

## Role Of Foreign Banks In Indian Economy

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### Abstract

Foreign banks in India have had a very small share in overall banking deposits and advances. However, in spite of their relatively small size when compared to their Indian counterparts, foreign banks have played a pivotal and catalyzing role in India's economic growth, helping to bring it to the forefront of global business and trade. From being mainly conduits of precious foreign exchange dollars to being global business facilitators for Indian and multinational corporate, foreign banks have adapted to every need of the 'economic' India at different time periods.

This chapter studies the role of foreign banks in India's growth over the last few decades. That being so, it would be useful to understand the specific contributions over three major economic phases mainly—the globalisation phase, 1999-2000 onwards.

**Key words :** Foreign banks, Economy,

### INTRODUCTION

The Globalisation Phase( 1999- 2000 Onwards) :

The decade started in the backdrop of the Y2K crisis , the technology bubble and world terrorism coming to the fore with the 9/11 terrorist attack .However ,this period was probably one of the best for the India capital markets ,probably even a shade better than the 1990s which laid the foundation for this through economic liberalisation. Access to global capital became easier for the Indian corporate sector as branches of foreign bank in India started showcasing India as an attractive location for foreign investment.

Taking India Inc Aboard:

During this decade, global investors and foreign institutional investors (FIIs) started investing billions of dollars in Indian markets. Simultaneously, Indian corporate mobilised a staggering US\$ 65 billion from the primary markets (SEBI. Handbook of Statistics, 2010), riding high on blockbuster IPOs like Coal India and Reliance Power. Maruti Suzuki's IPO became iconic in the public issue market history, which in a way paved the way for disinvestment prospects in the country. It was the decade when the Indian capital markets and the Indian economy came on the radar of the world.

Foreign banks also played a significant role in raising cheap capital for Indian companies with huge growth plans. With Indian firms increasingly looking for investments overseas, foreign banks played a critical role in raising money for them, connecting them with a global clientele and consumers. They were instrumental in developing the investment banking industry in the country during this period. As mergers & acquisitions (M&A) activities in India grew sharply, a majority of the top deals were being advised by foreign banks. Further , the twin advantages of large balance sheets and a global network provided MNC banks the ability to finance big- ticket acquisitions. Given their in – house knowledge and capabilities, they were major participants in a majority of the M& AI ADR/GDR deals that took place in the last two decades connecting global clientele as well as local investors to corporate by India. In fact, from 2004, the reverse trend of overseas acquisitions by large Indian conglomerates also gained substantial pace. Some of the biggest deals- Tata- Tetley, Tata- Corus, Aditya Birls- Novalis, Tara-Land Rover and Bharti- Zain- were financed or advised by foreign banks.

Apart from Indian corporate, who benefited from these institutions to pursue domestic and cross- border deals, domestic Indian banks and financial institutions also benefited substantially in building their cross- border M&A capabilities by forming joint ventures and partnerships with large international investment banks. This has led to several large homegrown financial institutions to subsequently branch out on their own in this space and provide would class business advice.

#### Developing the Financial Markets:

Foreign banks played a significant role in developing the domestic capital markets by bringing in international expertise. They were instrumental in directing F11 capital flows into the equity, debt and credit markets, thereby adding the much –need depth and breadth to the Indian financial sector. They also increased equity participation in domestic banks (old and new) in need of funds, be it for growth, restructuring, or entering into alliances and joint ventures, so as to market global services to domestic customers.

Further, in a market where financial instruments were less developed, foreign banks pioneered the introduction and creation of sophisticated financial products and services (for example, derivatives, futures and options) during this period. They also laid the frame work for these innovations to benefit corporate India and the domestic banking players. One of the prime examples is the formation of FIMMDA, a voluntary market (nationalised bank, private sector banks, financial institutions, foreign banks and insurance companies) for the bond, money and derivatives markets.

#### Fuelling the Knowledge Processing Industry

Global banks were the first to identify the huge opportunity that lay in India's large English- educated workforce. They understood the cost advantage of centralising their global business processes back into India and thus helped in creating an entire new industry. Seeking to expand their presence in the world's second- fastest growing economy and benefit from low- cost opportunities in IT-enabled back – end operations, foreign banks have been increasingly with their headcount.

