FINANCE INDIA
© Indian Institute of Finance
Vol. XXXI No. 4, December 2017
Pages—1239—1258

Performance of Foreign Banks In India : Post Reforms

MONIKA AGGARWAL*

Abstract

Globalization, deregulation and World Trade Organization (WTO) have lead to financial integration of markets, thereby, the banking sector, which is the pillar of every economy, has to be financially sound and competent to face competition. This paper has analyzed the financial performance of foreign banks in comparison with other bank groups in India. The study is important for policy makers, as Indian banking sector has to be opened for foreign banks, to face global competition in the future. The time period for the performance analysis has been chosen as 1991- 2010-11. The RBI released the roadmap for the presence of foreign banks in February 2005. The paper employs the ANOVA post hoc (Scheffe) method for comparing different bank groups. The study has come to the conclusion that liberalization of financial services has lead to several benefits. Main benefits of foreign entry of banks are higher competition in banking sector, leading to higher productivity, development of local financial market and efficient allocation of resources.

I. Introduction

THE INDIAN BANKING sector as on March 2011 consists of 83 commercial banks – 26 public sector banks, 36 foreign banks and 14 old private banks and 7 new private banks – excluding cooperative banks and regional rural banks. Scheduled Commercial Banks (SCBs) play an important role in the financial intermediation of the economy. India's public sector banks are the biggest segment of SCBs comprising of 70 per cent of total assets of the banking system (followed by private sector banks (PrSBs) (20 per cent) and foreign banks (FBs) (10 per cent) as at end-March 2009 (RBI, 2009-10).

The Indian banking system has undergone significant structural transformation since the 1990s. Prior to 1991, India's economy and financial system were heavily regulated and dominated by the public sector; as a

* Assistant Professor of Commerce, Post Graduate Government College, Sector 11, Chandigarh, 160022, INDIA

Submitted June 2014; *Accepted* August 2015

to increase in efficiency and productivity. In India foreign banks started many new products which provided growth to the industry banking and infrastructure i.e. mortgage of houses and cars, reverse mortgage, leasing and consultancy. Foreign banks played an important role in boosting economy of India by providing flow of foreign exchange to the individuals, corporate sector and conglomerate.

It can be concluded that foreign banks are making excellent profits and there is hardly any discrimination between Indian and foreign banks, in fact there is positive discrimination in the form of lower contribution to priority sector lending(32 per cent), branch net work in urban areas. Thus, the policy changes on entry of foreign banks in India implemented during 1995 and 2004 had significant impact on their presence in the structure of Indian banking industry.

Reforms should be taken to strengthen the regulatory mechanism to avoid potential conflicts between home country regulators of foreign Service providers and host country regulators. India's strategy of opening the banking sector for new private banks has certainly yielded good returns and has also led to increase in the efficiency of public sector banks and measures should further be taken to reform the public sector banks by adopting the strategies of consolidation and improving productivity and bringing down operating cost which eventually will lead to profits.

References

Buch, C.M., (1997), "Opening up for Foreign Banks: How Central and Eastern Europe Can benefit," *Economics of Transition*, Vol. 5, No. 2, pp. 339-366, November 1997

Claessens, S., Asli Demirguc-Kunt, and Harry Huizinga, (2001), "How does foreign entry affect the domestic banking market?", *Journal of Banking and Finance*, Vol. 25, No. 5, pp. 891-911

Claessens, Stijn and Luc Laeven, (2003), *"What Drives Bank Competition? some International Evidence",* Policy Research Working Paper Series 3113, World Bank

Claessens, Stijn, Asli Demirgüç-Kunt, and Harry Huizinga, (1998), *"How does foreign entry affect the domestic banking market"*, World Bank Working Paper, World Bank.

Claessens, Stijn, Asli Demiriguc-Kunt and Harry Huizinga, (2000), *"The Role of Foreign Banks in domestic Banking Systems",* in S. Claessens and M. Jansen (Eds.) The Internationalization of Financial Services: Issues and Lessons for Developing Countries, The Hague: Kluwer Law International.

Clarke, George R. G., Robert Cull and Maria Soledad Martinez Peria. (2006), "Foreign Bank Participation and Access to Credit Across Firms in Developing Countries," *Journal of Comparative Economics,* Vol. 34, No. 4, pp. 774-795.

Dash, Mihirand and Charles Christabel,(2009), "*A Study of Technical Efficiency of Banks in India*", SSRN Network.

Domanski, D., (2005), "Foreign Banks in Emerging Market Economies: Changing Players, Changing Issues", *BIS Quarterly Review*

Gormley, Todd A., (2007), "*The Impact of Foreign Bank Entry in Emerging Markets: Evidence from India*", SSRN Network

Mihaljek, Dubravko, (2006), "*Privatisation, Consolidation and the Increased Role of Foreign Banks*", BIS Paper, 28 August 2006.

Mittal, Manish and Aruna Dhade, (2007), "Profitability and Productivity in Indian Banks: A Comparative Study", *AIMS International*, Vol. 1, No. 2, May 2007, pp.137-152.

Rakhe, P.B., (2010), "Profitability of Foreign Banks vis-à-vis Other Bank Groups in India – A Panel Data Analysis", *Reserve Bank of India Occasional Papers* Vol. 31, No.2

RBI, (2009), "*The Report of the Committee on Financial SectorAssessment*", The Reserve Bank of India Mumbai, India.

RBI, (Various year), "*The Report on Trend and Progress of Banking in India*", The Reserve Bank of India Mumbai, India.

RBI, (Various year), "*Statistical Tables Relating to Banks in India*", The Reserve Bank of India Mumbai, India.

Sanjeev, G. M, (2006), "Data Envelopment Analysis (DEA) for Measuring Technical Efficiency of Banks," *VISION- The Journal of Business Perspective*, Vol. 10, No. 1.

Sathye, M., (2001), "*Efficiency of Banks in a Developing Economy: The Case of India*", University of Canberra Australia

Sensarma, R., (2006), "Are Foreign Banks always the best? Comparison of State-Owned, Private and Foreign Banks in India", *Economic Modelling*, April 2006, pp. 717-735.

Song, Inwon, (2004), "*Foreign Bank Supervision and Challenges to Emerging Market Supervisors*", IMF Working Paper No.WP/04/82

Uhomoibhi, Aburime, (2008), "Foreign Bank Penetration: An Expose of the Pros and Cons", *European Journal of Economics, Finance and Administrative Sciences*, No. 9, pp. 48-56.