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Role of Foreign Direct Investment (Fdi) in Indian Banking System

KEYWORDS

FDI, RBI, Indian Economy, Globalization

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ABSTRACT *Indian banking sector has created very important platform in the development of economy of India and in forming wealth to the economy. In 2008 when United States of America and world economy got into trouble, the financial sector of India also got affected but only Indian banking sector maintained its business because of the better controlled system and saving habits of Indian middle man. This paper discuss about the history of Indian banking system, need of foreign direct investment in Indian banking system, this paper also consider that FDI in banking sector can notify some issues like encouraging development of new financial and unique product, its improve the risk taking ability of Indian banking sector, improved efficiency of this sector and better handle the financial changes of the banking sector.*

Introduction:

Indian banking system is totally different from the other nation of Asian region because India's unique geographical, social, economical conditions. Indian has a large volume of land size and approx 1250 million populations, and a diverse culture. India has an unbalanced system of income and expenditure . There are high levels of illiteracy among a big percentage of Indian population but, at the equal time, the country has a large role changer and revolutionary talents in management and technology. In India near about 30 to 35 percent of population live in metro cities and urban areas and rest of 60-65 percent spread in several semi- urban and rural area 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 centres. Foreign Direct investment acts as a bridge to fulfil the gap between investment and saving. In the process of economic development in India, FDI is painstaking as a developmental instrument, which is capable of help in achieving independence in different areas of the economy. When new industrial policy was proclaimed in 1991, big volume of incentives and concession were arranged for the flow of foreign capital to India. Foreign Direct investment acts as a bridge to fulfil the gap between investment and saving. In the process of economic development India is a rising nation and economy with large space for consumer and capital goods too. India has plentiful and diversified natural wealth (recourses), its sound economic policy, better market conditions and highly skilled human resources make it a proper target for foreign direct investments. India's economy policy framework is the combination of socialist and capitalistic features. All these features you can see in the size and structure of Indian banking system. In order to accomplish the want of administration, government planning and course of action it has been subjected to various nationalization schemes diverse time.

Historical premonition:

In the year of 1786, the general Banking of India was emerging, helped by bank of Hindustan and Bengal Bank. The East India Company started Bank of Bengal (1809), Bank of Madras (1843) as autonomous banks and collected them as presidency Banks. These banks were amalgamated in the year of 1920 and imperial Bank of India was created.

1865 – Allahabad Bank was formed

1894- Punjab National Bank was formed

1906- Bank of India was formed

1907 to 1913- Indian Bank, Bank of Mysore established The RBI was formed in 1935

- In the result of the continues failures in Banking system Indian government passed the Banking companies act 1949 and later on it is customized as Banking Regulation act.
- In 1965 Reserve bank of India got power to manage the functioning of other nationalised banks
- Imperial Bank of India was nationalised in 1955
- The SBI was established to be active as the controlling authority to RBI
- 7 banks were nationalised and assigned subsidiaries to SBI in the year of 1960.

After Nationalization of Banks
- 14 major banks was nationalised in 1969
- 7 more banks was nationalised in 1980, now 80 % banking sector coming in the under control of Indian government.

Reforms in Financial sector post liberalization
- Rapid transformation of financial sector during the time of post liberalization which got clearness and answerability in the financial markets.
- It gave the results in great inflow of investments from FII's into the capital markets of India.

Literature review:

Agarwal G., Khan M. A. (2011), "Impact of FDI on GDP: A Comparative Study of China and India", the study found that 1% increase in FDI would result in 0.07% boost in GDP of China and 0.02% boost in Indian GDP. We also found that China's growth is more affected by Foreign Direct Investment, than India's growth.

Singh Arjun and Singh Narender (2011), says that Foreign Direct Investment is a tool for economic growth by its power of local capital, power of gen-

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erating productivity and employment. FDI also plays a very important role in the polishing and upgrade of skills, technology and capabilities of management in various sectors of the economy. They also analysis that since 1991 FDI inflows in service sectors of India and relating the growth of the service sector FDI in creation of employment in conditions of skilled and unskilled

Bhattacharyya Jita, Bhattacharyya Mousumi (2012), "Impact of FDI and Merchandise and Services Trade of the Economic growth in India: an Empirical study" , this study exposed that there was a long term bonding between FDI, banking, services business and economic growth of India. Bi-directional causality is experiential between merchandise trade and economic growth, services trade and economic growth.

Laghane.K.B (2007), LPG (liberalization, privatization, and globalization) sponsored FDI model's impact positively on the effectiveness on the overseas banks and Indian banks. In his study He found that FDI must be seen as to reducing poverty, unemployment and increase primary education and priority sector of banking. Due to LPG, Indian banks stand their business at global and many foreign banks setting up market in India.

Singh J. (2010), "Economic Reforms and Foreign Direct Investment in India: Policy, Trends and Patterns", in the context of increasing competition among nations and sub national entities to attract Foreign Direct Investment (FDI), the present paper tries to find out the rising trends and patterns of FDI inflows into India in attraction to various policy measures announced by the Indian government since mid-1980 and after. The experiential analysis tends to suggest that the FDI inflows, in general, show an increasing trend during the post-reform period. Furthermore, country-wise comparison of FDI inflow also indicates that FDI inflow into India has increased considerably in comparison to other developing economies in the recent years. Thus, the study indicates that the FDI inflows into India responded positively to the liberalization measures introduced in the early 1990s.

