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Role of FDI in Banking, in generating wealth to Indian Economy

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Abstract

Indian banking sector has created golden path in the development of Indian economy and in generating wealth to the economy. In 1998 when US economy got into trouble, the financial sector of India got affected but the only sector which has maintained its growth is Indian Banking system. This paper discuss about the history of banking system, necessity of FDI in banking system, guidelines for FDI and also shows the statistics of FDI in Indian banking sector.

KEY WORDS: FDI, RBI, NBFC, SBI, FII, WOS

Introduction

The banking system in India is significantly different from that of other Asian nations because of the country's unique geographic, social, and economic characteristics. 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 illiteracy 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.

Objective of the study

- Study about the growth of banking sector.
- FDI in banking in India (Govt. decision)
- Guidelines for investment in banking sector.
- Problems faced by Indian banking sector.
- Benefits on FDI in Banking sector in India.
- Investment percentage banking sector.

Hypothesis of the study

The main objective of this paper is to study the history of Indian banking sector and its favorable environment for FDI, which leads to the development of the Indian economy.

H1: FDI leads to increase in the wealth of the Nation.

H2: Is Indian banking regulations are in par with FDI guidelines.

Review of History

1786-1969

In the year 1786, the general Banking of India was setup, followed by bank of Hindustan and Bengal Bank. The East India Co. formed Bank of Bengal (1809), Bank of Madras (1843) as independent banks and collected them as presidency Banks. These banks were unified in 1920 and imperial Bank of India was formed.

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

- Due to the continues failures in Banking system Government of India passed the Banking companies act 1949 and later on it is modified as Banking Regulation act.

Reforms in Financial sector post liberalisation

- In 1965 RBI got authority to control the functioning of other nationalised banks
- In 1955 the Imperial Bank of India was Nationalised
- The SBI was established to act as the controlling authority to RBI
- In 1960 7 banks were nationalised and assigned subsidiaries to SBI

After Nationalisation of Banks

- 1969 under the directions of P.M Indira Gandhi 14 major banks was nationalised
- 1980 7 more banks was nationalised, resulting in 80% of banking sector coming under the control of the government.

Post liberalisation

Reforms were introduced in the banking sector to strength Indian banks and make them internationally competitive and banks to play a vital role in the economic development of the country. The banking sector was opened up for private participation and the entry of new private banks increased competition. The efficiency of the banking sector improved as suggested by indicators such as gradual in cost of intermediation and decline in non-performing loans. Efficiency in the banking sector was driven by improved technology and competition.

- Financial sector has undergone rapid transformation during post liberalisation

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- Which got transparency and accountability in the financial markets
- Which results in greater inflow of investments from FII's into the capital markets

Trends in Banking

The scheduled commercial banks are classified as following after liberalisation

- Public sector banks
- Old private sector banks
- New private sector banks
- Foreign banks

FDI in Banking in India – voice against Govt. decision

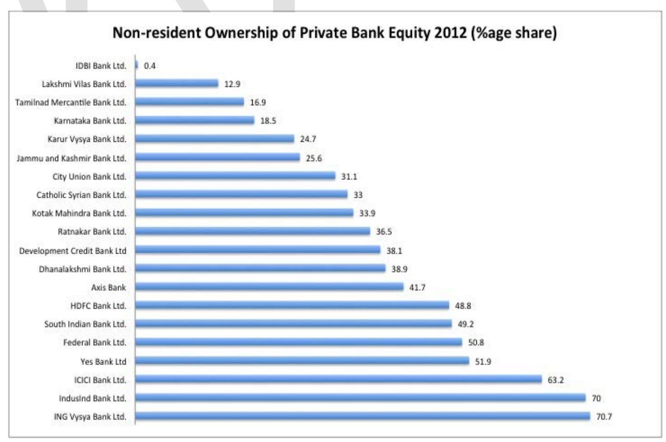
Due to adamant decision of P M and congress party about their advancing their programme of financial liberalisation, allowing FDI in banking sector led to strike by the banking employees.

