Emerging trends in FDI in Banking sector and its impact on Private sector Banks in India

Dr. Shaikh Aftab Anwar
Vice Principal and HOD Commerce, Poona College of Arts, Science and Commerce,
Camp, Pune, (MS) INDIA
Email - dranwarshaikh@gmail.com

Abstract: *FDI is an important source of non debt inflows and is increasing being sought as a vehicle for flow of capital in the country and a means of attaining competitive efficiency by creating a meaningful network of global interconnections. The financial sector is always the key sector for the overall development of any country, and the banking sector is the primary sector amongst all. Indian banking has come a long way since India adopted economic reforms in 1991. Today, Indian banks are as technology savvy as their counterparts in the developed countries. The competitive and reform forces have led to the emergence of the Internet, e-banking, ATM, credit cards, and mobile banking too in order to attract and retain the customers by a bank. This paper aimed at examining the emerging trends in FDI in Banking sector and its impact on Private sector Banks in Indian Economy.*

Key words: *Banking, Retail and Private Sector, FDI, Government, New Policy.*

1. INTRODUCTION:

Foreign Direct Investment in India is one of the major monetary sources for economic development in India. Foreign companies invest in India to take benefits of lower wages and changing business environment of India. Economic liberalisation started in wake of the 1991 economic crisis and since then FDI has steadily increased in India. According to the *Financial Times*, in 2015 India overtook China and the United States of America as the top destination for the Foreign Direct Investment. In first half of the 2015, India attracted investment of $31 billion compared to $28 billion and $27 billion of China and the United States of America respectively. Currently, the Government permits 74% FDI in private banks, with up to 49% allowed under the automatic route. The Government of India has amended FDI policy to increase FDI inflow in the country. It also launched Make in India initiative in September 2014 under which FDI policy for 25 sectors was liberalised further As of April 2015, FDI inflow in India increased by 48% since the launch of "Make in India" initiative. India was ranking 15th in the world in 2013 in terms of FDI inflow; it rose up to 9th position in 2014 while in 2015 India became top destination for foreign direct investment.

According to UNCTAD's World Investment Report 2015, India ranks third among most prospective host economy for 2015-17 (after China and the US) in the world, as per a survey among Multi National Enterprises. India's rank also improved to ninth among the top countries ranked by FDI inflows in 2014, compared to 15 in 2013'.

Fig.1 fdi

2. RESEARCH METHODOLOGY:

The present study is of analytical in nature and makes use of secondary data. The relevant secondary data are collected from various publications of Government of India, Ministry of Finance, Department of Economic Affairs, Economic Division, India, Reserve bank of India reports and World Investment Report Published by UNCTAD etc.

3. OBJECTIVES OF THE STUDY:

1) To study the Recent Trends in FDI in banking Sector
2) To study the impact of flow of FDI on Private sector Banks.

4. FDI IN BANKING SECTOR:

Indian Federal Government has opened up the banking sector for foreign investors raising the ceiling of foreign direct investment in the Indian private sector banks to 49 percent. However, the ceiling of FDI in the country's public sector banks remains unchanged at 20 percent. Foreign banks having branches in India are also entitled to acquire stakes up to 49% through "automatic routes". It is to be noted that under "automatic route" fresh shares would not be issued to foreign investors who already have financial or technical collaboration in banking or allied sector. They would require FIPB approval. However, some statutory approvals of the Reserve Bank of India (RBI), country's central banking authority, would be required. There are 29 Indian private sector banks. RBI has also specified the voting rights of foreign investors. The scope for disinvestment is also there.

Seeking to further relaxation investment norms Government is considering increasing the FDI limit in private banks to 100 per cent from the existing 74 per cent. If 100 per cent FDI is allowed in banking sector it will help the existing private sector banks and small finance banks to tap overseas markets to enhance their capital base. RBI has recently given in-principle approval to 11 entities to set up payments banks and 10 for small banks. Recently, the Government has introduced the concept of composite caps but given the sensitivities in the sector. But foreign institutional investors cannot exceed the cap or limit prescribed for portfolio investments in private sector banks.

5. FDI IN PRIVATE SECTOR BANKS:

Private lenders including Axis Bank, YES Bank, Kotak Mahindra Bank and even Federal Bank stand to benefit from the government's move to remove the distinction between foreign portfolio investment (FPI) and foreign direct investment (FDI),Bureau in Mumbai. The Bank Nifty rose 616.65 points after finance minister Arun Jaitley announced to club foreign investments like FPI and FDI under a composite cap. Currently, the limit for FPI in banks is 49% while the FDI cap is 74%;.now FIIs will have headroom to buy into some private sector bank stocks. The FII holding in Axis Bank is currently around 48%, almost near the cap of 49% under the present rules. In YES Bank it is at 46% while in ICICI Bank it is 41.74%. "The move is positive for private banks and it will increase the FII investment limit (including FDI) in private banks to 74% from the current 49%," Kotak Securities wrote in a note.

