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FOREIGN DIRECT INVESTMENT IN BANKING SECTOR

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Abstract

India has been an important recipient of Foreign Direct Investment and it also plays an important role in the development of a country. Amongst all the sectors Indian Banking Sector is the primary one that is attracting most of the Foreign Direct Investment inflows and using it for the competitive efficiency. After Economic Reforms 1991, Indian Banking Sector got major benefits due to opening up of doors of the world either in terms of innovative technology, liberal policies, employment opportunities, access to managerial capabilities, making industry internationally competitiveness. This paper attempts to discuss the FDI equity inflows in Service Sector in India, its impact in Indian Economy and also highlights the future prospects and investments development that is being undertaking place in the Banking Sector.

Keywords:

Foreign Direct Investment;

Indian Economy;

Banking Sector.

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Introduction

Post to the economic reforms 1991 policy led by Dr Manmohan Singh, Liberalization Privatization and Globalization help our country to get globally involved in the businesses that were running in the foreign countries. It also brought various investments in the country which help the country to grow economically. The major sectors that attracted FDI are services, telecommunications, construction activities, computer software and hardware. Among services, banking sector also get benefit from it in terms of technological innovations, better risk management, financial stability and better capitalization. FDI has played an important role in the growth and development of the country.

FDI - Introduction

Foreign direct investment is the investment which is made by one country to another country either in production or business. In general terms we can say FDI refers to capital inflows from abroad with the purpose of investment in the productive capacity of the another country.

According to International Monetary Fund, FDI is defined as Investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of the investor. Also ownership of 10% of the voting power by the foreign investor is an evidence of such a relationship (Organization for Economic Co-operation and Development, OECD).

FDIs can be achieved by adopting one of the two strategies. The first strategy is for the company to set up new factories and plants from the ground up. This method is called a ‘Greenfield investment’ (Chaudhari S. and Mukhopadhyay U.) and 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’ (Chaudhari S. and Mukhopadhyay U.)

FDI can also be classified into Horizontal investment, Vertical investment and Conglomerate investment. A company opens up the same business in a foreign country in case of horizontal investment. While in case of vertical investment, a company invests when there is slightly differentiated business established in a foreign country and in conglomerate investment is made even if the business is unrelated to its existing business.

Ceilings of FDI on Indian Banks

According to consolidated FDI policy 2017,

· Banking – Private Sector – Beyond 49% & Up to 74% (5.2.18)

· Banking – Public Sector – Up to 20% (5.2.19)

(Source: make in India)

Literature Review

Reddy M. (2014) analyzed that India is third preferred nation from which service sector is the dominating one in attracting more FDIs. He stated that FDI not only helping India from various problems but also providing many benefits. Further, he examined periodic inflows from different sectors and concluded that year by year there will be an increasing trend.

Yadav M. K. and Dular B. K. (2017) have studied the role of the FDI in the service sector and concluded that service sector is attracting highest equity flow in India. They stated that FDI plays an important role in enhancing the economy. They analyzed the inflows in sub sectors of service sector from Jan 2000 to June 2015.

Garg R. (2013) has explained the importance of FDI in Indian banking sector. She stated why FDI is required in the country and how it is going to help the economy in globally connecting with the other countries. She further pointed out the shortcomings that our country may suffer if there will be no ceilings on the limits of investments.

Further it has been stated that FDI is a tool that helps in global integration. He analyzed that LPG model encouraged foreign banks to invest in domestic country which help to have positive impact in profitability ratio but the impact in Indian banking sector was negative. He suggested poverty reduction, unemployment reduction, primary education and primary sectors of banking should be focused (Laghane K.B 2007)

Dwivedi S.K and Kumar V (2017) have studied that how progressive policies led by RBI or LPG help India to be an attractive point for other foreign countries to invest in the home country. They stated that schemes run by banking sectors inducing people to save which is helping economy to grow faster but such investment is not enough for India to establish links globally and that's the reason FDI is required but certain limits should be set by RBI so that FDI do not over write regulations of it.

Jaiswal P. (2016) has stated that FDI is an important tool for the growth and development of the economy. She discussed various RBI guidelines conducted by it for the encouragement of investment in the home country and revealed benefits or problems that Indian banking sector is going through. She acclaim that 47% of the population is enjoying the facilities provided by banking sector.

Jindal M. (2016) pointed out the impact of foreign direct investment in the growth and development of the Indian economy. The study involves the positive effect of FDI in all the sectors namely infrastructure, automotive sector, financial services, technology, retail, consumer products and cleantech and also stated the reason of low developing economy i.e. capital account convertibility and capital lock-ins. The attractive policies introduced by Government of India for encouraging FDI are also mentioned.

