GNP by the year 2000.

Globalization is the new buzzword that has come to dominate the world since the nineties of the last century with the end of the cold war and the breakup of the former Soviet Union and the global trend towards the rolling ball (*Singh B. right, Economics of Development with special reference to India, PP- 64-65*). The frontiers of the state with increased reliance on the market economy and renewed faith in the private capital and resources, a process of structural adjustment spurred by the studies and influences of the World Bank and other international organization have started in many of the developing countries. Also, Globalization has brought in new opportunities to developing countries. Greater access to developed country markets and technology transfer hold out promises improved productivity and higher living standard. Till the nineties the process of Globalization of the Indian economy was constrained by the barriers to trade and, liberalization of trade, investment and financial flows initiated in the nineties has progressively lowered the barriers to competition and hastened the pace of Globalization.

So, the most important factor shaping today's world is global economy environment. Companies are moving is search of low-cost markets, technology is driving growth in production and productivity and competition is becoming more intense. A second factor is the faster growth in private capital flows notably short-term flows by banks and financial institutions, portfolio flow by mutual funds and pension funds and direct foreign investment. All this has been made possible by the explosion in communication technology, which has led to greater integration of financial markets across the world. But in this environment, crisis also spreads quickly and there is greater danger of contagion than ever before. A third factors is the increasing share of emerging market economics in world trade. (*www.finci.com, presentation on changing environment 2002.*)

With increase in global trade and finance, there is need for a level playing field and this gap is sought to be filled by the WTO, which has laid down common rules to facilitate smooth trade among member countries. Another fallout of a global economic environment is the increase in volatility and vulnerability of markets. In order to detect timely fault lines in global financial markets and put in

Author Name: Dr. Rajeev Shukla

Acceptance Date: 11.05.2024

Publication Date: 28.05.2024

place appropriate corrections, the adoption of international standards and global benchmarks becomes important.

### **Reforms in Industrial and Trade Policy**

Reforms in industrial and trade policy were a central focus of much of India's reform effort in the early stages. Industrial policy prior to the reforms was characterized by multiple controls over private investment which limited the areas in which private investors were allowed to operate and often also determined the scale of operations, the location of new investment and even the technology to be used. The industrial structure that evolved under this regime was highly inefficient and needed to be supported by a highly protective trade policy, often providing tailor-made protection to each sector of industry. The costs imposed by these policies had been extensively studied (*for example, Bhagwati and Desai, 1965; Bhagwati and Srinivasan, 1971; Ahluwalia, 1985*) and by 1991 a board consensus had emerged on the need for greater liberalization and openness. A great deal had been achieved at the end of ten years of gradualist reforms.

#### ▪ **Trade Policy**

Trade policy reform has also made progress, though the pace has been slower than in industrial liberalization. Before the reforms, trade policy was characterized by high tariffs and pervasive import restrictions. Imports of manufactured consumer goods were completely banned. For capital goods, raw material and intermediates, certain lists of goods were freely importable, but for most items where domestic substitutes were being produced, imports were only possible with import licenses. The criteria for issue of licenses were nontransparent, delays were endemic and corruption unavoidable. The economic reforms sought to phase out import licensing and also to reduce import duties.

Import licensing was abolished relatively early for capital goods and intermediates which became freely importable in 1993, simultaneously with the switch to a flexible exchange rate regime. Import licensing had been traditionally defended on the grounds that it was necessary to manage the balance of payments, but the shift to a flexible exchange rate enabled the government to argue that any balance of payments impact would be effectively dealt with through exchange rate flexibility. Removing quantitative restrictions on imports of capital goods and intermediates was relatively easy, because the number of domestic producers was small and Indian industry welcomed the move as making it more competitive. "It was much more difficult in the case of final consumer goods because the number of domestic producers affected was very large (partly because much of the consumer goods industry had been reserved for small scale production) Quantitative restrictions on imports of manufactured consumer goods and agricultural products were finally removed on April 1, 2001. (*Nambiar, R.G.; B.L. Mumgekar and G.A. Tadas, "Is Import Liberalization hurting domestic Industry and employment?" Economic weekly 1999*)

If we talk about the Indian Share in the total world trade then we find that, in 1950, the Indian share in the total world trade was 1.78% (table 2.5) which came down to 0.6% in 1995. India's share in world merchandise exports after remaining unchanged at 0.8% between 2003 to 2004, reached 1.0% in 2005 and remained there in 2006 and also in the first half of 2007. Currently India is the 30<sup>th</sup> leading exporter and 23<sup>rd</sup> leading 3 importer in world merchandise trade which clearly indicates that India has failed to increase its share in the total world trade. Trade policy (2004-09) has set a target of achieving 1.5% share in global trade by 2009. here a look of India's share in world trade

