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The Role of FDI in development of Indian Banking Sector

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Abstract: Foreign Direct Investment as a strategic element of funding is required in every develop & developing country for achieving the financial growth & reforms and continue the pace of development and progress of the economy. FDI inflows are long term in nature which causes source of non debt finance, as well as bring modern & innovative technology in country by creating international network. In this paper, author attempted to discover how FDI is crucially important economic catalyst of Indian monetary progress by stimulating domestic investment. The essential purpose of this paper is to investigate the effect of FDI on fiscal growth by analyzing most important sector i.e. Banking Sector. And this sector is rapidly expanding with several challenges, raise due to competition by the new players in this ever growing sector. Whereas new initiatives of government like demonetization & Digital India, leads toward need of modern technologies & polices in banking sector which could be only possible by FDI in banking sector.

Keywords: Foreign Direct Investment, Demonetization, Digital India.

I. INTRODUCTION

India is the most favorable & growing economy among leading nations in world. Various international institutions have projected India as the most favorable destination for Foreign Direct Investment in the whole World. The World Bank has improved India's ranking by 12 places in the 2016 in Ease of Doing Business. IMF has elevated India as the rising star in the Global Economy whereas the World Bank projects India's growth at 7.5%.

In Today's modern era Indian Banks are technology savvy & able to compete with develop countries throughout the world. The banking sector plays an important role in economic development of country. Indian banking system is different from that of other Nations because of the country's unique economic characteristics. FDI is a tool for economic growth through its strengthening of domestic capital, productivity & employment. India has a large population and land size, a diverse culture, and extreme disparities in income, which are marked among its regions. There are high levels of unawareness regarding modern technology among a large percentage of its population but, at the same time, the country has a large reservoir of managerial and technologically advanced talents. Between about 30 and 35 percent of the population resides in metro and urban cities and the rest is spread in several semi-urban and rural centers. The country's economic policy framework combines socialistic and capitalistic features with a heavy bias towards public sector investment. India has followed the path of growth-led exports rather than the "Export-led growth" of other Asian economies, with emphasis on self-reliance through import substitution.

History of FDI in India

Foreign Direct Investment (FDI) is a type of investment in to an enterprise in a country by another enterprise located in another country by buying a company in the target country or by expanding operations of an existing business in that country. In the era of globalization FDI takes vital part in the development of both developing and developed countries.

FDI has been associated with improved economic growth and development in the host countries which has led to the emergence of global competition to attract FDI. FDI offers number of benefits like overture of new technology, innovative products, and extension of new markets, opportunities of employment and introduction of new skills etc, which reflect in the growth of income of any nation. Foreign direct investment is one of the measures of growing economic globalization. Investment has always been an issue for the developing economies such as India. The world has been globalizing and all the countries are liberalizing their policies for welcoming investment from countries which are abundant in capital resources. The countries which are developed are focusing on new markets where there is availability of abundant labors, scope for cheaper production, and higher profits. Therefore, Foreign Direct Investment (FDI) has become a battle ground in the emerging markets.

Foreign investment plays a significant role in development of any economy as like India. Various countries provide numerous incentives to attract FDI. Need of FDI depends on saving and investment rate in any country. Foreign Direct investment acts as a bridge to fulfill the gap between investment and saving. In the process of economic development foreign capital helps to cover the domestic saving constraint and provide access to the superior technology that promote efficiency and productivity of the existing production capacity and generate new production opportunity.

India’s recorded GDP growth throughout the last decade has lifted millions out of poverty & made the country a favored destination for foreign direct investment. A recent UNCTAD survey projected India as the second most important FDI destination after China for transnational corporations during 2010-2016. Services, telecommunication, construction activities, computer software & hardware and automobile are major sectors which attracted higher inflows of FDI in India. Countries like Mauritius, Singapore, US & UK were among the leading sources of FDI in India.