Firms in the banking and services industries were early adopters of knowledge process outsourcing (KPO), with many of them performing high-end analytical work through their offshore captives. They accounted for nearly two-thirds of the workforce in 2007.<sup>3</sup> This investment has aided in building a young ,confident ,professional and global Indian workforce.

Further ,foreign banks and financial institutions can be credited as being the biggest users of India's ITES services and therefore a major catalyst in the birth and implemented world class core banking systems with the 'made in India 'tag much before new age private sector adopted them. Today ,because of its ubiquity ,Indian –developed systems are products of choice globally.

#### Exporting World Class Human Talent:

One of the biggest contributions of global banks to corporate India has been world class human talent .Foreign banks have been the breeding ground for most of India's senior banking management as well. It can safely be claimed that a majority of the existing senior management in old and new private sector banks has at some time worked with a multinational bank .Providing opportunities to talented Youngsters helped in introducing new ideas and products into a highly staid banking sector .

The most visible recognition of Indian talent by foreign banks is the fact that almost all large and foreign banks in India are today headed by Indians and not expatriates as, fore example , Bank of America ,Deutsche Bank, HSBC ,RBS ,and Standard Chartered Bank. The other side of the coin is that this is also opening greater opportunities for Indian managers to get into senior positions inter –nationally. This is borne out by the fact that two of the largest global banks in the world are now headed by Indian managers.

#### The Economic Crisis of 2008:

In contrast to the global scenario, India was by and large spared by the global financial contagion. Even in the midst of the crisis, India's financial sector remained safe and sound and continued to function normally. There are a variety of reasons for this- with the primary one being the cautious but pragmatic approach of the regulator (Reserve Bank of India (RBI) towards financial products through prudent policies that prevented excessive risk taking.

What also helped insulate the Indian economy from the crisis was that there were restrictions on investments by residents in such products issued abroad, and regulatory guidelines on securitisation did not permit immediate profit recognition.

In fact, since then foreign banks have been even more involved in working with regulators like the RBI, SEBI (Securities & Exchange Board of India), etc to draft regulations on issues ranging from know your customer (KYC) norms to complex products like structured notes. They have shared best global regulatory practices so that the Indian banking sector remains insulated from any volatility through strict monitoring.

However, the crisis has shown that those foreign banks with a large host country presence (and who had acquired a large share at the expense of domestic banks) tended to substantially curtail their

operations in the host country as a result of the crisis, sometimes even withdrawing completely. The Indian experience has been similar, but for one variation: while foreign banks withdrew from credit markets in India, they compensated by providing the much needed dollar financing.

Foreign banks are often seen as improving the allocation of credit since they have more sophisticated systems for evaluating and pricing credit risks. In particular, foreign banks can provide a more stable source of credit as branches and subsidiaries of large international banks can draw on their parent for additional funding and capital, when needed. They have generally galvanized the domestic banking sector by encouraging and bringing in healthy competition. Governments as well as regulators have also concluded that the entry of foreign banks generally has an overall positive effect on the efficiency and stability of a growing banking system.

That said, there are concerns that foreign banks cherry pick the most profitable domestic banks to serve the other customers and less profitable trades, thereby increasing the overall riskiness of domestic banks' portfolios. In addition, credit risk evaluation methods used in mature markets may face informational constraints in emerging markets like India and end up reducing the availability of credit to small firms. There have also been concerns about the behaviour of foreign banks during crisis periods. Indeed, in Asia, one of the most frequently cited reasons for limited foreign bank entry is the perception that foreign banks have 'cut and run' during crises, especially in the period following the 1997 crisis.

We should understand that the presence of foreign banks is not a zero sum game. Rather, they complement domestic banks and deepen the financial markets in emerging economies, in this case India. All this underlies the case for greater freedom for foreign banks.

While we have discussed the role of foreign banks in the past, it is also important to discuss what their role could be in the future. Viewing this in the context of the economic needs of India, there are three big national priorities which should propel India's growth in the current decade.

