Operation Of Commercial Banking System In Indian Foreign Exchange Economy

Dr. Venkatesh. J* and Balasubramanian. M**

* Associate Professor, Department of Management Studies, Anna University, Regional Centre, Coimbatore, Jothipuram, Coimbatore – 641 047.
** Research Scholar – Department of Management Studies, Anna University, Regional Centre, Coimbatore, Jothipuram, Coimbatore – 641 047.

Abstract: Banking has come to occupy a crucial position in a nation's economy. According to the modern concept, banking is a dealing which not only involves the action of borrowings, leading and remittance of funds, but it is also a vital instrument for nurturing economic growth. No economy can function with out finance and the banks provide it. They work as reservoirs of `saving' of the community and also lenders or banking business is properly regulated so that the interest of the depositors, borrowers and the nation's economy can be well protected. Most of the commercial banks were established in India on the British pattern in the being of the 19th century. The peculiarly of the Indian commercial banking is that the banks were started, funded and managed buy industrialists and business houses to enable them get adequate finance their business or industries. The primary objective of any commercial bank is to earn profit. A profitable bank collects money from the depositors and let somebody use it to trade industry and exchange. The difference between the lending rate and the borrowing rate is the profits. The interest rates governed by the reserve Bank of India's directions. A bank is usually thought of as reliable agency with which money is deposited. The modern commercial Bank renders many services.

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THE BANKING SCENARIO

The new private sector banks have performed very well in the year 2000. Most of these banks have indexed an increase in net profits of over 65%. They have been able to make considerable position in the retail market of the public sector and the previous private sector banks. During the year, the two foremost banks in this sector had set a new inclination in the Indian banking sector. HDFC Bank, as a part of its expansion plans had taken over Times Bank. ICICI Bank became the first bank in the country to list its shares on NYSE. In the post liberalization period, there has been a sharp boost in the total business done by the foreign banks. In the last couple of years, some of the foreign banks have penetrated the retail segment and established a number of new products in the market. This has increased the competition in the banking sector and most of the old players tamper with their approach. Looking at the prospective of the Indian markets, some of the foreign banks in recent times have uttered their plans of purchase few Indian banks for further expansion.

FOREIGN EXCHANGE

In today's world no country is self-reliant; thus, there is need for exchange of goods and services in the midst of different countries. However in the early age, the exchange of goods and services is no longer carried out on barter basis. Every self-governing country in the world has a prevalence that is a legal tender in its region and this currency does not act as money external its boundaries. Therefore, at any time a country buys or sells goods services from or to another country, the people of two countries have to barter currencies. At present, the foreign exchange market encompass of all the foreign exchange traders who are connected to each other throughout the world through telecommunications network. They will made transaction with each other through telephones, telexes, and electronic system. With the dawn of advanced technology like `Reuters' Money 200 – 2002' it is possible to access any trader in any corner of the world in a few seconds. In fact now arrangement can be done through electronic dealing system, which permit tender and offer rates to be matched routinely through central computers and thus transactions take place in minute. The largest foreign exchange market is that of London, followed by New York, Tokyo, Zurich and Frankfurt. The markets are located during the different time zones of the globe in such a way that when one market is closing the other is open. Therefore, it is declared that foreign exchange market in performance rounds the clock.

PARTICIPANTS IN FOREIGN EXCHANGE MARKETS

- Customers; Commercial banks; Central banks; Exchange brokers
- Overseas forex markets; Speculators

Commercial banks have a vital role in the foreign trade of a country. They provide the finance needed to execute the transaction. For the banks, foreign exchange dealing is a specialized activity with good potential for profit.

Major Functions of International banking services includes

Import Services

- *Commercial Letters of Credit*
- *Import Lines of Credit*
- *Import Documentary Collections*

Export Services

- *Export Letters of Credit*
- *Export finance, including government agency programs (eg. Export Import Bank)*
- *Export Documentary Collections*
- *Bills purchase program*
- *Standby Letters of Credit*

Functions of a Foreign Exchange Department

1. Financing Exports

The financial requirements of the exporter, starting from the second he consider the project and till he recognize export proceeds, are by banks. The credit extended to the exporter to procure raw materials, process them and prepare them for shipments to the importer is known as ***PACKING CREDIT*** or ***PRESHIPMENT CREDIT***. On shipping goods the exporter would draw a bill of exchange with or without a letter of credit, and discount it with the blank. The credit extended to the exporters after shipment is known as ***POST SHIPMENT FINANCE.*** Besides financing the other service rendered by banks to exporters is advising, confirming letter of credit issued in favour of the exporters by their correspondent's abroad. Even if the exporter does not require any financial accommodation from the banks, the exchange control regulations require him to receive the export proceeds only through an authorized dealer. Therefore the exports bills are to be collected through a bank.

