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# ROLE OF FDI IN BANKING SECTOR, IN GENERATING WEALTH TO INDIAN ECONOMY

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**Abstract**
*Foreign direct investment (FDI) is an integral part of an open and effective international economic system and a major catalyst to development. Foreign direct investment (FDI) has grown dramatically as a major form of international capital transfer over the past decade. Between 1980 and 1990, world flows of FDI-defined as cross-border expenditures to acquire or expand corporate control of productive assets-have approximately tripled. 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 inflows are essentially long-term in nature and are primarily driven by growth prospects of the Indian economy and confidence of international investors in India as an attractive long-term. Foreign Direct Investment as seen as an important source of non-debt inflows, and is increasing being sought as a vehicle for technology flows and as a means of attaining competitive efficiency by creating a meaningful network of global interconnections. 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. However, many mechanisms and dynamics of FDI-assisted development have changed: there is greater variation in the kinds of FDI, the benefits each offers, and the manner in which each interacts with the host economy.FDI seen as an important catalyst for economic growth in the developing countries, It affects the economic growth by stimulating domestic investment, increasing human capital formation and by facilitating the technology transfer in the host countries. The benefits of FDI do not accrue automatically and evenly across countries, sectors, and local communities. National policies and the international investment architecture matter for attracting FDI to a larger number of developing countries and for reapingthe full benefits of FDI for development. The challenges primarily address host countries, which need to establish a transparent, broad and effective enabling policy environment for investment and to build the human and institutional capacities to implement them. This paper discusses the role of FDI in Indian banking sector, in generating wealth to Indian economy.*

***Key Words: Foreign Direct Investment, Banking system, Globalization, Indian Economy.***

## Introduction
Foreign direct investment (FDI) is an integral part of an open and effective international economic system and a major catalyst to development. Yet, the benefits of FDI do not accrue automatically and evenly across countries, sectors and local communities. National policies and the international investment architecture matter for attracting FDI to a larger number of developing countries and for reaping the full benefits of FDI for development. Foreign Direct Investment as seen as an important source of non-debt inflows, and is increasing being sought as a vehicle for technology flows and as a means of attaining competitive efficiency by creating a meaningful network of global interconnections. 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. India has sought to increase inflows of FDI with a much liberal policy since 1991 after decade's cautious attitude. The 1990's have witnessed a sustained rise in annual inflows to India. Basically, opening of the economy after 1991 does not live much choice but to attract the foreign investment, as an engine of dynamic growth especially in view of fast paced movement of the world forward Liberalization, Privatization and Globalization

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 ramework 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.

FDI eludes definition owing to the presence of many authorities: Organisation for Economic Co-operation and Development (OCED), International Monetary Fund (IMF), International Bank for Reconstruction and Development (IBRD) and United Nations Conference on Trade and Development (UNCTAD). All these bodies attempt to illustrate the nature of FDI with certain measuring methodologies. Generally speaking FDI refers to capital inflows from abroad that invest in the production capacity of the economy and are "usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depend on the performance of the projects financed by the investors. FDI also facilitates international trade and transfer of knowledge, skills and technology." It is furthermore described as a source of economic development, modernization, and employment generation, whereby the overall benefits (dependant on the policies of the host government)…triggers technology spillovers, assists human capital formation, contributes to international trade integration and particularly exports, helps create a more competitive business environment, enhances enterprise development, increases total factor productivity and, more generally, improves the efficiency of resource use.

**Objective of the Study**

1. To study the role of the FDI in the Indian Banking Sector
2. Benefits on FDI in Banking sector in India.

**Research Methodology**

Research and experimental development is formal work undertaken systematically to increase the stock of knowledge. The present study is of descriptive nature. Therefore the use is made of secondary data collected primarily from journals, articles, online database of Indian Economy, RBI bulletin, websites or newspaper etc.

**FDI in Indian Banking**

In the private banking sector of India, FDI is allowed up to a maximum limit of 74 % of the paid-up capital of the bank. On the other hand, Foreign Direct Investment and Portfolio Investment in the public or nationalized banks in India are subjected to a limit of 20 % in totality. This ceiling is also applicable to the investments in the State Bank of India and its associate banks. FDI limits in the 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 Reserve Bank of India governs the investment matters in the banking sector.