#### Infrastructure:

According to the Planning Commission, infrastructure investment will need to increase from about 8 per cent of GDP in the base year (2011-2012) of the 12<sup>th</sup> Plan to about 10 per cent of GDP in 2016-17. The required investment in infrastructure would be US\$700 billion and will need to be raised by participants. The good news is that both domestic and international infrastructure players and investors are keen to invest in this sector. If the success in the telecom sector is anything to go by, they may be on the right course since it has been widely acknowledged that foreign capital has played a big role in the development of the Indian telecom sector. However, unlike other sectors, infrastructure requires long-term financing—generally up to 10 years, raising asset liability mismatches—which has hindered financiers and investing norms on alternative sources of financing as, for example insurance and pension funds will need to be changed to meet the growing requirements.

And, notwithstanding a supportive regulatory environment, foreign banks will need to innovate debt financing products and models if they want to participate in building India's infrastructure.

#### Small and Medium Enterprises:

Small and medium enterprises (SME) play a major role in emerging market economies as they represent around 80-90 per cent of the total firms' population, generate a large share of employment (more than 50 per cent in many countries) and value added in the economy, and are significant sources of innovation. Access to credit to SMEs is the commercial banking system. Foreign banks can play an even greater role in India by channelling resources to SMEs and taking the emerging corporate India to the next level, similar to what they achieved in the early 1990s.

#### Financial Inclusion

The importance of an inclusive financial system is globally recognised as the path to comprehensive growth. It is estimated that approximately 40 per cent of Indians still do not have access to even the most basic banking services. Essentially, what is still lacking is a comprehensive product suite that caters to this segment and an efficient distribution network that can deliver these products to the target population. Foreign banks could take the lead in this area through adopting and disseminating innovative technologies and business models which are not infrastructure- or resource- heavy and help bridge the last mile.

To conclude, foreign banks committed to making a play in India will need to adopt alternative approaches to win the race for the customer and build a value-creating customer franchise in the coming decade. Maintaining a long-term value-creation mindset will be their greatest challenge.

## NEED FOR THE STUDY :

Though a number of studies have focused on the different aspects of foreign banks operations, majority of these studies were conducted during the period prior to 1995. In view of the importance attached to the foreign banks in India by the RBI since late 90's with its positive approach, there have been pertinent policy developments taken place. As a result there is an imperative need to study the contemporary policies of the Government of India and RBI aiming at the aggressive expansion of FBs' presence in the present context and its likely implications in the globalization period..

## OBJECTIVES OF THE STUDY :

The objectives of the proposed study are to:

- Present an overview of the growth of foreign banks in India.
- To examine the trends of foreign banks in India for developing of Indian economy relating to business, priority sector lending ..
- To offer a meaningful and feasible suggestive framework to promote the performance of foreign banks in India.

## Methodology :

Research methodology is a way to systematically solve the research problem The study is primarily based on the secondary data. The information is gathered by different books journal articles and publications of Reserve Bank of India, Indian Bankers association publications, data base on Indian economy.

## REVIEW OF LITERATURE :

Ankush Bhargava, Dr. Manisha Verma (2014)<sup>1</sup> Post Liberalisation Era paved the path for the great reforms in the banking sector; this led to a great deal of efficiency and profitability in the banking institutions. The foreign banking system is diverged and contains tremendous potential to impact the outcome of the Indian banking scenario. The present study thus focuses on ten banks out of the forty three foreign banks on grounds of comparative performance, profitability and growth rate. The study gives suggestive measures for the banks regarding operational inefficiencies. The study also reveals different areas where they can improve their financial performance. The study further put some light on the banks which are professionally managed and able to attract more customers and have grown much faster than other banks in the competition.

Ghosh (2012)<sup>2</sup> discusses how foreign banks have an impact on domestic profitability. The paper concludes that foreign banks presence improves profitability and asset quality of domestic banks.

Gaurav Saradha, Namrathaswamy, Charan Singh(2014)<sup>3</sup> Further, it discusses the various opinions towards the foreign bank operations in the host country, with India as the example. The paper looks

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<sup>2</sup> Ghosh, S. (2012), "Foreign banks in India: liabilities or assets?" Economic Papers, The Economic Society of Australia, vol. 31(2), pages 225-243, 06

<sup>3</sup> Gaurav Saradha, Namrathaswamy, Charan Singh, [working papers No 451 February,2014

at the regulatory framework in India to understand the attitude of RBI towards foreign banks. It also discusses what several foreign banks feel about the Indian regulatory setup and how these banks have adapted themselves to deal with the changes. To look at the impact of foreign banks the paper analyses various parameters like the rural presence, contribution towards priority sector, technological development and financial ratios like return on asset and equity. Two case studies have been discussed – one, about The Hong Kong and Shanghai Banking Corporation's (HSBC) journey in India and the other, about BCCI in India. The paper ends by discussing various challenges which are faced by foreign banks when they set-up their shop in the country.