Khan M.S and Khan M.K. (2015) suggested that for the growth of the economy FDI is necessary in which Make in India initiative help India to attract most of the countries to invest in the country. There are many challenges that need some feasible solutions among them implementation of rules, policies or regulations is important. There is a requirement of transparent and consistent policy for the achievement of the goals of vision 20-20.

Sharma N.K and Krishna B. S. (2013) have stated the life of Indian Banking System and how its working from pre to post liberalization and when all economies got affected by US economic crisis how Indian Banking system doesn't affected by the policies and regulations that are running by the RBI and Government of India. The study discuss about the problems solve by

FDI and benefits getting by FDI and the percentage of investment banking sector is having from overall inflow of FDI.

R. Anitha (2012) stated how FDI is helping in filling the gap between the resources available or resources actually required. FDI is enhancing the competitive capabilities of the domestic country. She analyzed that during pre-liberalization the inflow was minimal but after economic reforms adopted by Government of India the inflow rate was increased comparatively. She explained the reasons which causes low FDI into the country and also pointed out the factors which are encouraging other countries to invest. She suggested that there is a need for adopting more policies, revised ceilings for attracting more and more capital from foreign investors.

Kumar S. (2018) discusses why there is a need of FDI in the country like it is helping in capital formation, technology up gradation and many more. He also analyzed from 2000-01 FDI is increasing year by year. He examines the challenges that the country can face like payment of interest and dividend, negative effect on balance of payment or bad effect on domestic initiatives.

Puthiran S.H. and R. Vijayakumar (2016) Stated that FDI is playing a vital role not only in economic development of the country but also opening the doors to optimize the earnings by utilizing unused resources. They analyzed the FDI inflows of 2000-15 and find it out that service sector is the most dominating sector that is attracting highest FDI inflows among them Mauritius, Singapore and United Kingdom are the top three investors of the domestic country. They also discuss the benefits and problems that FDI is helping to reach out.

Balrambhai M.A. and Gopalakrishna B V (2014) they stated that FDI is the life blood for economic development of the countries. As per report of IMF 2013, India gained the third rank in attracting foreign countries for investment among them service sector bagged the highest portion of it. They explained due to liberalized policy initiated by Government of India or global financial crisis gave opportunities to foreign banks to set up in domestic countries from which the number of foreign banks in the country increases year by year. An initiative of RBI 2005 of Wholly Owned Subsidiary presence haven’t feel.

Anwar S.A (2017) stated the recent trends that are there in the economy relating to FDIs and their impact in the private banks. He discussed that there are different types of investors in the market including FDI, FII, NRIs, and Depository Receipts etc. He explains various composite rates of FDIs and FIIs in private banks. India has gained third rank in attracting foreign investors in 2017 which was less in earlier years but recent changes in the limits helping private as well as public sector to industrial growth.

Malhotra B. (2014) analyzed that there is a positive impact of FDI in the growth of the Indian economy. Government of India uses many steps for attracting the foreign investors and it also helps the economy in improving the skills and technology of the existing companies. FDIs inflow has been increasing yearly. He discusses the recent developments that are taking place in the country itself due to foreign investors and also the initiatives taken by the government.

Vyas A.V. (2015) stated during pre-liberalization period Government of India announce technology policy and Industrial policy for providing liberal environment to the foreign investors. He discusses the problem for low investments in India, the determinants of FDI, the need for FDI in India and the obstacle to larger inflow of FDI to India. The study further analyze FDI cumulative inflows from 2000-2015, month wise inflows for the year 2015, top countries investing in 2015, various sectors attracting highest FDIs for the year 2015, RBIs data relating to FDI inflows in regional offices state wise, country wise investment from 2000-2015, sector wise inflow from 2000-2015. He conclude FDI is helping the country in generating employment opportunities, supporting small scale industries and globally interlink with other countries.

Singh N. and Singh B. (2017) have analyzed the trends that are setting up in the various sectors in form of FDI. They compare the inflow of India with the china stating in India FDI is in the form of fresh equity and in China it is of retained earnings. They explain how Government of India is taking initiatives in expanding the roots of FDI in different sectors. They stated the recent developments that are taking place in welcoming the foreign investors in different fields and also the role of government in various aspects.

Devajit M. (2012) stated that there is a requirement of foreign inflow in the economy for the growth and development of the economy but that inflow can also affect the economy positively or less significantly depending upon for how long the investment is made. He suggested the Government of India should design the policy in such a way that it utilized FDI in an effective manner or promote export oriented sectors that would help our economy to grow and attract other foreign countries to invest too.

