

# Impact of Globalisation on Indian Banking Industry

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**ABSTRACT:** Globalization is the integration of economies of the country, cross border trade, cross border capital flow, the widespread diffusion of technology and people. Undisputedly trade and finance have always been the driving force behind globalisation as a result the biggest impact of globalisation has been witnessed in the manufacturing and industrial sector and banking sector. Globalisation in India can be traced back to the liberalization of the economy in the 1990s, along with all the demands of IMF and World Bank included tariff and subsidies reduction and several other trade liberation measures and considerable steps to be taken to enable foreign investors and financial institutions like banks to create a market share in India.

**KEYWORDS:** globalisation, banking, impact, industry, economy

## I. INTRODUCTION

The globalisation of the banking sector  
Narasimham Committee-I

Due to above-mentioned reasons, a nine-member High-Level Committee head by Mr Narasimham was established to revive the banking and finance sector of the country, the following were its recommendations:

- A four-tier hierarchy was advised to be established with 3-4 banks at the top and the bottom the rural agriculture banks.
- Branch licensing policy ought to be abolished.
- Interest Rates should be de-regularised.
- Supervisory role over banks and financial institutions to be done by an RBI sponsored quasi-autonomous body.
- Promotion of competition among financial institutions by promoting the entry of private entities.
- Setting up an asset reconstruction fund to handle a portion of that loan portfolio of banks which is difficult to be recovered.
- It phased a reduction in cash reserve ratio and statutory liquidity ratio (dealt in detail below).[1,2,3]

The government in furtherance to these recommendations took the following measures:

- The SLR and CRR reduced the profit percentage of the bank, from 1991 to 1997 SLR was reduced from 38.5% to 25% (reduced by 13.5% ) and the excess funds enhanced the allocation to the priority sectors like agriculture, SMEs etc.
- Scheduled commercial banks had only minimum floor rates and maximum ceiling rates.
- The rate of interests over Rs. 2 lakhs was completely deregulated, and the interest rates on deposits and advances of all co-operative banks only had a minimum lending rate of 13%.
- Recovery of Debts due to Banks and Financial Institutions Act, 1993 was enacted for the speedy recovery of debts to banks and financial institutions, with 6 tribunals and one appellate tribunal.
- There was freedom of operations given to scheduled commercial banks like the opening of new branches or closing of non-viable branches.
- Local Area Banks were established to channelize rural savings into investment.
- Lastly, RBI set up an independent Department of Supervision for the supervision of commercial banks.

Narasimham Committee -II

After the first report, apart from these changes, the Indian economy also witnesses huge changes under LPG reforms i.e. Liberalisation, Privatisation and Globalisation. The entry of foreign banks and the survival of Indian banks in the current form was threatened thus, the committee was established again.

The Committee made the following recommendations in its report:

- The sector can be strengthened by merging strong banks with strong banks and weak banks with weak banks (determined by the Current Account Convertibility) to make bigger banks having bigger customer base and resources i.e. the multiplier effect.

- The narrow banking should be practised by weak banks, i.e. only allowed to extend low-risk loans.
- The capital adequacy requirements should take the market risks into account in addition to the existing credit risk.
- The banking laws like the Banking Regulation Act and the RBI Act need to be amended.
- Government guarantees' advanced and its prescription on risk weight for Government should be calculated in the same manner as for other advances.
- Higher norms for capital adequacy should be set, the minimum capital to risk assets ratio should be increased to 10%.
- PSBs should meet their credit requirements from the capital market instead of the Government.[4,5,6]
- An asset should be classified as doubtful if it is under the substandard category for 18 months in the first instance and eventually for 12 months if it is identified but not written off.

The following measures were taken by the Government in furtherance of these recommendations:

- RBI monitored the potential weakness of the banks based on 5 parameters based on insolvency, profitability and earnings as recommended by the Working Group on Restructuring of Weak Public Sector Banks.
- Banks were mandatorily required to assign a risk weightage of 2.5% for government and other approved securities outside the SLR.
- In case of Govt. guaranteed advances and invoked and defaulted guarantees by the State Government on the end of FY1999-20 should be assigned 20% and at the end of FY 20-21 should be assigned 100%.
- Minimum capital risk asset ratio was enhanced to 9% w.e.f from FY 1999-20.
- Banks were permitted to access capital from the markets.
- The period to classify an asset as doubtful was reduced from 24 to 18 months and provisioning of not less than 50% of total doubtful assets is required.