A Credit Suisse report notes that even small banks such as Karur Vysya Bank, Karnataka Bank and South Indian Bank will see an expansion of their current headroom to attract more FII stake. However, in the case of large lenders such as HDFC Bank and ICICI Bank, the incremental room to raise FII holdings is minimal. Taking into account the American depository receipts and global depository receipts issued by both lenders, the incremental room for HDFC Bank is a mere 1.7% while that of ICICI Bank is 3.2%.

6. THE IMPACT OF FDI ON BANKING SECTOR:

The Global Banking industry weathered turbulent times in 2007 and 2008. The impact of the economic slowdown on the banking sector in India has so far been moderate. The Indian financial system has very little exposure to foreign assets and their derivative products and it is this feature that is likely to prove an antidote to the financial sector ills that have plagued many other emerging economies.

Owing to at least a decade of reforms, the banking sector in India has seen remarkable improvement in financial health and in providing jobs. Even in the wake of a severe economic downturn, the banking sector continues to be a very dominant sector of the financial system. The aggregate foreign investment in a private bank from all sources is allowed to reach as much as 74% under Indian regulations.

The third quarter of 2008 saw the beginning of negative net capital inflows into the country. Notwithstanding this bleak scenario, the investment pattern with regard to foreign direct investment (FDI) and inflows from non-resident Indians remains resilient and FDI inflows into the country grew by an impressive 145% between fiscal 2006 and 2007 and by a respectable 46.6% between fiscal 2007 and 2008. However, owing to the economic downturn, the growth in FDI inflows in fiscal 2009 slowed to 18.6% from the previous fiscal.

Despite the surge in investments, the stringent regulatory framework governing FDI has proved to be a significant hindrance. However, FDI norms have been relaxed to a considerable extent with respect to certain sectors. Private banks, for instance.

Foreign investment, in addition to technological innovation and expertise, brings with it a plethora of risks. An unwarranted increase in the size of foreign holding in the banking and insurance sector will inevitably exposes the country to risks not commensurate with those that an emerging market economy such as ours is equipped to grapple with.

At the same time, it is important to recognize that FDI in banking can address several issues pertaining to the sector such as encouraging development of innovative financial products, improving the efficiency of the banking sector, better capitalization of banks and better ability to adapt to changing financial market conditions.

7. NEW FDI NORMS AND PRIVATE SECTOR BANKS:

The decision of the Government to remove sub-limits for foreign investments in Indian companies, domestic banks, especially those in the private sector, could benefit from enhanced capital-raising options from overseas investors.

Currently, the different types of foreign investments include foreign direct investment (FDI), foreign institutional investors (FIIs), foreign portfolio investors (FPIs), non-resident Indians (NRIs), qualified foreign investors (QFIs), and depository receipts (DRs). Each class of these investors is allocated a sub-limit for investment in the capital of an Indian company. Within the banking sector, foreign investment up to 74 per cent (including investment by FIIs/FPIs) is allowed in private sector banks. This limit stands at 20 per cent (FDI and portfolio investment) in the case of public sector banks.

8. SECTORAL CAP:

According to Madan Sabnavis, Chief Economist, Care Ratings, the intermingling of sub-limits will help attract foreign investments into Indian banks, especially those in the private sector, where the 74 per cent sectoral cap on foreign investment has not yet been reached. “This provision may not be of much help to banks which have already hit the sectoral cap,” he said. Public sector banks could benefit from this move only if the sectoral cap for foreign investment is raised above 20 per cent.

Rana Kapoor, MD and CEO of YES Bank, said, “Approval of the composite FDI cap, while it may appear procedural, is a significant reform for the economy as a whole, as there will be more capital flowing into the system and significantly ease the procedural investment decisions by foreign investors.”

Yes Bank had received board approval in April 2015, as well as an enabling approval from shareholders for increasing the FII limit to 74 per cent, in the annual general meeting in June 2015. Currently, the bank’s FII holding is below 49 per cent.

9. CONCLUSION:

New Trends in FDI in Banking sector has its impact on Private sector Banks in India. India is now emerging and upcoming market for money investment in many modes. Hence FDI facilitate money circulation and increase in employment generation to local people. FDI in banking as relates to FDI in retail sector gives great rise in providing infrastructure and basic amenities to India. Current trends in FDI in Public sector as well as private sector leads to industrial growth. It results in high regulation of import and export policies in India.

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