Niels Hermes and Robert Lensink(2012)<sup>4</sup> explained the foreign bank presence, domestic bank performance and financial development. This paper analyses the relationship between foreign bank presence and the performance of the domestic banking sector and takes into account the role of the level of development of the financial sector of the recipient country. We use bank level data of 982 banks in 48 countries for the period 1990-1996. Our results show that in general we find support for the hypothesis that financial development does matter. In particular, we show that foreign bank presence is associated with higher costs and margins of domestic banks at low levels of financial development while it is associated with falling costs and margins of domestic banks at higher levels of financial development.

#### FOREIGN BANKS AT A GLANCE:

Table : 1.1

It has been the general impression of many that the foreign banks in India do generate insignificant employment opportunities, since their banking operations are carried out dominantly by e-banking devices. To ascertain the correctness of this fact an attempt is made to trace the category wise number of employees in all the foreign banks together operating in India during the study period 1999-2014 and the result are incorporated in table (1.1) contrary to the general opinion, the foreign banks in India managing their operations with more number of personnel. It is evident from the table that there was an increase of about 83 per cent in number of employees during the study period and a massive jump since 2005-06. This can be contributed to the announcement of RBI on the roadmap for the foreign banks in India. It can also be observed from the table that the share of officer cadre employees among the total employees accounted for the bulk share of about 90 per cent during the period under study. This might be due to the policy of foreign banks in recruiting officers more in number with diversified skills expertise in technology.

Table : 1.2

Notwithstanding the fact of talking of branchless banking in the modern computer era, still the their presences in urban areas their exceptions to this. having a glance at table (1.2) one can easily notice that the branches of foreign banks rose to 311 during 2013-14 from 181 during 1999-

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2000 reflecting a growth rate of about 72 per cent .this can be more evident particularly from the year 2005-06 and onwards, in which year the roadmap for foreign bank was unveiled .the population wise branch particulars of foreign banks reveal that though they had about 80 per cent of branches in metropolitan areas for obvious reasons , gradually this figure came down to about 70 per cent by the end of study period by increasing . More interestingly, the foreign banks do have their branches even in rural areas, of course in negligible number. However, it can be inferred here that the foreign banks in India also demonstrated their inclination to have their presence in rural and semi urban areas.

Table : 1.3

Foreign banks in India are known for their 100 per cent computerization, definitely the ATM's play a key role in enabling customers to have any time banking facility. Hence an attempt is made to identify the number of ATMs in the form of both on site and off site opened by foreign banks during 2004-14 and the results are furnished in table(1.3). As is evident, the number of ATMs rose to significantly to 1179 during 2013 as against 363 during 2004-05 showing growth rate of about 225 per cent, out of the total ATM's, majority of ATM's are located on site to the extent ranging from 70 to 85 per cent . from the above table (1.3 ) from the above table, one can notice that there was a big push to the number of ATM's after 2004-05. Besides, a shift can also be noticed in the policy of foreign banks in favour of off site ATM's significantly. this can be ascribed to the RBI's roadmap for the foreign banks released in 2005.

Table: 1.4

The performance of any banking institution can be judged basically on its total business comprising of total deposits and advances and this equally applies to foreign banking also .hence the details regarding these parameters are recorded in table() for the period 1999-2014.a peep into table, one can catch the sight of manifold increase in the total business of foreign banks during the study period particularly since 2005 due to RBI's road map for foreign banks. This can be corroborated with the growth rates of foreign banks in total business during 2004 to 09. It can also be noted that over a period under study, it is clear that the share of total advances in total business has been on the gradual increase . this in turn indicates the rising level of CD ratio, which itself is a healthy sign.