Sahni P. (2012) analyzed the trends and pattern of the FDI on economic growth for the period 1992-93 to 2008-09 by using ordinary least square OLS method. The empirical study results found that there is a positive relationship among GDP, Inflation and trade openness with FDI while foreign exchange reserves have a negative relationship. India's share in world foreign direct investment is rising as compared of 1990's.

Sharma R. and Khurana N. (2013) examined FDI is an important factor for the development of the Indian industry either in terms of technological up gradation, improvising managerial skills, efficiently using unused resources etc. they analyzed FDI trends in which they found out FDI related to real GDP positively while relates inversely with inflation during previous period. They conclude government should simplify the trade barriers and other policies to provide an investor friendly system to investors.

Objectives

Based on the above literature the present paper attempts to explore and analyze the following dimensions of FDI in India:

1. **To present Foreign Direct Investment inflows in Banking Sector**
2. **To evaluate the impact of FDI on Indian economy**
3. **To state the future prospects and developments being undertaking place in Banking Sector**

Research Methodology

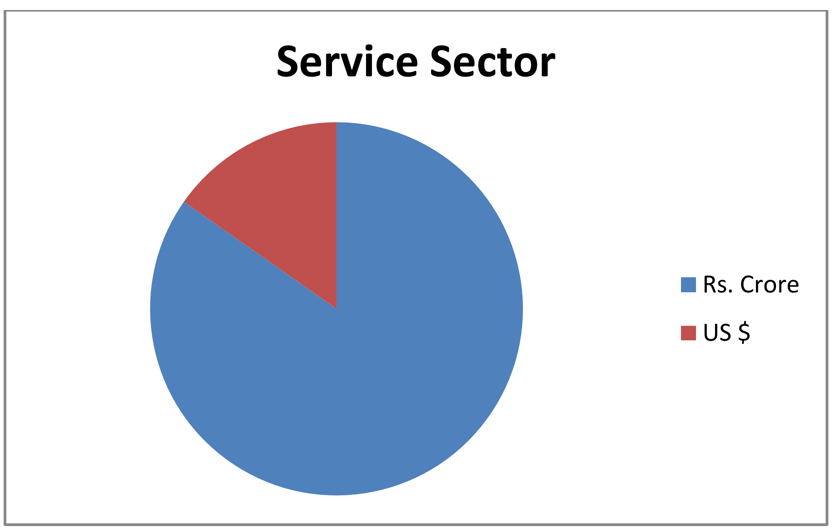
This study is based on descriptive as well as analytical type of research in nature. This study is based on secondary data purely. The data is collected from various sources such as Journals, Articles, RBI publications, Ministry of Finance publications, Department of Industrial policy and Promotion publications. Data was analyzed by using statistical tools such as tables, pie charts and graphs.

FDI inflows in banking sector

Cumulative FDI inflows from April 2000 to December 2018

S.NO	Sector	Amount of FDI inflows		%age of Total flows
		(In RS. Crore)	(In US$ million)	
1	SERVICES SECTOR (Fin., Banking, Insurance, Non Fin/Business, Outsourcing, R&D, Courier, Tech. Testing and Analysis, Other)	393,432.32	70,910.54	17.33

(Source: www.dipp.gov.in)