#### Basel norms

Basel norms are global standards approved and accepted by several banks, the objective of the establishment of such norms was to increase coordination between the central banks all over the world. It also wanted to promote transparency in the banking sector and reliance on banks to recover from financial shocks These were given by the Basel Committee on Banking Supervision.

#### Basel I norms

Base-I norms came out in 1988 it focused on credit default risk and the maintenance of adequate capital. The capital adequacy ratio was 8%. The capital was classified as Tier 1 and Tier 2.

Tier 1 was the core capital of the banks which is permanent and reliable including equity capital and disclosed reserves whereas Tier 2 was supplementary capital including provisions for NPAs, cumulative non-redeemable preference shares, undisclosed reserves.

The bank assets were clarified into 5 categories depending on their risk percentage, 0%, 10%, 20%, 50% and 100%.

India adopted the Basel I Norm framework in 1992-93 under RBI guidelines, the compliance was a phase for the banks having an oversea presence, the deadline was March 1994 and the other could comply by March 1996.

#### Basel II norms

Basel II was released in 2004. Primarily, it has three interdependent frameworks, minimum capital, supervisory review and market discipline.

**Minimum Capital:** There is a requirement of maintenance of minimum capital adequacy of 8% of risk-weighted assets. Also the two categories of the capital created by Basel I Norms Basel 2 created Tier 3 for the short term subordinated loans.

**Regulatory Requirement:** The banks also had to develop and practice risk management techniques for credit risk, market risk and operational risks. The basic indicators of risk were to be identified and a standardised approach to be developed.

**Market Discipline:** Lastly, many disclosure requirements were added like CAR, risk exposure etc. to the central bank. This was to increase transparency in the banking sector and to enable central banks to keep a tab on the position of the commercial banks.

India adopted Basel II Norms in 2009 under RBI Guidelines.

Basel III norms

Basel III was adopted after the 2007-8 financial crisis, 2010. The norms raised the capital adequacy ratio to 12.9%. The tier 1 and tier 2 capital ratio were to be maintained at a minimum of 10.5% and 2% respectively.

Furthermore, a capital conservation buffer of 2.5%, counter-cyclical buffer of 0-2.5% was to be maintained as well.

There were two types of liquidity ratio required to maintain the Liquidity Coverage Ratio (“LCR”) and Net Stable Fund Rate (“NSFR”).

The RBI issued regulations to implement the Basel III Norms Capital Regulations, originally the deadline was by March 2011 but it was postponed to March 2011.

## II. DISCUSSION

There was a profound impact of globalisation on the banking sector of the country, some of them are:

Integration of the financial market

Globalisation, as stated above, aims to form a more connected market by free cross border movement of capital, technology and other resources. The financial market is no exception as the markets were opened for foreign investors. The investors were allowed to invest in foreign markets, this was achieved by relaxing the existing policy norms of closed economies, and developing international standards for business.[7,8,9]

The Indian LPG economic reforms and then subsequent adoption of international practices and standards like enabling entry of foreign banks, enhancing private bank operations, reducing government’s stake in banking and adoption of Basel norms I and II are some examples of it.

Deregulation of the market

During License Raj, the banks needed to obtain licenses and go through extensive government procedures for all banking and financing activities like the determination of pricing, determination of interest rates, restriction on certain activities and the compliances to start or shut down the operations.

After the liberalisation steps were taken to re-establish autonomy in the banking sector, it was one of the recommendations by the Narasimham Committee like accessing the capital market, interest rates were determined by the banks and not the government. And most importantly the individual branch licensing was liberalised to a large extent allowing banks to determine the number and the locations based on commercial viability.

Diversification of services provided by the banks

Post globalisation the banks diversified in their services, diversification of services are of the following three types:

Narrow spectrum diversification

Narrow Spectrum Diversification (“NSD”) is the diversification of services by banks in a field related to banking itself. These are usually vertical integrations by banking industry players. Two examples of this can be:

- **Universal banking-** multi-purpose and multi-functional providing banking and financial services, it serves the needs of corporates and individuals both. SBI provides universal banking services.
- **Retail Banking- focus on banking for the general public and not a large company or corporations, it includes checking and savings accounts, personal loans, credit cards etc.**
- Broad spectrum diversification
- Broad Spectrum Diversification (“BSD”) includes the services which are unrelated to banking, some examples of such services are:
- **Merchant banking-** banking activities related to securities transactions and the stock market. Bank of Baroda provides merchant banking to its customers.
- **Insurance Services-** banks have started to extend insurance services and these are quite popular in the general public, SBI Life Insurance, HDFC Life Sanchay and ICICI Prudential Life are one of the best insurances in the market.

