FDI in Indian Banking Sector: A Conceptual Exposition

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Abstract

After globalization, like all other countries India also allowed FDI in various sectors including banking. FDIs have been playing an important role in promoting economic growth, triggering technological transfer and creating employment opportunities. Increased economic growth reduces poverty and raises the living standards. FDI refers to capital inflows from abroad that are invested in to enhance the production capacity of the economy. In the rapidly changing economic environment, Foreign Direct Investment (FDI) is used as the stimulus for growth in the most of developing countries including India. Globalization has engulfed all the sectors into its fold, out of which the banking sector is a crucial one. FDI in Indian banking sector has a lot of opportunities as well as challenges. This Paper attempts to study about the FDI in banking in India.

Key Words: Indian Banking, FDI, Globalisation

Introduction

In the rapidly changing economic environment, Foreign Direct Investment (FDI) is used as the stimulus for growth in the most of developing countries including India. Globalization has engulfed all the sectors into its fold, out of which the banking sector is a crucial one. FDI in Indian banking sector has a lot of opportunities as well as challenges. This Paper explores the opportunities for FDI in Indian banking sector and highlights its various forms of presence in India. It further investigates the trends in FDI into Indian banking sector and attempts to reckon the impact of presence of foreign banks on Indian domestic banks. The study also throws light on RBI's amendments and recent foreign policy with respect to FDI in India.

Liberalization of Indian Policy Regime and FDI Inflows

The approvals of FDI inflows since the liberalisation of policy in 1991 reveal a dramatic jump.

Table 1: Trends in Net (FDI Inflows to India: 1980-2010) (Values in US$ billion)

Year	FDI Inflows (net)	Percent change over preceding year
1980	0.08	0
1981	0.09	13
1982	0.07	-22
1983	0.01	-86
1984	0.02	100
1985	0.11	450
1986	0.12	9
1987	0.21	75
1988	0.09	-57
1989	0.25	178
1990	0.24	-4
1991	0.08	-67
1992	0.25	213
1993	0.53	112
1994	0.97	83
1995	2.15	122
1996	2.53	18
1997	3.62	43
1998	2.63	-27
1999	2.17	-17
2000	3.59	65
2001	5.48	53
2002	5.63	3
2003	4.32	-23
2004	5.78	34
2005	7.62	32
2006	20.33	167
2007	25.35	25
2008	42.55	68
2009	35.65	-16
2010	24.64	-31

Source: UNCTADSTAT, World Development Indicators, World Bank, 2012.

As is clear from the above table, the trends in some years of FDI investment has been negative, but overall in majority of years, this trend has been positive and now India has emerged as one of the leading destinations of FDI in the world. Countries in developing world like India and China account for a major chunk of foreign direct investment. The emerging pattern is quite clear. Now the developed countries alone are not the host of FDI; rather the developing countries and the emerging economies like China and India are some of the most attractive destinations of FDI in the world economy.

Table-2: Systematic View of FDI Policy (1990-91 to 2009-10)

1. 1990-1991

In 1991 automatic approval of upto 51% of foreign ownership was introduced in 34 priority sectors, including mostly manufacturing industries and a few services sectors.

2. 1992-1993

Indian mining sector was opened to foreign direct investment.

3. 1993-1994

Permission was granted to foreign investors and Non Residents Indian investors to repatriate their profits and capital.

4. 1997-1998

* Non Resident Indians (NRI) and overseas corporate Bodies (OCB) were given automatic approval for equity in priority industries.

* In January 1997 FDI Policy in mining was further liberalized. Automatic approval upto 50%

was granted in foreign equity participation in mining projects while this limit was raised to 74% in services incidental to mining.

* In January 1998 simplified procedures for automatic FDI approvals were announced by RBI. This in turn implied that there is no need for Indian companies to acquire prior clearance from RBI for inward remittance of foreign exchange or for the issuance of shares to foreign investors.

5. 1998-1999

FEMA replaced FERA revealing change in government attitude towards FDI.

6. 1999-2000

Foreign investment implementation authority (FIA) was set up for providing a single point interface between foreign investors and the government machinery, including state authorities. This body was also empowered to give comprehensive approvals.

7. 2000-2001

The dividend balancing condition on consumer goods was finally abolished.

8. 2005-2006

In March 2005, the government announced a revised FDI policy, an important element of which was the decision to allow FDI upto 100% foreign equity ownership under the automatic route in townships, housing, built-up infrastructure and construction- development projects. The year 2005 also witnessed the enactment of the Special Economic Zones Act, which entailed a lot of construction and township development that came into force in February 2006.

9. 2009-2010

* FDI norms in various sectors such as commodity exchanges, credit information and aircraft maintenance were relaxed.

*Hundred percent foreign direct investments in Maintenance, Repair and Overhauling (MRO) was allowed.

* Hundred percent FDI permitted in mining of titanium bearing minerals.

*Hike in the ceilings on public sector oil refineries.

*Foreign investors were exempted from minimum capitalization and a three year lock-in-period.

Source: compiled from various sources like Economic Survey of India, Handbook of Statistics on Indian Economy and others.