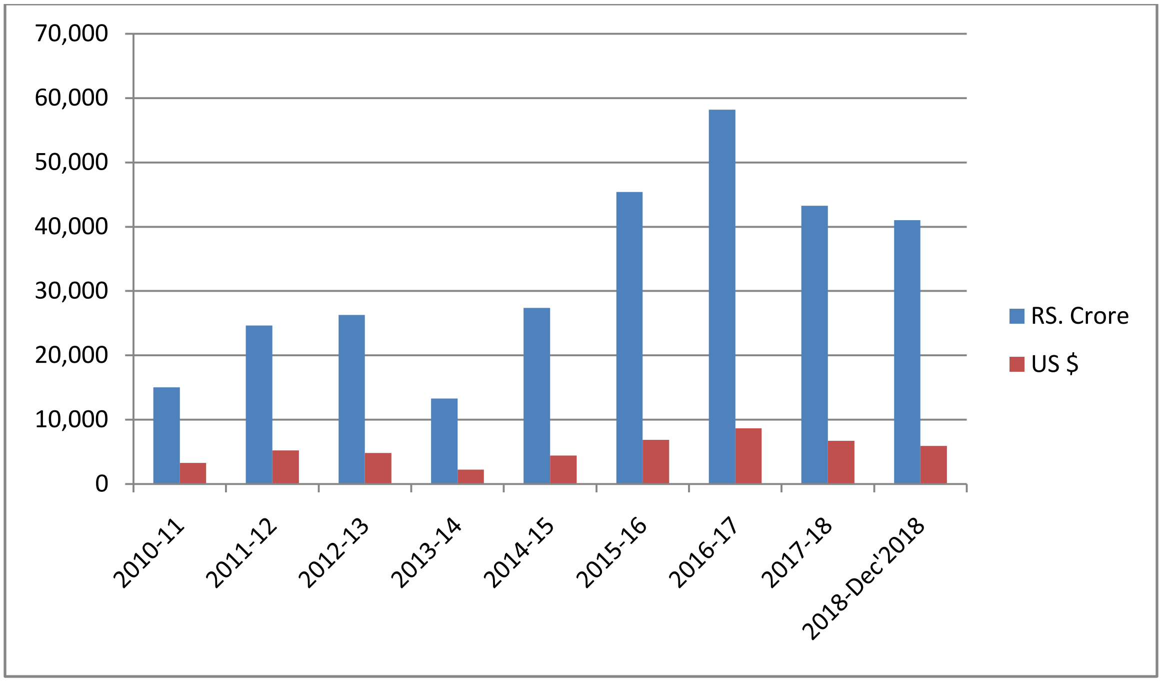
Interpretation: This table and chart depicts the cumulative FDI inflow in Service sector from April 2000 to December 2018 having 17.33% equipped from overall inflow.

Statement of FDI equity inflows in Service Sector from April 2010 to December 2018

Amount in RS. Crores (US$ in Millions)

S.NO	Sector	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19 April'18-Dec'18
1.	**SERVICE SECTOR** (Fin., Banking, Insurance, Non Fin/Business, Outsourcing, R&D, etc)	**15,053 (3,296)**	**24,656 (5,216)**	**26,306 (4,833)**	**13,294 (2,225)**	**27,369 (4,443)**	**45,415 (6,889)**	**58,214 (8,684)**	**43,249 (6,709)**	**41,041 (5,919)**

(Source: www.dipp.gov.in)



SERVICE SECTOR

Interpretation:

In the above table and chart, it shows the statement of FDI equity inflows in the service sector from April 2010 to December 2018. It shows the amount in Rs Crore and in US $ million. The highest FDI inflow in the country was in the year 2016-17 i.e. 58,214 in Rs Crore and 8,684 in US $ millions and the lowest inflow was in the year 2013-14 13,294 in Rs Crore and 2,225 in US $ million. Due to the efforts put by Government of India in taking initiatives and implementing new policies FDI inflow is increasing year by year.

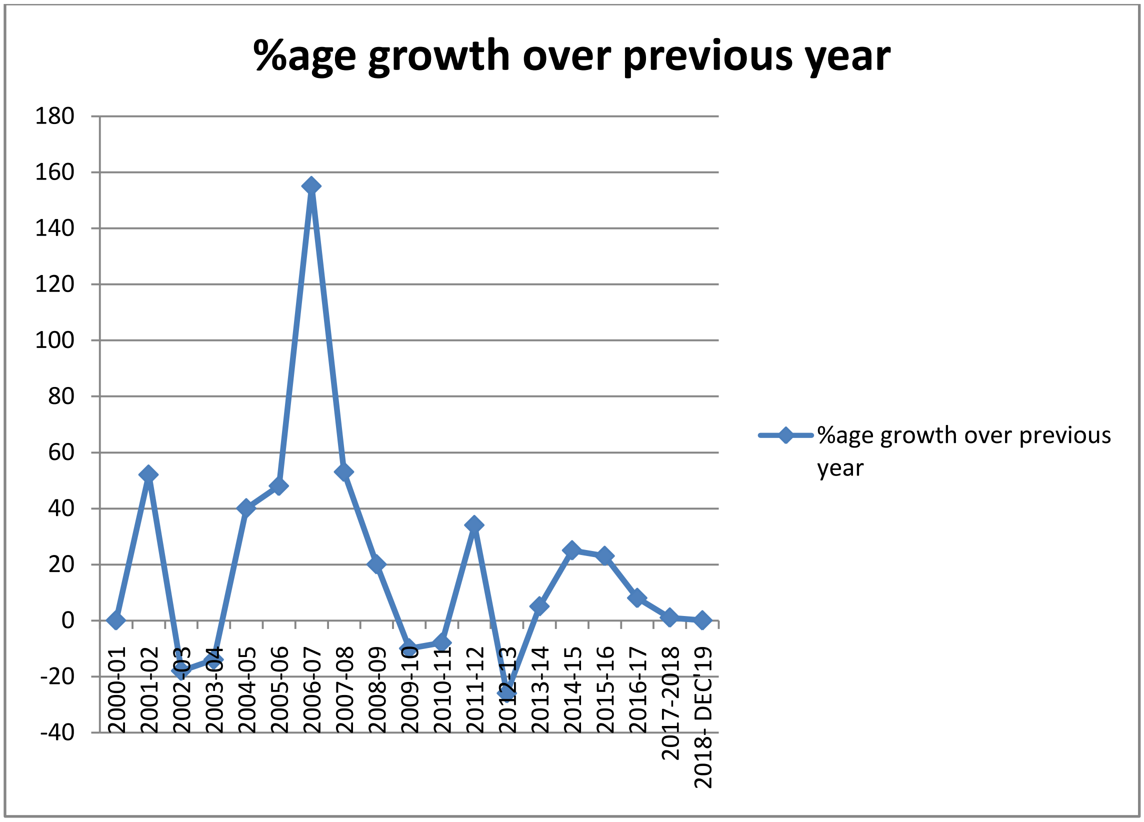
FDI and ECONOMIC GROWTH from April 2000 to December 2018