2. Financing Imports

Banks on behalf of their importer customers issue letters of credit. The opening of the letter of credit by the bank, whereby it undertakes to make payment to the exporters on shipment, enables the importers to conclude the deal with ease. The bank for the import may finance the importer. This finance may take any form, cash credit or loans. The bank in foreign exchange pays the exporters abroad. The importing of goods into India is subject to the import policy of the Govt. and exchange control regulation of the Reserve Bank.

3. Remittance Facilities

An importer in India has to pay the overseas exporter. Similarly an Indian exporter has to receive payment for abroad. An Indian who is in work at overseas may like to send funds for protection of his family in India. Thus all dealings in foreign exchange ultimately result in either remittance of funds to India (inward remittance) or remittance of funds from India (outward remittance).. For the benefit of Indians residing abroad, banks open and maintain **NON-RESIDENT ACCOUNTS**.

4. Dealings in Foreign Exchange

Banks buy and sell foreign exchange from and to the public. To carry out this function, the banks have to keep sufficient stocks of foreign exchanges. These are kept in the form of bank account abroad. Banks of India maintain accounts with banks in important financial centers abroad through which all sales and purchases of foreign exchange are routed. Banks dealing in foreign exchange may sometimes necessitate it to sell or buy, from other banks in the place or the Reserve Banks, the required foreign currency.

5. Furnishing Credit Information

With a network of correspondent relations with bank in a foreign country, a bank in India is in a situation to deliver business information to exporters and importers in India. The department should also provide periodic information on its dealings to its management and to the Reserve Bank.

FOREIGN CURRENCY ACCOUNTS

To aid transactions in foreign exchange, a bank in India may preserve accounts with banks abroad. Similarly some foreign banks may retain accounts with banks in India.

Nostro Account

In Latin, Nostro account means **'our account with you'**. It is an account maintained by an Indian bank abroad. This is always foreign currency bank may, depending on its requirement have many such accounts in foreign currencies it is not uncommon that the bank may have more than one account even in one currency.

Vostro Account

In Latin, **'Vostro Account'** means **'your account with us'.** It is a financial credit retain by a foreign bank with a bank in India. This is in rupees and is maintained in the books of a bank in India. It should be noted that credit to a non-resident bank accounts amounts to remittance of foreign currency from India to the country of the bank maintaining the Vostro account. Similarly debit to the account amounts to inflow of foreign exchange from the country concerned into India.

FERA Vs FEMA

In FERA regulating payments, dealing and transaction are done with the objective of conservation of foreign exchange and its proper utilization for economic development. Then FEMA facilitate external trade and payments and promote the orderly development and maintenance of the foreign exchange market in India.

Transaction of FERA to FEMA - Impact

The Foreign Exchange Regulation Act (FERA), which was enacted in 1973, has been taken over by Foreign Exchange Management Act (FEMA) with effect from **1.6.2000**. The contents of the Act are to renounce the current economic state in the country. The Foreign Exchange Regulation Act, 1973 was assessed in 1993 and several amendments were endorsed as part of the on-going process of economic liberalization concerning to foreign investment and foreign trade for closer interface with world economy. Considerable developments have taken place since 1993 such as significant increase in foreign reserve, growth in foreign trade, current account convertibility, liberalization of Indian investments abroad etc.

Taking into consideration the above fact a bill to repeal and replace the Foreign Exchange Regulation Act, 1973 was introduced. The said bill was referred to the Standing Committee of Finance, with submitted its report to the House, with modifications and suggestions. After incorporating certain modifications and suggestions of the Standing Committee on Finance, Central Government has decided to introduce Foreign Exchange Management Act and repeal the Foreign Exchange Regulation Act, 1973. The refreshing change that FEMA has brought in is that there is a move from control to management of foreign exchange. The most significant change brought in by the Act is that foreign exchange law connecting to foreign exchange with the purpose of assisting external trade and payments and for endorsing the organized development and maintenance of foreign exchange markets in India.

Outsource Financial Services

There are a number of activities in a business that are not vital to it and these processes can be effectively managed through outsourcing. Several banking and financial services can be handled proficiently by offshore companies. India is a place where outsourcing takes place effectively as it has proven to be capable of managing a range of processes of varying complexity. India service providers are proficient, specialized, practiced, and the cost advantage will speak for itself. Here are some of the financial and banking services that can be outsourced to India.