FDIs can be Achieved by One of Two Strategies

- The first strategy is for the company to set up new factories and plants from the scratch. This method is called as a “Greenfield Investment”. Companies like McDonald's and Starbucks tend to use the Greenfield approach when expanding overseas.
- The second FDI strategy is through cross-border mergers and acquisitions that involve acquiring an existing foreign enterprise in the country of interest. This method is called a “Brownfield Investment”. An example of a Brownfield investment occurred in 2008, when the Indian truck company Tata Motors acquired Land Rover and Jaguar from Ford. Tata Motors didn't have to build those factories from scratch.

FDIs can also be classified into horizontal and vertical forms. A company investing in the same business abroad that it operates domestically is a case of a horizontal FDI. On the other hand, vertical FDI occurs if a company invests in a business that plays the role of a supplier or a distributor.

FDI in Indian Banking Sector

The traditional argument against foreign equity participation in domestic companies is that these businesses often involve national and strategic interests and therefore, operational and strategic control must be retained to prevent a take-over or a buyout [Lam (1997)]. Until 1993, most Indian banks were 100 percent owned by the central government and private investment was allowed only in a handful of private banks formed around the 1940s. Further, foreign banks and financial institutions were allowed only 20 percent ownership stakes in Indian banks. For the next five years, changes in the banking sector mainly aimed at allowing banks more flexibility in the design and marketing of products.

Ceiling on FDI in Indian banks

Banking - Public Sector

Sector/Activity	% of Equity / FDI Cap	Entry Route
Banking- Public Sector Subject to Banking Companies (Acquisition & Transfer of Undertakings) Acts 1970/80. This ceiling (20%) is also applicable to the State Bank of India and its associate Banks.	20%	Government

Banking- Private Sector

Sector/Activity	% of Equity/ FDI Cap	Entry Route
Banking- Private Sector	74%	Automatic up to 49% Government route beyond 49% and up to 74%

Other Conditions

1. This 74% limit will include investment under the Portfolio Investment Scheme (PIS) by FIIs/FPIs, NRIs and shares acquired prior to September 16, 2003 by erstwhile OCBs, and continue to include IPOs, Private placements, GDR/ADRs and acquisition of shares from existing shareholders.
2. The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74% of the paid up capital of the Bank. At all times, at least 26 % of the paid up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank.
3. The stipulations as above will be applicable to all investments in existing private sector banks also.
4. Other conditions in respect of permissible limits under portfolio investment schemes through stock exchanges for FIIs/FPIs and NRIs, setting-up of a subsidiary by foreign banks and limits in respect of voting rights are at **Annexure-9**.
5. In the Private Banking sector of India, FDI is allowed up to a maximum limit of 74 % of the paid-up capital of the bank. On the other hand, Foreign Direct Investment and Portfolio Investment in the public or nationalized banks in India are subjected to a limit of 20 % in totality. This ceiling is also applicable to the investments in the State Bank of India and its associate banks. FDI limits in the banking sector of India were increased with the aim to bring in more FDI inflows in the country along with the incorporation of advanced technology and management practices. The objective was to make the Indian banking sector more competitive.

II. Objectives of the Study

The main objective of the study is to analyze the FDI inflows in Banking Sector with special reference to Country –wise inflows.

1. To understand concept of Foreign Direct Investment.
2. To study Foreign Direct Investment in Indian banking sector.
3. To study the new guidelines for investment in banking sector.
4. To study about the growth of banking sector.
5. To study benefits of FDI in banking sector in India.
6. To identify the problems faced by Indian banking sector.

III. Research Methodology

The study is basically based on secondary data. The main source of information are various Economic Surveys of India and Ministry of Commerce and Industry data, DIPP reports, RBI bulletin, various research journals, articles, news papers, etc.

IV. Review Literature

1. **Laura Alfaro** :-In his research paper "Foreign Direct Investment and Growth - Does the Sector Matter"? [April 2003 Harvard Business School.]

His paper shows that the benefits of FDI vary greatly across sectors as well economic conditions in host country by examining the effect of foreign direct investment on growth in the primary, manufacturing, and services sectors. An analysis using cross-country data of 47 countries for the period 1981-1999 suggests that total FDI exerts an ambiguous effect on growth. Foreign direct investments in the primary sector, however, tend to have a negative effect on growth, while investment in manufacturing a positive one. Effects of FDI on the service sector are ambiguous.