Table : 1.5

The RBI instructed all the scheduled commercial banks to be compliant with the targets fixed for the priority sector advances and foreign banks are also under obligation to meet the specified targets in priority sector financing. From this view point , it is desirable to discern the fact regarding contribution of foreign bank towards priority sector and hence the relevant data is compiled and presented in the table . a sizable portion of total advances is in the form of priority sector finance ranging from 21 per cent to 30 per cent. It is pleasant to observe that there has been a gradual increase in the share of priority sector advances in total advances. Here also the period 2004-09 witnessed massive upsurge in lending to priority sector as a share of total advances. However , it is constrained to notice that the growth rate is during 2009-14.In this regard was impressive due to lack of momentum which was at its best during 2004-09.this necessitates the foreign banks to address on their vital issue.

Table :1.6

The recovery performance of any banking institutions provide a basis to judge the quality of its assets and this can be studied with the computation of NPA's and the same yardsticks is applicable to foreign banks also. In view of this data pertaining to Gross NPAs and Net NPAs of all foreign banks in India was collected and exhibited in table(1.6).it is very much distressing to notice that the level of NPAs both in terms of Gross NPA's and Net NPA's has been mendaciously on the increase during the study period. These figures are at a peak level during 2004-09.this might be due to increasing inclination of foreign banks towards widening loan portfolio as part of RBI's road map for the foreign banks towards widening loan portfolio as part of RBIs roadmap for foreign banks by passing certain minimum prescribed norms in lending.

Table : 1.7

Effective redressal of customers complaints in a bank do really help the banks in widening the customer complaints in a bank do really help the bank in widening the customer base and to ascertain the status of foreign banks in the regards , relevant information is obtained and presented in table (1.7 ).it is heartening to mention that the foreign banks have demonstrated their ability to redress complaints to the extent of around 98 per cent which itself is a positive indication. More over, the number of complaints pending at the beginning of the year clearly confirms the above positive status.

Table : 1.1 Total number of Foreign and branches in India during 1999-00 to 2013-14

Source: 1.Performance highlights of foreign banks in India relevant issues  
2.Trends and Progress of Reserve Bank of India.

Table 1.2 Total number of foreign banks and branches in India 1999-00 to 2013-14  
(in numbers)

AREA WISE BRANCHES						
YEAR	No.of banks	rural	Semi urban	urban	metropolitan	Total branches
1999-00	42	0	2	32	147	181
2000-01	42	0	2	38	149	189
2001-02	40	0	0	39	155	194
2002-03	33	0	0	43	137	180
2003-04	33	0	2	43	160	205
2004-05	31	0	2	54	170	226
2005-06	31	0	2	58	195	255
2006-07	29	0	2	67	199	268
2007-08	29	1	3	65	207	276
2008-09	31	1	4	75	212	292
2009-10	34	2	6	81	218	307
2010-11	36	3	8	88	215	314
2011-12	41	5	8	81	226	320
2012-13	43	5	7	85	232	329
2013-14	43	5	6	73	227	311

  

CATEGORY WISE NO.OF EMPLOYEES				
YEAR	OFFICERS	CLERKS	SUB ORDINATES	TOTAL
1999-00	8314	4042	1153	13509
2000-01	9136	3878	1129	14143
2001-02	9033	3714	1080	13827
2002-03	9011	2381	359	11751
2003-04	11856	1723	512	14091
2004-05	15237	1608	522	17367
2005-06	18978	1979	1342	22117
2006-07	26472	1666	288	28426
2007-08	30200	1330	634	32164
2008-09	27668	1282	632	29582
2009-10	26133	1419	467	28019
2010-11	25816	1438	529	27783
2011-12	24156	1384	447	25987
2012-13	23627	1343	472	25442
2013-14	23028	1361	420	24809

Source: 1.Performance highlights of foreign banks in India relevant issues  
2.Trends and Progress OF Reserve Bank of India

Table : 1.3 ATMs of foreign banks in India during 2004-05 to 2013-14

( in numbers)

Source: 1.Performance highlights of foreign banks in India relevant issues  
2.Trends and Progress OF Reserve Bank of India