### Economic Liberalization & Globalization

In early 1990s there were major policy reforms in Indian economy. The reforms were popularly known as LPG model (Liberalization, Privatization and Globalization model) Globalization has been identified with the policy reforms of 1991 India. "The series of reforms were under taken to make Indian economy more efficient. The reforms were in the industrial, trade and financial sector. Under the reformed policy the concept of localization totally changed to concept of globalization. Go globally and think globally become the requirement under new reforms. Globalization becomes the thrust area right from manufacturing to service sector. (Ojha, A.K., "Globalization and Liberalization on prospects of new world order, 2005, p.p.-152). Globalization is a motivation force for the nations to develop themselves on such a faster space that creates more gainful environment in the world scenario for each economy for developing and transition economics especially for India. **"THINK GLOBAL & ACT GLOBAL** (Order levist of Harward Business School)

The word globalization is used in two ways, which is the source of confusion and the Controversy. It is used in a positive sense to describe a process of increasing integration into the world economy. It is used in normative sense to prescribe a strategy of development based on a rapid integration with the world economy. Some see this salvation while other sees it damnation. The official line from the **former Prime Minister Atal Behari Vajpayee's Economic Advisory Council** is unequivocal, arguing, "Globalization is an unavoidable process which is taking place independent of us. It forces us to cope with it. There is not room in a globalize world for an economy delinked from world trade and foreign investment". (Financial times columnist wrote in a October 2004,) Globalization means many things to many people.

### Benefits of Globalization

Globalization has many positive, innovative and dynamic aspects; Globalization led to the increased market access, increased access to capital and increased access to technology and information, finally resulting into greater income and employment opportunity.

- THE GDP of India in the 1970s was very low at 3% while at the same time GDP growth in countries like Brazil, Indonesia, Korea and Mexico was more than twice that of India. The

liberalization of the domestic economy and the increasing integration of India with the global economy have helped step up GDP growth rates, which picked up from 5.6% in 1990-91 to a peak level of 7.8% in 1996-97. The pickup in GDP growth had helped improve India's global position. As a result, India's position in the global economy has improved from the 8<sup>th</sup> position in 1991 to 4<sup>th</sup> place in 2001. A global comparison shows that India is now the fastest growing country after China. The Indian GDP growth has been very consistent and outperforming. With the help of table 2.7 and figure 2.5, we can understand to status of GDP in India after Globalization.

analyses that there is a little bit reduction in the level of NPAs. Gross NPAs of SCBs which had declined by Rs 8276 crore in 2005-06, declined further by Rs 611 crore in 2006-07. But still Banks need to take some fruitful step for the recovery of NPAs.

- The sharp increase in the volume of business and the explosion in information technology have also given rise to scope for some weaknesses. The increase in frauds and scams in the financial sector is a cause for concern and calls for greater vigilance on the part of banks and financial institutions. "It is therefore very vital that the internal controls including internal inspection and audit, submission of control returns, risk management systems, documentation, procedures and internal communication channels are strengthened. The implementation of such control systems would necessitate revisions in operational manuals, audit procedures and closer follow up by controlling officials." (*www.rediff.com, "Indian banks ahead of foreign peers, 2005*)
- The National sample survey organization has released a Report entitled, "Indebtedness of Farmer Households". This Reports contains a wealth of data relating to the extent and nature of indebtedness. One stunning fact that emerges is that there is a substantial difference between marginal and sub-marginal farmers on the one hand and the rest of the farmer households on the other regarding the purpose for which loans are obtained and the sources of credit. For all farmer households taken together, at the all-India level, institutional sources were responsible for providing 57.5 per cent of the total credit. But as far farmer households owning one hectare and less, this proportion in only 39-6 per cent. For all farmer households, the proportion of loan going for production purpose is 65.1per cent as against 40.2 per cent for marginal and sub-marginal farmer households. Thus, for sub-marginal and marginal farmers, the proportion of production loan is lower than for all farmers. Similarly, the proportion of institutional credit is lower for sub-marginal and marginal farmers than for all farmers. This, in fact, is true of every state of the country. Thus, a critical issue is now meet the credit requirements of marginal and sub-marginal farmers happened. We may have to think in terms of restructuring the rural branches of commercial banks so that credit will be supplemented by expert advice. However, the main issue of how to meet the credit needs of marginal and sub-marginal farmers will remain. Banks need to think deeply on how to meet this challenge.