#### Alliance Diversification

Alliance Diversification (“AD”) refers to diversification by banks by tie-ups, joint ventures or other alliances with other banking or non-banking entities. Thus these can be NSD or BSD just there are multiple entities involved.

SBI Life is a JV with Cardiff and SBI Asset Management is a JV with Societe Generale.

#### The entry of foreign banks

Currently, there are 37 foreign banks and over 270 banking branches operating in the Indian market, however, in the year 1980, the number of foreign banks was merely 14 banks which significantly increased in 1990 to 24 and its highest to 41 in 2000. According to RBI, before liberalisation, the share of foreign banks in total commercial banks was 9.5 % in 1980 which increased to 13.9% in 2000.

#### The entry of private banks

In the 1990s new policies for licensing private banks were issued in 1993 which only allowed 8 private banks to function and after India’s commitments under WTO w.r.t. Foreign investment etc. the foreign banks were allowed to open 12 branches a year, the share of private bank’s deposits of the total deposits was 4% and it increased to 18% in 2010.

#### Increase competition

Reduction in entry barriers in the banking sector led to an increase in the number of participants like several new private banks and foreign banks which led to an increase in efficiency and competition in the market.

The government also strengthened the PSBs by lending its capital to them and also enabling them to raise capital from the public. Functional autonomy of PSBs was also considerably increased.

#### Indian banks become global

Liberalisation has not only provided access to the foreign banks to Indian market but also provided Indian banks access to foreign banks and an opportunity to expand their organisation. In the year 1991, there was the negligible global presence of Indian banks and by 2011 there are in total 136 branches of Indian Banks at overseas centres with both Bank of Baroda and State Bank of India having 36 i.e. the highest number of branches.

SBI has branches in 19 countries including Singapore (highest number of branches, 6) the United States of America, South Korea, Belgium, Bangladesh etc.

Bank of Baroda has a considerable overseas presence in 14 countries including the United States of America, United Arab Emirates, United Kingdom, Singapore, Thailand, Malaysia, China, Australia etc. It also has subsidiaries in 8 foreign countries.

#### Impact on Public Sector banks

Indian Public Sector Banks (“PSBs”) went through sizable changes like independence in conducting its operations, and the compulsory priority sector lending was reduced. This enabled the PSBs to look for more commercial viability in their operations which were earlier more connected by the social policies the government aimed to achieve through their policies norms. The Banking Companies Act 1970/80 amendment enabled the PSBs to raise funds from the capital market by way of securities or debt instruments.

#### Improvement of the banking sector

Due to a reduction in cost, overhead expenses and interest margins of domestic banks.

There has been greater transparency in the banking operations after the globalisation due to the Central Vigilance Commission (“CVC”) direction of following open policy by the banks, including disclosures with regards to the net Non Performing Assets, the maturity profile of loans, investments, and financial details of subsidiaries as well. [10,11,12]

The entry of well established foreign banks and private banks established by huge corporates raised the level of services provided to the customers and forced the existing banks to raise their services to the same level as well.

### Introduction of IBC

#### Need for IBC

A recent and one of the largest reforms in the banking sector is the introduction of Insolvency and Bankruptcy Code, 2011. The legislation particularly deals with corporate insolvency and one of its major objectives was to provide ease and faster exit for the businesses.

Globalisation only allows the investors to invest internationally but the choice of where to invest resides on the investors themselves. As a result, there is a competition among the countries to make their markets the best option for the investors. The earlier insolvency regime in the country was extremely complex and led to a delay in the completion of the process almost 4 and a half years which was substantially more than other developed countries like the USA and UK where the periods were 1 and a half year and 1 year respectively. Therefore, there was a clear need to simplify and consolidate the insolvency and bankruptcy law particularly for body corporates to increase foreign investment.

#### Impact of IBC

The code provided an exhaustive framework for corporate insolvency and bankruptcy and even revival of sick companies, the clarity of legislation is an important aspect foreign investors look into when investing in a country.

The code was proved useful in inviting new investments in the market and increasing India's international position in the World Bank's Ease in Doing Business, in 2011 the ranking was 142nd and within five years of functioning of the Code the country is on 63rd position.

According to the World Bank, an average of 42.5% of the filled amount was recovered through IBC in 2011-19 as compared to 14.5% under SARFAESI, 3.5% under DRT and 5.3% in Lok Adalats.

