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FDI REFORMS IN BANKING SECTOR

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ABSTRACT:

The role of FDI in the present world is note worthy. It acts as the lifeblood in growth of the developing nations. Opening up of doors by many countries of the world has resulted foreign participation in the financial sector of emerging market economies during the 1990s. FDI plays a vital role in the economy because it does not only provide opportunities to host countries to enhance their economic development but also opens new vistas to home countries to optimize their earnings by employing their ideal resources. FDI has an important impact on country's trade balance, increasing labour standards and skills, transfer of technology and innovative ideas, skills and the general business climate. FDI also provides opportunity for technological transfer and up gradation, access to global managerial skills and practices, optimal utilization of human capabilities and natural resources, making industry internationally competitiveness, opening up export markets, access to international quality goods and services and augmenting employment opportunities. This paper provides the major policy implications from their analysis, besides drawing attention on complexities in interpreting FDI data in India.

***Key Words**: FDI, Trade balance, Technological reforms, Optimum utilization of resources.*

INTRODUCTION:

FDI is basically a cross - border investment. Foreign Direct Investor generally acquires Shares or Bonds of the Investment enterprise that give voting power or control over the company. FDI generally includes Mergers & Acquisitions, Building new Facilities, etc.

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.

FDIs help less-developed and developing nations to overcome their Saving - Investment gap, which limits the level of domestic investment. FDIs fill such gaps by bringing foreign investment into the country. They also help in bridging gaps in management, technology, entrepreneurship and skills.

If you look at FDI in the perspective of the host country, FDI helps in increasing the Capital and Tax revenues for the host country. Greater competition from new companies can lead to productivity gains and greater efficiency in the host country. The local population may be able to benefit from the employment opportunities created by new businesses.

Objectives of the study:

- To study about the growth of banking sector.
- To understand Foreign Direct Investment in Indian banking sector.
- To identifying the problems of Indian banking sector.
- Benefits of FDI in Banking sector in India.

According to the guidelines of FDI in the banking sector, Indian operations by foreign banks can be executed by any one of the following three channels

- Branches in India
- Wholly owned subsidiaries.
- Other subsidiaries

Growth of FDI IN Banking Sector:

The banking industry in India has shown remarkable progress in financial health and offering employment since the last few years. The banking sector continues to remain a highly dominant sector in India in spite of financial slowdown. Because of globalization, many Indian banks are competing at global level on the virtue of their innovative products and sound financial status.

Foreign Direct Investment plays an important role for the economy of the host country as it not only provides opportunities to enhance economic development but also opens several doors to optimize national earnings by employing all the resources effectively. FDI has contributed a lot in enhancing efficiency of the Indian banking sector, creating innovative financial products and improving capitalization of banks by making them adaptable to changing market conditions.

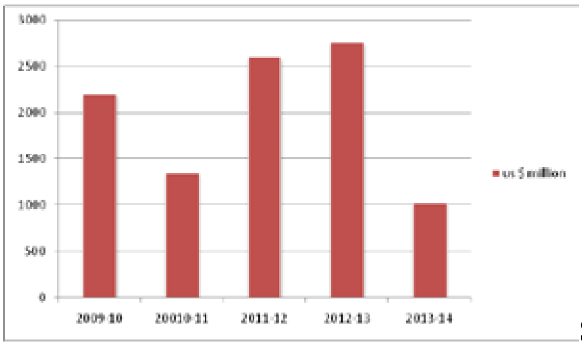
Since the year 1990, the banking sector in India has undergone many drastic changes. Initially, Indian government has contributed to the equity of a large number of public sector banks in order to enhance their capital adequacy levels. After that, the Government has tried to improve the structure of the Indian banking sector by offering licenses to latest generation of private sector banks. This step was highly successful, as most of the banks introduced modern technology to excel in the competition by opening branches and ATMs across the

India in order to acquire customers from their competitors. In recent times, the Indian government has taken an important step by allowing foreign banks to take over Indian private sector banks.