Rationalisation of FDI in India

A comprehensive review of the FDI policy was undertaken during the current year vide Press Note 4 dated february 10, 2006, to consolidate the liberalisation already effected and further rationalise the FDI policy governing various activities. The major policy initiatives taken are:

Change of Route: FDI has been allowed up to 100 per cent under the automatic route for distillation and brewing of potable alcohol, manufacture of industrial explosives, manufacture of hazardous chemicals, manufacturing activities located within 25 kms of the Standard Urban Area limits requiring industrial license under the IDR (Act) 1951, setting up of Greenfield airport projects, laying of natural gas/LNG pipelines, market study and formulation and Investment financing in the petroleum sector, and cash and carry wholesale trading and export trading

Increase In Equity Caps: FM caps have been Increased to 100 per cent and automatic route extended to coal and lignite mining for captive consumption, setting up of infrastructure relating to marketing in petroleum and natural gas sector and exploration and mining of diamonds and precious stones.

FDI in New Activities: FM has been allowed up to 100 per cent on the automatic route in power trading and processing and warehousing of coffee and rubber. FIJI has also I been allowed up to 51 per cent for 'single brand' product retailing which requires prior approval of Government. Specific guidelines have been issued for governing FDI for 'single brand' product retailing.

Removal of Restrictive Conditions: Mandatory divestment conditions for Business to Business e-commerce has been dispensed with.

Procedural Simplification: The transfer of shares from resident to non-resident including acquisition of shares in an existing company has been placed on the automatic route subject to sectoral policy on FDI.

Significant initiatives have been made in the FDI policy regime in the recent times to ensure that Indian economy remains increasingly attractive and investor-friendly. Some of the main initiatives have been as

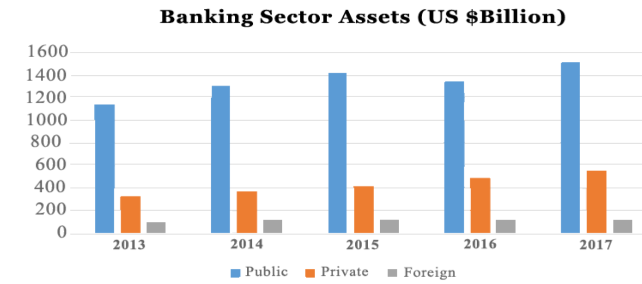
1) consolidation of FDI Policy: For ease of reference, all existing regulations on FDI were integrated into one consolidated document. The consolidation involved integration of 178 Press Notes, covering various aspects of the policy since 1991, as also other regulations governing FDI. The consolidated circular is being issued in April every year to keep it updated. The latest being the consolidated circular issued on April 5, 2013.
2) rationalisation and liberalization: In order to make the FDI policy more liberal and

investor- friendly, further rationalization and simplification has been carried out since. Government allowed FDI up to 100 per cent on the automatic route for most activities and a small negative list was notified where either the automatic route was not available or there were limits on FDI.

The FDI policy has been gradually simplified and rationalized and more sectors have been opened up for foreign investment. Some of the recent decisions are: the limits in single brand retailing have been increased to 100 per cent; in multi brand retail trading the limit is approved up to 51 per cent; in telecom it is approved up to 100 per cent; in asset reconstruction company recently approved up to 100 per cent; in credit information company recently approved up to 74 per cent; in defence beyond 26 per cent recently made possible on case to case basis.

FDI in Indian Banking Sector

Assets base of total banks has increased at a CAGR of 5.97 % to US$ 2.22 trillion during FY13–18 with interest income CAGR of 6.61% over FY09-18.



Source: Reserve Bank of India (RBI)

Sectors of the banking industry include investment banking, retail, and private banking. Investment banking is a growing sector with more Indians looking to invest funds in mutual funds and stocks rather than the traditional fixed deposits and schemes.

Retail banking is when the bank deals with individual customers rather than corporations. Services offered by these banks are normal savings, personal loans, checking accounts, and debit/credit cards amongst others. This is also a growing sector as the drive for cashless transactions is growing. More people are opting for debit and credit cards. Private banking is where the personalized financial services are provided to individuals or corporations of high worth.

All these sectors are showing immense growth prospects. Internet banking is also gaining prominence. The phone banking sector is also gaining in popularity. Thus, the entire banking sector is growing and offers immense potential.

This is why foreign banks are increasingly establishing their base in India. JP Morgan, Standard Chartered, Bank of America, and many other international banks have established centers in India to tap its potential.

FDI in this sector has been raised. 74% FDI via the automatic route is allowed in the private sector banks. This means that the aggregate foreign investment in any private bank considering all sources should be up to 74% of the paid-up capital. In the case of nationalized banks, the Portfolio and FDI investment's maximum limit is 20%. This cap also applies to the investment in state banks and other associated ones.

Conclusion:

Even with the global recession, the investment in the banking industry is still prevalent though the volume may have been reduced. The FDI entries in the country grew by 145% between 2006 and 2007 and by 46.6% during 2007–2008. The FDI in 2009 was down to 18.6%. However, with the recession abating the investments are sure to rise. The government is also encouraging foreign investment in this sector, as the entry of foreign players will help the sector. FDI in Indian banking can lead to improved efficiency, better capitalization, and improved adaptability. So the government is attracting FDI, FII, and NRIs in this field. Overall, the Indian banking industry has immense potential for further growth and expansion.

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