Although there are several factors attributable to such improvement IBC is one of the contributors to it.

#### Pros and cons of globalisation

There are undeniable advantages of globalisation of financial markets like market stability, uniform regulation and creating an investor trusted market. There has been an overall increase in the product quality and service qualities in the global market which is beneficial to the customers. It not only provided a wider market access but also the wider set of investors.

In addition to these, there are also some disadvantages of globalisation mostly due to improper and delayed implementation of standards or protective measures. Some of them are:

#### Impact of Recessions

But the integration has led to the interdependence of economies which has also paved the way for the transfer of disruptions as well, the great depression of the 1930s started with the United States of America but spread throughout the globe leading to millions of persons getting unemployment.

Another such example was the 2007-09 financial crisis, it was started in 2006 by the housing crises of the United States and the biggest global banks failed. Some of them were Lehman Brothers, Douglas National Bank, ANB Financial, Washington Mutual and a total of 465 banks failed and shut by the Federal Deposit Insurance corporation between 2008-12.

The financial crisis impacted the European banks significantly, Romania entered into recession in 2009. According to Eurostat Statistics, 2009 the total GDP growth of EU15 was 3 in 2006 which reduced to -4.1 by the year 2009.

Although the Indian Banking Sector was not much affected by the 2008 recession, the reason for this was the non-integration of Indian finance sector particularly the banking sector to the global market. The Indian banks were also not exposed to mortgage-backed securities which were the root cause of the crisis.

#### The decrease in MSME lending

The impact of globalization was unsettling on the MSME sector of the country due to their lack of resources and smaller scale of operations it was difficult to compete with the global players. MSMEs are not only important in a country for the creation of employment and domestic production but also for the banking sector as a considerable portion of lending used to be facilitated to MSMEs, however that has reduced. According to the RBI Report on

MSMEs, the demand for credit by MSMEs is estimated to be 37 trillion and the overall supply is 14.5 trillion thus there is an estimated gap of 20-25 trillion.

#### Fugitive economic offences

One of the major problems of globalisation is that there has been an increase in the commission of economic offences and economic fugitive offenders, these are the persons accused of committing an economic offence who elope to foreign jurisdictions to safeguard themselves from prosecution.

In the last decade itself, India has witnessed the biggest banking frauds in its history all three of which were economic fugitive offenders, three such infamous offenders are Rajiv, Nirav Modi and Vijay Mallya. There is an urgent need to better the extradition treaties with other countries to prevent such scams concerning public money deposited in banks.

### III. RESULTS

In this section, we begin by highlighting some of the forces behind recent advances in banking globalization and then overview some of the resulting international banking positions. Broader trends in global capital market integration have been discussed elsewhere in rich detail by Obstfeld and Taylor (2004) and in the empirical studies of Lane and Milesi-Ferretti (2001, 2006). More specific details on banking globalization in the latter part of the 20th century are nicely overviewed by Turner (2006).[12,13]

The impetus for the globalization of banking varies by player, by time, and by country. From the perspective of the parent bank, some episodes of enhanced international positions originate in bank-specific searches for yield and diversification opportunities. Other episodes have followed regulatory changes in the home of host country markets, which have increased the accessibility of expanding services to the host country, either as cross-border transactions or through establishing branches and subsidiaries in the host. Some cases of foreign bank entry into previously restricted markets have occurred in the aftermath of crises, or as a result of agreements made in conjunction with negotiations over international trade and specific forms of market access.

Particular episodes of expanded global banking include the period following the dissolution of the Soviet Union, when bank entry into central and eastern Europe in the early 1990s led to a rapid growth of foreign ownership in local banking systems. By the early part of the 21st century, foreign participation in the markets often exceeded 80 percent of local banking assets. Another episode of expansion occurred with the liberalization of FSs in Latin America through the mid to late 1990s. The first wave of liberalization was a follow-your-customer type, taking place in the aftermath of expanded FDI into manufacturing and resource extraction industries and enhanced competition that Latin American countries faced from Asian counterparts. Another burst of foreign banking activity within Latin America occurred as a result of financial crises of the mid to late 1990s, as countries sought to recapitalize their ailing banking systems and to improve the overall efficiency of their FSs.

Acquisition data present one window into the vibrant changes in international banking in recent decades. Figure 1 shows the value and number of acquisitions of banks in developing countries by source countries between 1990 and 2003. During this period, banks in countries with highly developed financial systems were the main sources of FS-FDI. Through this FS-FDI parent banks based in industrialized countries assumed substantial, if not majority, control of assets in host-country financial systems.