- **Credit Decision**
- **Accounts Servicing**
- **Account Reconciliation**
- **US GAAP Reporting**
- **Account Setup**
- **Credit/Debit Card services**
- **Check Processing**
- **Mortgage loan servicing**
- **Collections**
- **Customer Account Management**
- **Treasury Operations Management**

Banks are the main contributor of the financial system in India. Banking recommends several amenities & prospects. However, remaining to the lack of information & guidance, general public cannot avail of full benefits from the Banking system. Banknetindia.com is the first, dedicated and neutral vertical portal on the Indian Banking Sector, supported by a career banker and maintained by a team of senior professionals in the field. This section of the portal affords inclusive and modernized information, direction and aid on all areas of banking in India. A frequently updated FAQ is offered for ready reference. A helpline has been given for the more snooping and a discussion board is committed to serious dialogue among the professionals and the students of this sector. Panel of professionals also respond to any question that may have remained un-responded on the discussion board for a long time. Two of the Clubs are meant for the growing community of banknetindia community to interact among themselves and also to pit their wit against the best in the industry. Banking professionals regularly update News & Articles and Policies to keep you abreast of the latest developments in the field of banking. Companies are now increasingly outsourcing their Finance & Accounting functions followed by Human resource (HR) outsourcing. The progress of IT services outsourcing in the Indian banks started from the basic level of annual maintenance contracts (AMCs) around 10-12 years ago and from there the IT services outsourcing curve in the banking sector has presently stimulated on to the level of Facilities Management (FM). In view of rising importance of outsourcing, we have launched an exclusive section on Business Process Outsourcing (BPO) in Financial Sector.

FUTURE PROSPECTS

The future scenario for the Banking and Finance sector in India can be viewed in the context of the sweeping changes that have come about during the past few years. It is expected that these changes will continue to grow stronger and influence the developments in this sector. The future scenario therefore lie in escalation of package of services previously provided as well as offer complementary services in the following areas:

- Preamble of New Products: The industry has started providing complete corporate and retail financial services to its customers. As discussed earlier, banks have been introducing new products to maintain their share in this highly competitive market where things have been changing quite rapidly. With growing expectations and demands of the customer, these ranges of products will have to both innovative and attractive.
- A Customer-oriented outlook: This would include factors such as extension of banking hours, provision of a wider network of ATMs, phone banking and net banking to enable the customers to transact as per their convenience. Customers can now withdraw money at any time and from any branch across the country.
- Banks conventionally involve in working capital financing have started offering consumer loans and housing loans.
- Financing non-traditional sectors: Some banks have started offering travel loans as well as finance for investing in Initial Public Offerings in stocks and shares to the investors.
- Retail financing is the new area where the banks have started to focus. The loan official process has been relaxed to a great extent and permit time has been speeded up. Customers can apply for credit online and even the dispensation of loan application is done online. This sector is also expected to grow vastly in the coming years.

For the NBFCs, the liberalisation of the Indian economy has thrown up vast opportunities in various sectors, which would be capitulated and consolidated upon in the coming years.

Transaction of FERA to FEMA – The Impact!

The Foreign Exchange Regulation Act (FERA), which was enacted in 1973, has been taken over by Foreign Exchange Management Act (FEMA) with effect from **1.6.2000**. The contents of the Act are to quit the present economic state in the country. The Foreign Exchange Regulation Act, 1973 was reviewed in 1993 and several modification were enacted as part of the on-going process of economic liberalization relating to foreign investment and foreign trade for closer interface with world economy. Significant developments have taken place since 1993 such as substantial increase in foreign reserve, growth in foreign trade, current account convertibility, liberalization of Indian investments abroad etc. Taking into consideration the above fact a bill to repeal and replace the Foreign Exchange Regulation Act, 1973 was introduced.

A Comparison!

Current A/C transaction	**FERA**	**FEMA**
Gifts	Rs. 1,000	Rs. 5,000
Donations	Rs. 1,000	Rs. 5,000
Employment	Rs. 2,500	Rs. 5,000
Business visits	Rs. 350 / day for 45 days Rs. 2,000	Rs. 25,000 per trip
Consultancy	Rs. 25,000	Rs. 1,00,000
Expected Commission	Max – 12.5%	Any amount
Claims payable	10%	Any amount
Violation		
Offence	Criminal	Civilian
Penalty	5 times the amount	1 – 3 times

The said bill was referred to the Standing Committee of Finance; which present its report to the House, with modification and suggestions. After including certain modifications and suggestions of the Standing Committee on Finance, Central Government has determined to introduce Foreign Exchange Management Act and repeal the Foreign Exchange Regulation Act, 1973. The stimulating change that FEMA conveyed is that there is a move from control to management of foreign exchange. The most momentous change brought in by the Act is that foreign exchange law concerning to foreign exchange with the purpose of aiding external trade and operating cost and for support the systematic development and maintenance of foreign exchange markets in India.

Conclusion

The Indian Banking sector has undergone incredible changes with the economic liberalization, especially in the last 5 years. The market, which was chiefly controlled by the public sector banks, has now been in front of stiff competition from foreign players and new age group private sector banks. The Banking and financial services section in India is observing vivid changes, which can be phrased as a revolution by itself, and the core of this revolution is “Concept Selling”. The future forecast therefore lie in intensification of the package of services already provided as well as present corresponding services where the banking and financial service industries should start to focus in customer oriented outlook with certain policy. In this paper, a comprehensive overview of the banking and the role of Foreign Exchange function in India have been given along with the convention that they are following in their operations.

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