Amount in US $ millions

Financial Year	**FDI inflow into India**	**%age Growth over previous Year**
2000-01	4,029	
2001-02	6,130	+52
2002-03	5,035	-18
2003-04	4,322	-14
2004-05	6,051	40

2005-06	8,961	48
2006-07	22,826	155
2007-08	34,843	53
2008-09	41,873	20
2009-10	37,745	-10
2010-11	34,847	-8
2011-12	46,556	34
2012-13	34,298	-26
2013-14	36,046	5
2014-15	45,148	25
2015-16	55,559	23
2016-17	60,220	8
2017-2018	60,974	1
2018-19	46,624	
Cumulative Total (From April 2000 to Dec 2018)	592,087	

(Source: www.dipp.gov.in)



Interpretation:

On the basis of the table and graph, it can be observed that due to FDI equity inflow the percentage of economic growth over the previous year shows too much fluctuation. During the period of 2006-07 it showed the highest change in the percentage i.e. 155% but after that time the growth falls down rigorously like 53, 20, -10, -8 etc. So it can be concluded that there are many ups and downs in the economy but still India is attracting many countries to invest in it and improve its growth through it too.

Future Initiatives and Development being undertaking place in Banking Sector:

- Till February 2019, the Government of India is working to achieve its goal of US $100 billion worth of FDI inflows.
- The Government of India is planning to inject Rs. 42000 crore (US $5.99 billion) in the public sector banks by March 2019.
- The Government of India launched India Post Payments Bank (IPPB) and opened branches across 650 districts.

- During 2017, the total value of mergers and acquisition in NBFC diversified financial services and banking was US $2564 billion, US $ 103 million and US $79 million respectively (EY Annual Report)
- In May 2018, total equity funds of microfinance sector grew at the rate of 39.88 (Microfinance Institution network)
- The scheme of Pradhan Mantri Jan Dhan Yojana (PMJDY) Sept 2018, helped to open 336.6 million banks accounts were opened and has also added more deposits of Rs. 926.78 billion (US $ 12.85 billion) (as of Feb 27, 2019)
- Jan Dhan Darshak a part of financial inclusion initiative launched by Department of Financial Services (DFS), Ministry of Finance and National Informatics Centre (NIC) to help people locate financial services in India through mobile (Sept 2018)
- After Demonetization, the use of debit cards is more preferred payment mode as compare to credit cards. (according to RBI, Sept 2018)
- Mobile Banking, Internet Banking and various extensions of facilities at the ATM stations helping banks to improve their operational efficiency.
- Increase in working population and growing disposable income will raise the demand of banking and related services. Rural banking is also expected to increase in the future

Conclusion

FDI is considered as one of the most vital initiative that is helping India to grow and get globally involved in the businesses. Throughout the years Service Sector is attracting much of the FDI inflows that are helping to innovate in services; get better technology; better risk management; financial stability; employment opportunities and supportive policies by the Government. FDI has also helped the Service Sector to raise the output, productivity and profitability. RBI is focusing to achieve the goal of financial inclusion by opening the banking outlets in villages and by taking many initiatives. As India is considered as the country of young people they are going to grow up and will help banking sector to have more customers in the future which will support to raise per capita income and enhance it.

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