The Indian Government always encourages foreign banks to strengthen their presence in the Indian banking sector. Recently, the RBI has announced important policy changes with regard to Foreign Direct Investment (FDI) in Indian banking sector. Here are these important guidelines –

- Foreign Direct Investment (FDI) of up to 49% from different sources will be allowed in private sectors banks of India on the automatic route.
- According to the government guidelines, fresh shares issue under automatic route will not be available to foreign investors who have technical or financial collaboration in the allied or similar field. Such category of foreign investors will have to take approval from Foreign Investment Promotion Board (FIPB).
- Foreign bank which has branch in India is eligible for FDI in private sector banks, after taking approval from the RBI, subject to the limit of 49% mentioned above.
- The RBI has allowed foreign investors to set up new branches in rural India and weak banks with an investment of up to 74 percent.
- The 74 percent limit will include all the investment done under Portfolio Investment Scheme (PIS) by NRIs and FIIs along with the all the shares acquired by OCBs. It also includes Private placements, IPOs and GDR/ADRs along with acquisition of shares from current shareholders.
- The aggregate foreign holding in private bank from different sources will be permitted up to 74% of entire paid up capital of the private bank. Apart from this, at least 26% of the entire paid up capital should be held by residents.

Chart 1: Foreign investment inflows in finance Industry in India (in us $ million)



Source:-RBI Annual Report 2013-14

FDI inflow into India was at an all-time high of $7.78 billion ie 77% in 2012. In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. During the period 20012-13 highest amount of FDI went to financing sector and Insurance sector. In that financial year foreign direct investment in financial sector increased with 2760 us million dollars. This is show that for overseas investors' financial sector is creating attraction and with the time it will attract more investors.

Benefits of FDI in Indian Banking Sector:

- Transfer of technology from overseas countries to the domestic market
- Ensure better and improved risk management in the banking sector
- Assures better capitalization
- Offers financial stability in the banking sector in India

Problems faced by Indian Banking Sector:

FDI in Indian banking sector resolves the following problems often faced by various banks in the country:

- Instability in financial matters
- Innovativeness in financial products or schemes
- Technical developments happening across various foreign markets
- Non-performing areas or properties
- Poor marketing strategies
- Inefficiency in management
- Changing financial market conditions

Impact of FDI in Indian Banking Sector:

In 2011, the number of projects in the Indian financial services sector increased by 21%, whereas the value of FDI projects increased by 75%. Despite a high growth potential, FDI in the industry remains low compared with other rapidly developing economies, due to capital account convertibility, capital lock-ins and numerous regulations. About 22% of the financial services companies surveyed said that capital convertibility is the main concern faced by investors and 21% believed that capital lock-ins are a key challenge in the sector. However, the demand for a wide array of financial services products, ranging from credit to insurance, is growing. Currently, only 47% of the Indian population has access to banking facilities, while only 15% of the total insurable populations have life insurance coverage. This is a tiny portion of the giant Indian market, underlining the domestic growth potential in the sector. Industry experts anticipate India will become the world's third-largest banking market by 2025 and the third-largest life insurance market by 2015. India's vast potential in financial services, and particularly in insurance, will increasingly attract investors as the GOI relaxes restrictions on investment. According to our survey, 38% of financial services companies believe that relaxing Insurance Regulatory and Development Authority (IRDA) caps on marketing commissions will attract more foreign participation in the sector, while 26% feel that it will be made more attractive by relaxing FDI caps.

CONCLUSION:

Since the capital raising capacity in India is very less to take the Indian banking sector to worldwide we require investment from abroad. Therefore FDI plays a crucial role in enhancing the economic growth and development of the country. Moreover, FDI as a strategic component of investment is needed by India for achieving the objectives of its second generation of economic reforms and maintaining this pace of growth and development of the economy. 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. MNCs should be allowed to set up in such a manner that they help increase the standard of living of our country instead of sole profit making.

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