YEAR	On site	Off site	Total branches
2004-05	312	51	363
2005-06	692	244	936
2006-07	660	290	950
2007-08	713	326	1039
2008-09	757	271	1028
2009-10	746	281	1027
2010-11	1080	287	1367
2011-12	1133	288	1421
2012-13	983	286	1269
2013-14	915	264	1179

Table : 1.4 Total business of foreign banks in india during 1999-00 to 2013-14



(Rs in crores)

Source: 1.Performance highlights of foreign banks in India relevant issues  
2.Trends and Progress OF Reserve Bank of India

YEAR	Total deposits	Total advances	Total business
1999-00	49377	35858	85234
2000-01	59240	43051	102291
2001-02	64511	48632	113143
2002-03	69110	52018	121129
2003-04	79141	59822	138963
2004-05	86389	75318	161707
2005-06	113745	97562	211307
2006-07	150750	126339	277088
2007-08	191443	161959	353402
2008-09	214076	16538	379461
2009-10	232099	163260	395360
2010-11	24067	195511	436177
2011-12	276948	229849	506796
2012-13	288144	263680	551824
2013-14	352424	291154	643578

TABLE : 1.5 Priority sector % to total advances of foreign banks during the year 1999-00 to 2013-14

(Rs in crores)

Source: 1.Performance highlights of foreign banks in India relevant issues  
2.Trends and Progress OF Reserve Bank of India

TABLE : 1.6 Priority sector % to total advances of foreign banks during the year 2004-05

YEAR	Loans and advances	Priority sector	Priority sector to total advances
1999-00	35858	7624	21.26
2000-01	43051	9222	21.42
2001-02	48632	10484	21.56
2002-03	52018	11417	21.95
2003-04	59822	14042	23.47
2004-05	75318	19412	25.77
2005-06	97562	26218	26.87
2006-07	126339	34665	27.44
2007-08	161959	47668	29.43
2008-09	165385	50647	30.62
2009-10	163260	55399	33.93
2010-11	195511	63911	32.69
2011-12	229849	72764	31.66
2012-13	263680	77452	29.37
2013-14	291154	84890	29.16

YEAR	Gross NPAs	Net NPAs
1999-00	1726	606
2000-01	3044	758
2001-02	2730	896
2002-03	2820	855
2003-04	2649	874
2004-05	2192	649
2005-06	1928	808
2006-07	2263	927
2007-08	2872	1254
2008-09	6445	2997
2009-10	7134	2976
2010-11	5069	1283
2011-12	6297	1411
2012-13	7977	2661
2013-14	11577	3172

Source: 1. Performance highlights of foreign banks in India relevant issues  
2. Trends and Progress of Reserve Bank of India

YEAR	No. of complaints pending beginning of the year (No.s)	No. of complaints received during the year (no.s)	Total Complaints during the year (no.s)	No. Of complaints Redressed during the year (no.s)	% of complaints Redressed during the year (no.s)
2008-09	4468	292223	296691	293791	99.02
2009-10	2902	141917	144819	142106	98.13
2010-11	2713	129528	132241	130695	98.83
2011-12	1546	78020	79566	78656	98.86
2012-13	910	51460	52370	50884	97.16
2013-14	1480	74631	76111	74640	98.07

TABLE :1.7 Customer complaints in all foreign banks in India 2008-09 to 2013-14

Source: 1.Performance highlights of foreign banks in India relevant issues  
2.Trends and Progress of Reserve Bank of India

#### CONCLUSIONS OF THE STUDY :

- The number of foreign banks are increasing tremendously, there was an increase of about 83 per cent in number of employees during the study period The branch licensing policy has been liberalized by road map in 2005.Foreign banks are mainly concentrated on urban and metropolitan cities.
- There is 100 per cent computerization, definitely the ATM's play a key role in enabling customers to have any time banking facility.
- The targets fixed for the priority sector advances and foreign banks are also under obligation to meet the specified targets in priority sector financing.
- Due to increasing inclination of foreign banks towards widening loan portfolio as part of RBI's road map for the foreign banks towards widening loan portfolio as part of RBIs roadmap for foreign banks by passing certain minimum prescribed norms in lending.
- Effective redressal of customers complaints in a bank do really help the banks in widening the customer complaints in a bank do really help the bank in widening the customer base and to ascertain the status of foreign banks.

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