According to GYANPRATHA – ACCMAN (Journal of Management, Volume 5 Issue 1, 2013) FDI for 2009-10 at US$ 25.88 billion was lower by five per cent from US$ 27.33 billion in the previous fiscal. Foreign direct investment in August dipped by about 60 per cent to approx. US$ 34 billion, the lowest in 2010 fiscal, industry department data released showed. In the first two months of 2010-11 fiscal. FDI inflow into India was at an all-time high of $7.78 billion up 77%from $4.4 billion during the corresponding period in the previous year. In 2013, the government relaxed FDI norms in several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. In retail, UK-based Tesco submitted its application to initially invest US$ 110 million to start a supermarket chain in collaboration with Tata Group's Trent. In civil aviation, Malaysia-based Air Asia and Singapore Airlines teamed up with Tata Group to launch two new airline services. Also, Abu Dhabi-based Etihad picked up a 24 per cent stake in Jet Airways that was worth over Rs 2, 000 crore (US$ 319.39 million).

Objective 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 on FDI in Banking sector in India.

Research Methodology:
Research and experimental development is work undertaken systematically to increase the stock of knowledge. The first objective of this paper fulfil by the analysis of historical premonition. This research paper is carried out with the help of only secondary data. The major tools for the collection of the information has been available collected primarily from journals, articles, online database of Indian Economy, RBI bulletin, websites or newspaper etc

Discussions and Analysis:The UPA Government selected to carry on the policy of banking deregulation, following the foot mark of the NDA Government. On 28th February, 2005, the Union Budget 2005-6 was presented before the Parliament, on same day the Finance Minister instance to RBI to release a roadmap for the presence of foreign banks in India. The RBI adopted his notification from the guidelines issued by the Ministry of Commerce and Industry under the previous government. Indian Government increases the limit of FDI in private sector bank to 74 % under the automatic route. This roadmap of RBI demarcates two phases for foreign bank presence. During the first phase, between March 2005 and March 2009, permission for acquisition of share holding in Indian private sector banks by eligible foreign banks will be limited to banks identified by RBI for restructuring. The notifications announce that overseas bank (foreign bank) will be permitted to set up their presence by way of setting up a conversion of the existing branches in to a wholly owned banking subsidiary. Government provide appropriate amending legislation will also be proposed to the banking regulation act 1949.Impact of these all announcement where the global banking industry turbulent times in 2007 and 2008. The impact of the economic reduces speed on the banking and insurance service sector in India has so far been restrained. Financial system of India has very small expose to foreign assets and their unique product. Economy of India is been pushing to rise the role of multinational banks in the insurance and financial sector , but the left communist parties are opposing the finance minister move to raise overseas investment limits in the insurance business. In this parliamentary session of winter new government of NDA leading with the Prime Minister Mr. Narendra das modi wants to fulfil a pledge to allow companies like New York life insurance, Met Life Insurance to raise investment in local companies to 49 percent from 26 percent. Left parties do not want overseas investors to have large voting rights in private sector banks and they also oppose the privatization of pension fund run by state. There are several reasons why that have such troubled with dangers when domestic or foreign investors get a large share holding in any bank or insurance company and exercise proportionate voting rights, it creates potential problems not only of indefinable concentration in the banking sector but also can expose the economy to more intensive financial crisis at the slightness hint of fear. Opposition parties are not considering the desire and need of present situation of the economy.

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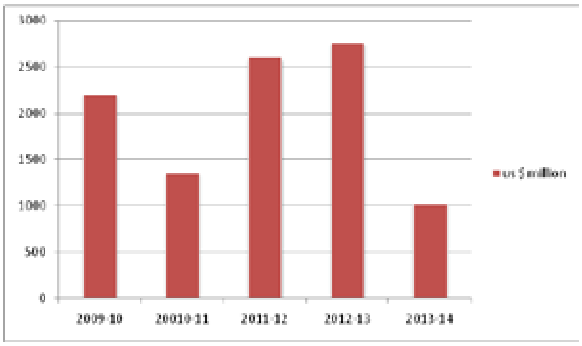
Chart 1: Foreign investment inflows in finance Industry in India (in us $ million)



Source:-RBI Annual Report 2013-14

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.

Problems of Indian banking sector

- Instability in Financial matters.
- Non performing areas or property.
- Lack of effectiveness in management.
- Poor marketing strategy.
- Changing in financial market condition.

Foreign Direct Investment is a non-debt inflow, which will directly solve the problem of capital base of the Indian Banks

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.
- Assure better risk management in financial sector

Investment percentage in banking sector

It is known that, India's growth story will never meet the reality without the financial support. There are 70% increase in FDI in financial sector during year 2011 compared to 2010. But the big downbeat that is keeping FDI's venture over whelming in this sector is convertibility factor. Due to delay of the projects, money is getting locked in projects without developing any return. Too many old rules regulations and administrative procedure are keeping projects to run at required pace.

vestment government has also taken several step to increase the FDI (e.g. Civil , Telecom, Aviation sector) up to 100 % by the way of RBI automatic route was a number of new sector in the session of 2005-06. These all steps have been contributing towards raising foreign direct investment.

Conclusion:

Indian banking sector is proving support since 1786 till today with the guidelines of RBI and Indian government. It has also proved itself during global economic crisis with its strong policies and procedures without upsetting Indian financial system. Development and diversification in banking sector has now across all over the globe. Over the last decade, the fast rate of economic growth and progressive policy liberalization has made India an eye-catching destination for world's investments. United States of America have been at the front position of investments in India power up the partnership between the two largest democracies in the world. From the above research it can be concluded that since India is a developing country and the people who are working in non-government organizations have less social security after their retirement. To encourage the saving habits among them our banking sectors are introducing various schemes. 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 result in the growth of Indian economy.

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