2. **R. Anitha.**

In her research paper "Foreign Direct Investment (FDI) & Economic Growth in India"[August 2012] she studied Pre liberalization & Post liberalization period from 1980 to 1991 & 1991 to 2010. The objectives of her study were to identify the factors which influence the flow of FDI in India. Identify the problems relating to inflow of FDI and to make suitable suggestions for attracting more FDI inflow to India. She suggested strengthening the research & development in the country, opening of educational sector for FDI. The issues of geographical disparities of FDI in India need to address on priority basis. Business friendly environment must be created on priority to attract large Greenfields projects. Regulations should be simplified so that realization ratio is improved. In India the manufacturing sector can grow if infrastructure facilities are improved and labour reforms take place. The country should take initiatives to adopt more flexible labour laws. The conclusion of the research work is to overcome this situation, the Government should revise the sectoral cap and bring more sectors under the automatic route.

3. **Laghane. B.K (2011)**

In his research paper he has examined the impact of FDI model on borrowers account, branches, time deposits, Profitability of Indian & Foreign banks. He concludes that the LPG sponsored FDI models impacts on foreign banks & Indian banks is relatively positive. Due to LPG, Indian banks stand their business at global and many foreign banks setting up market in India.

4. **Malla Reddy. M [**FDI in Indian Banking Sector: Study, IJARCSMS (2014)]

The researcher has concluded in his research work regarding various issues like, FDI in Banking sector solve various problems like Inefficient Management, Non Performing Assets, Financial instability, & Poor capitalization. Further the FDI in Banking brings various positive changes like technology transfer, Better risk management, Financial stability, Innovative products & new employments. As well in year 2013 banking sector accounts for 17 % of total FDI. And it's increasing year by year.

Table I CUMULATIVE FDI FLOWS INTO INDIA (2000-2016):
(up dated up to September 2016)

1. **A. TOTAL FDI INFLOWS (from April, 2000 to September, 2016):**	**CUMULATIVE AMOUNT OF FDI INFLOWS (Equity + 'Re-invested earnings' +'Other capital')**	-	**US$ 453,183 Million**
2.	**CUMULATIVE AMOUNT OF FDI EQUITY INFLOWS (excluding,** amount remitted through RBI's NRI Schemes)	Rs. **1,640,000 Crore**	**US$ 310,137 Million**

(Source – DIPP – SIA News Letter)

Table II STATEMENT ON COUNTRY-WISE FDI EQUITY INFLOWS
FROM APRIL 2000 TO SEPTEMBER 2016

S.No	Name of the Country	Amount of Foreign Direct Investment Inflows		% Age with Inflows
		(In Rs Crore)	(In US$ Million)	
1	Mauritius	519,499.57	101,759.68	32.81
2	Singapore	287,948.94	50,559.91	16.30
3	United Kingdom	122,028.31	24,072.30	7.76
4	Japan	129,416.11	23,760.47	7.66
5	U.S.A	104,193.13	19,380.43	6.25
6	Netherlands	105,327.96	18,929.16	6.10
7	Germany	48,806.50	9,217.02	2.97
8	Cyprus	45,227.13	8,933.35	2.88
9	France	27,749.56	5,294.36	1.71
10	UAE	24,023.67	4,384.82	1.41
11	Other	233095.24	43890.80	14.15

(Source – DIPP – SIA News Letter)