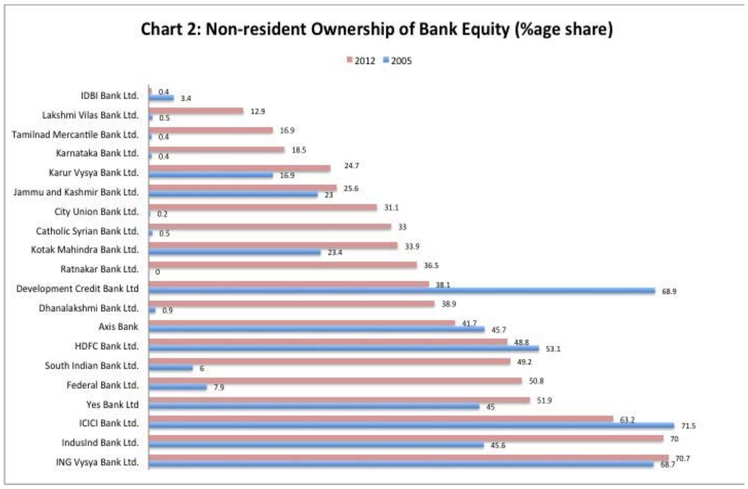
The additional point which also supported for raising voice against FDI in banking sector is, beside permitting the entry and consolidation of new private banks, the govt. on 05-03-04 announced a set of decisions with reference to FDI in the banking sector, which relaxed the capital on foreign equity in Indian banks to 20% in the case of public sector banks and 74% in the case of private banks. This was an additional permission to foreign banks to operate in the country through wholly owned subsidies to increasingly relaxed rules.

After keeping the above problem in mind, the RBI decided to retain the stipulation under the banking regulation act, section 12(2) that in the case of private banks the maximum voting rights per shareholder will be 10% of the total voting rights (1% of the public banks). The 10% of ceiling on equity ownership by single foreign entry was partly geared to aligning ownership guidelines with the rule of voting rights. The response to this form liberalisation advocated was that the whole exercise was pointless in a much as the ceiling on single investor ownership and voting rights would deter foreign investors.

The evidence shows that this expectation has turned out to be completely false as chart 1 shows, the shares of foreign investors in private bank equity exceeds 50% in five banks and stands at between a third and a half in another eight.

Chart 2 shows that in a number of instances the share of foreign equality has increased between 2005 and 2012.





The implication of this is clear. The problem with well-performing private banks is not that it is different to attract FDI. The problem is that current rules do not allow entry of those whose intent is to exercise control over a local bank with an adequate share holding and equivalent voting rights.

Hence, if the need is to allow foreign equity infusion to meet prudential requirements such as the Basel norms, that is still possible. What is not allowed is the entry of single foreign investor seeking to establish or acquire domestic private banks with a controlling stake and voting rights.

Guidelines for investment in banking sector

- The limits of FDI in the banking sector has been increased to 74% of the paid up capital of bank
- FDI in the banking sector is allowed under the automatic route in India
- FDI and portfolio investment in the public or nationalised banks in India are subject to limit of 20% in totality.
- This ceiling is also applicable to the investors in SBI and its associated banks
- FDI limits in 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.
- The RBI of India governs the investment matters in the banking sector.

According to the guidelines for 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 subsidies
- Other subsidies

Incase of wholly owned subsidies (WOS), the guidelines for FDI in the banking sector specified that the WOS must involve a capital of minimum 300 corers and should ensure proper corporate governance.

Problem faced by Indian banking sector

- Inefficiency in management
- 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
- Changing financial market conditions

Benefits of FDI in Banking sector in India

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

Investment percentage in banking sector

It is known that without the financial support, India's growth story will never meet the reality. In year 2011 there has been more than 70% increase in FDI in financial sector compared to 2010. But the big negative that is keeping FDI's venture over whelming in this sector is convertibility factor.

Due to delayed project, money is getting locked in projects without developing any revenue/returns. Too many outdated regulations and bureaucratic procedure are keeping projects to run at required pace.

FDI can be attracted 49% in private sector banks as per terms of RBI, in case of NBFC's 100 % FDI in merchant banking, investment/portfolio management, investment consultancy, sector broking, asset management, Housing finance, credit card business, credit for rural India etc..

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Conclusion

Indian banking sector is proving itself since 1786 till date with the guidelines of RBI and Government of India. Indian banking system has also proved during global economic crisis with its strong policies and procedures without affecting Indian financial system.

From the above research it can be concluded that since India is a developing country and the people who are working in non-government organisations 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 world wide we require investment from abroad.

RBI should make such policies that FDI should not over ride the regulations of RBI and should result in the growth of Indian economy.

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