- “Management of credit risks would have to be accorded a very high priority. This is an area which has received considerable attention in recent years. The new Basle Accord rests on the assumption that an internal assessment of risks by a financial institution will be a better measure than an externally imposed formula”. (*Consolidation in banking industry: mergers and Acquisitions: special Issues on Banking 2005.*) The economic structure is undergoing a change. The service sector has emerged as a major sector. Assessing credit risks in lending to service sectors needs a methodology different from risk assessment in lending to manufacturing. There are other emerging areas of lending such as housing and consumer credit which will need new approaches.

At last, but not the least, a significant improvement in customer service by Banks can no longer be ignored. In a competitive environment, banks which provide poor customer service will find themselves losing their clients. In this regard, there is a paramount need for banks to put in place appropriate corporate strategies, depending upon the nature of their clientele.

In a conclusion, we can say that in an age where the world has become smaller and money moves as quickly as information, achieving global benchmark is important for global players. But underlying this is the need to have sound fundamentals. There is no doubt that only banks and financial institutions that are focused on efficiency, productivity and profitability have a chance to survive in the highly competitive environment and therefore need to equip themselves thoroughly. A winning strategy has to be unique and different. Each bank can find its, own set of valuable resources that can be the foundation for winning strategies (*www.India.com/Banking services in India. PDF*)

Thus, the description shows that now Globalization of the Indian Economy’ is in such position that we can say that ‘**who had the ability to innovate have always won the day**’. We all know of call centers. Data base production, financial accounting, foreign connectivity in the field of insurance, medical transcription, database production, financial accounting etc. There is a whole range of service where India is making very major breakthrough. There was a talk that while China is becoming a manufacturing hub; India is nothing but a hub for service. It is not true, India is not lagging behind in manufacturing, we are doing exceedingly well and we will continue to offer the services. I want to share some examples of services where India is used as a venue for services production at the Global level. At the global level in **banking**, we have a number of foreign banks e.g. HSBC, Citibank, Standard Chartered, ABN-Amro; in **insurance**, GE, AIG, Alliance, Ayiva, Metlife, in **IT**, Yahoo, Sub Micro Systems, Oracle, Amazon; in **communications**, ATT; in **Engineering** Ford, Bechtel, Beck, Cements, GE, in **business services**, airline like Swissair, British Air, American Express. The World Bank has the second largest office, outside USA, in India. Do we know we are coming also a “Preferred back office”. We are also emerging as a “Preferred destination” for global investment because of our strong growth outlook. We have new co-relation with global perspectives, we are therefore providing ideal opportunity for diversification. We have very sophisticated security infrastructure in equities, equity derivatives, debt-instruments. We have sound law accounting firms and all this augurs very well for our future and a lot of companies abroad, multi nationals have

Author Name: Dr. Rajeev Shukla

Acceptance Date: 11.05.2024

Publication Date: 28.05.2024



increased their R & D facilities in India. There is a major change taking place in front of our eyes into the private and public sector partnership with Telecom, Roads, Ports, all these sectors are doing extremely well and what is happening there augurs very well for the future. Remember for the first time of the Indian history, the President and the Prime Minister started talking about, India becoming a super power. Thus we can conclude with this fact that our productivity as a nation is maximum and therefore, this is time we are best suited to achieve the highest possible growth as we go toward 2018 where we have God smiling at us because productive population of young can be maximum savings of the country could be maximum, which can easily be translated into an unprecedented increasing growth rate, if we have a right kind of policy, mixed with implemented at the particular period we can achieve highest possible growth rate and solve our problems and emerge as an economic super power, as all our dreams are playing a role in the comity of nation that we will be able to do it in 20 years. If we could stay on course and develop policy combination, which would help rather than impede. If we do not take advantage of all these opportunities, then we would mean to be most unfortunate.

### **BIBLIOGRAPHY**

Adarker, B.N. "Commercial Banks in India After Nationalization". AI Shroof Memorial Trust, Bombay- 1971.

Alhadaff, D.A.- "Competition and Control in Banking A study of the regulations of banks' competition in Italy, France and England" university of California press, Los Angles, 1954.

Basu, A.K.- "Fundamentals of Banking: Theory and Practice" A.R. Mukherjee, Calcutta- 12.

Bery S.- "India commercial Bank Reform, financial sector Refroms, Economic Growth and Stability EDI seminar series, The world Bank Washington D.C.

Bhagwati J.N. "Foreign trade Regimes and Economic Development India" New York" (1975)

Bharadwaj R. "Structural Basis of India's foreign Trade" 2003.

Bhasin. Uday "Challenges in India's Banking sector 2005. Price