TOP TEN INVESTOR COUNTRIES Chart I

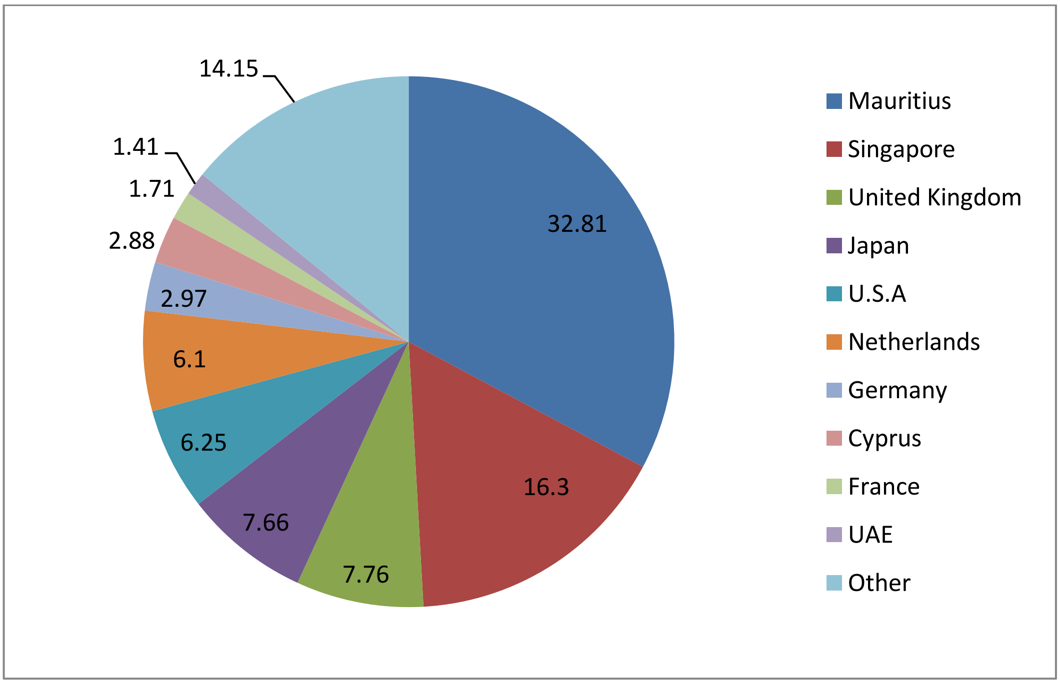
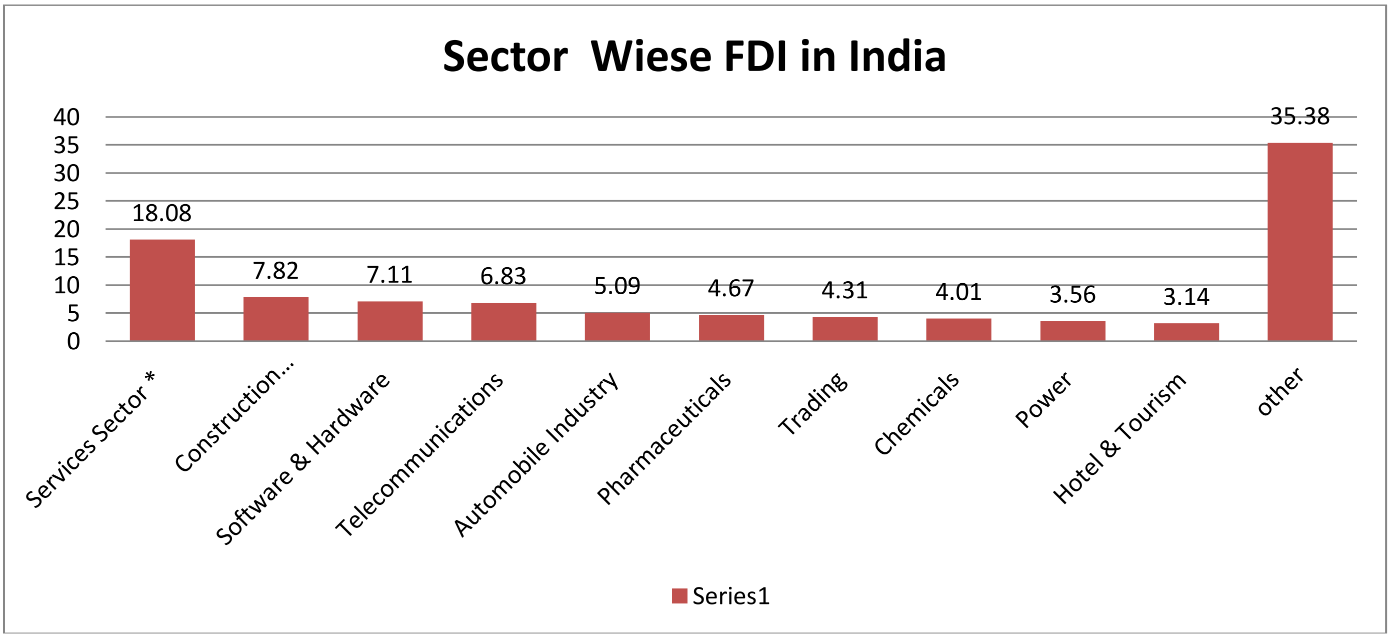