The evolution of banking in India has been slower. India's public sector banks hold more than 75 percent of commercial bank assets. As of 2007, 8 of the 10 largest commercial banks in India were public sector banks, with the State Bank of India alone directly accounting for 17 percent of commercial bank assets. Although foreign banks currently have limited participation in Indian banking, in late 2007 the Reserve Bank of India announced pending phases of partial access with the first stage through March 2009, and a second phase thereafter. Meanwhile, foreign banks are increasing their nonbank businesses, expanding activities through consumer finance franchises.<sup>2</sup>

Data collected by Bank for International Settlements (BIS) facilitate perspectives from the vantage point of countries with large international banking positions. Thirty countries report national consolidated data to the BIS, consolidated across banks with international positions at quarterly frequency.<sup>3</sup> The data reflect banks' "on-balance-sheet" financial claims on the rest of the world, aggregated across all banks within each reporting country, covering contractual lending by the head office and all its branches and subsidiaries on a worldwide consolidated basis, that is net of interoffice accounts.

The types of claims reported to the BIS are organized under two headings: international claims and foreign claims. International claims encompass cross-border lending and the local claims extended by foreign affiliates of the parent bank that are denominated in foreign currency. Foreign claims are broader than international claims, in that they also capture local claims, which are loans extended by foreign affiliates of the parent bank and denominated in local currency terms.

To gauge the scale of global lending of those countries with large international banking positions, we begin with Table 1 that presents September 2007 information. The countries profiled are those with the largest absolute claims, whether on an immediate-borrower basis or on an ultimate risk basis. Germany, the United Kingdom, and France have the largest foreign claims on an immediate-borrower basis, although the composition of these claims differs substantially across countries. For example, the United Kingdom dominates this group in terms of local claims, whether reported on an ultimate risk basis or an immediate-borrower basis. By contrast, the international banking by Germany and Japan occurs largely through international claims. The positions of the United Kingdom, the Netherlands, and Switzerland are largely balanced across local currency vs. foreign currency lending, whereas the United States and France more often lend in a currency other than that of the local market. These types of claims may have different underlying motivations and different determinants. For example, Cetorelli and Goldberg (2006) show that cross-border claims of the United States tended to be more volatile than claims issued abroad by the branches and subsidiaries of the U.S. banks.

#### IV. CONCLUSION

To sum up it can be stated globalisation has aided the development of the Indian banking sector and increased the efficiency and profitability in a manifold manner, by providing more autonomy and less government regulation in the sector. However the same is not devoid of challenges which are to be faced by increased competition and disparity in the scale of operations. Some of the consequences of bank globalization for the real economy come under the headings of allocative efficiency, technology transfer, consequences for workers, and institutional and regulatory changes. FDI is typically associated with improved allocative efficiency. This improvement can occur when foreign investors enter industries with high entry barriers and then reduce local monopolistic distortions. The presence of foreign producers may also increase technical efficiency: heightened competitive pressure or some demonstration effect may spur local firms to use existing resources more effectively. FDI is also associated with higher rates of technology transfer and diffusion as well as with greater wages.[13,14] Although there is evidence of technological improvements from FDI and a presumption that such investment will consequently stimulate economic growth, the strength of these effects is disputed. FDI into host countries also induces higher wages, although these wage effects are sometimes limited to the foreign-owned production facilities and do not spill over more broadly. The employment and growth effects of FS-FDI are more subtle than other effects, depending in part on whether the investment is Greenfield or mergers and acquisitions. In the latter case, the effects also depend on whether the acquired institution was financially sound or in need of restructuring, regardless of the nationality of the new owners. However, if financial intermediation improves, FS-FDI should support greater employment and growth prospects.

The institutional effects of FS-FDI are potentially clearer and quite positive. FS-FDI from well regulated and well supervised source countries can support emerging market institutional development and governance, improve a host country's mix of financial services and risk management tools, and potentially reduce the incidence of sharp crises associated with financial underdevelopment in emerging markets. Yet this type of investment can initially pose formidable challenges to local supervisors, who will need to develop expertise in the practices and products introduced into their economies.

Improved regulation and supervision occasionally occur with a lag, as supervisors in the host countries at first may not be prepared to evaluate the new products and processes introduced by foreign entrants. The path forward on regulatory and supervisory reform continues to be an important focal point in the policy community, with continued importance underscored both by trends in banking globalization and by recent events reinforcing the strength of international financial linkages across the industrialized and emerging economies of the world.[14]

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