Table III STATEMENT ON SECTOR-WISE FDI EQUITY INFLOWS FROM APRIL 2000 TO SEPTEMBER 2016

No.	Sector	Amount of FDI Inflows		%age of Total Inflows
		(In Rs Crore)	(In US$ million)	
1	Services Sector *	293,722.25	56,080.38	18.08
2	Construction Development: Townships, housing, built-up infrastructure and construction-development projects	114,350.25	24,249.79	7.82
3	Computer Software & Hardware	119,086.87	22,050.02	7.11
4	Telecommunications	111,388.19	21,169.09	6.83
5	Automobile Industry	86,258.79	15,793.24	5.09
6	Drugs & Pharmaceuticals	74,367.25	14,490.21	4.67
7	Trading	78,772.13	13,354.42	4.31
8	Chemicals (Other Than Fertilizers)	63,116.31	12,432.77	4.01
9	Power	56,357.06	11,034.73	3.56
10	Hotel & Tourism	53,207.16	9,749.97	3.14
11	Other	575227	109723	35.38

(Source – DIPP – SIA News Letter)

Chart II



Foreign Direct Investment Inflow In Banking Sector
(From January, 2000 to December,2010)

S.No	Sector	Amount of FDI Inflows		%age of Total Inflows in Service Sector in US $
		(In Rs Crores)	(In US$ million)	
1	Banking Sector	13471.6	3099.06	11.64

(Source – DIPP – SIA News Letter)

Cumulative FDI Equity inflow in Banking Sector from January, 2000 to December, 2010 received Rs. 13,471.60 Crores which accounts for 1.89 % of total FDI inflow & 11.64 % in total Service Sector FDI inflows in terms of US $.

Problems of Indian banking sector

- Instability in Financial Market.
- Non performing assets are high.
- Lack of effectiveness in managerial decision.
- Ever changing financial market condition.

Benefits of FDI in Banking sector in India

- Technology transfer from overseas nation.
- Comfort better capitalization.
- Reduce financial instability in the banking sector of India.
- Foreign Direct Investment is a non-debt inflow, which will directly solve the problem of capital base of the Indian Banks.
- Assure better risk management in financial sector

V. Findings

- FDI inflow in Banking Sector have been increasing year on year in an increasing trend.
- Among the Sub sectors of Service Sector, Financial Sector is stood at top place in attracting huge FDI inflows.
- Among Top Countries Mauritius (32.81), Singapore (16.30), USA (14.15) Are leaders.
- FDI in Banking Sector can solve various problems such as NPA, Financial instability, less GDP etc.

VI. Conclusion

FDI plays a vital role in the economy by providing opportunities to host countries to enhance their economical development. It is visibly identified that service sector is dominant sector in attracting more FDI inflow among all other sectors. To encourage the saving habits our banking sectors are introducing various schemes like JAN – DHAN YOJANA. Apart from all the above, since the capital raising capacity in India is very less to take the Indian banking sector to worldwide we require investment from abroad. Last but not the least RBI should make policies like such that FDI should not over write the regulations of RBI and should become as a media of the growth of Indian economy. Countries like Mauritius (32.81), Singapore (16.30), USA (14.15) are the continues investors & largest contributor in the growth of India.

FDI in Banking provide various benefits like Technology Transfer, reduction in NPA, Better risk management, Financial Stability, new pool of employment, Innovative products. Hence FDI is a significant factor which influences the level of economic growth in India. It provides a sound base for economic growth and development by enhancing the financial position of the country. It also contributes to the GDP and foreign exchange reserves of the country. FDI inflow in India is increasing year on year. Which leads to overall economical growth of country.

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