The global banking industry weathered turbulent times in 2007 and 2008. The impact of the economic slowdown on the banking and insurance services 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 insurance sector has also been fast developing with substantial revenue growth in the non-life insurance market. However, despite its enormous population, India only accounts for 3.4%

of the Asia- Pacific general insurance market's value. The cap on foreign companies' equity stakes in insurance joint ventures is 26%, but is expected to rise to 49%.

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.

**FINANCIAL YEAR-WISE FDI INFLOWS DATA:**

| *S. No* | *Financial Year (April-March)* | *FOREIGN DIRECT INVESTMENT (FDI)* | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | *Equity* | | | | *FDI FLOWS INTO INDIA* | | |
| | | *FIPB Route/ RBI's Automatic Route/ Acquisition Route* | *Equity unincorporated bodies* | *Re-invested earnings +* | *Other capital +* | *Total FDI Flows* | *%age growth* | *Investment by FII's Foreign Institutional Investors Fund* |
| 1. | **2000-01** | 2,339 | 61 | 1,350 | 279 | **4,029** | **-** | **1,847** |
| 2. | **2001-02** | 3,904 | 191 | 1,645 | 390 | **6,130** | **(+) 52 %** | **1,505** |
| 3. | **2002-03** | 2,574 | 190 | 1,833 | 438 | **5,035** | **(-) 18 %** | **377** |
| 4. | **2003-04** | 2,197 | 32 | 1,460 | 633 | **4,322** | **(-) 14 %** | **10,918** |
| 5. | **2004-05** | 3,250 | 528 | 1,904 | 369 | **6,051** | **(+) 40 %** | **8,686** |
| 6. | **2005-06** | 5,540 | 435 | 2,760 | 226 | **8,961** | **(+) 48 %** | **9,926** |
| 7. | **2006-07** | 15,585 | 896 | 5,828 | 517 | **22,826** | **(+) 146 %** | **3,225** |
| 8. | **2007-08** | 24,573 | 2,291 | 7,679 | 300 | **34,843** | **(+) 53 %** | **20,328** |
| 9. | **2008-09** | 31,364 | 702 | 9,030 | 777 | **41,873** | **(+) 20 %** | **(-) 15,017** |
| 10. | **2009-10 (P) (+)** | 25,606 | 1,540 | 8,668 | 1,931 | **37,745** | **(-) 10%** | **29,048** |
| 11. | **2010-11 (P) (+)** | 21,376 | 874 | 11,939 | 658 | **34,847** | **(-) 08 %** | **29,422** |
| 12. | **2011-12 (P)** | 34,833 | 1,022 | 8,206 | 2,495 | **46,556** | **(+) 34 %** | **16,812** |
| 13. | **2012-13 (P)** | **21,825** | **1,059** | **9,880** | **1,534** | **34,298** | **(-) 26%** | **27,582** |
| 14 | **2013-14 (P)** | **24,299** | **984** | **9,047** | **2,066** | **36,396** | **+ ) 6%** | **5,010** |
| 15. | **2014-15** | **10,736** | **299** | **2,755** | **820** | **14,610** | **-** | **-** |

**STATEMENT ON RBI'S REGIONAL OFFICES (WITH STATE COVERED) RECEIVED FDI EQUITY INFLOWS[1]** ***(from April, 2000 to July, 2014):***

| S.No. | RBI's - Regional Office[2] | State covered | 2012-13 ( April - March) | 2013-14 ( April - March) | 2014-15 (April- July, 2014) | Cumulative Inflows (April '00 - July '14) | %age to total Inflows (in terms of US$) |
|---|---|---|---|---|---|---|---|
| 1 | MUMBAI | **MAHARASHTRA, DADRA & NAGAR HAVELI, DAMAN & DIU** | 47,359 **(8,716)** | 20,595 **(3,420)** | 14,077 **(2,351)** | 328,166 **(69,108)** | 30 |
| 2 | NEW DELHI | **DELHI, PART OF UP AND HARYANA** | 17,490 **(3,222)** | 38,190 **(6,242)** | 9,503 **(1,587)** | 216,274 **(44,123)** | 9 |
| 3 | CHENNAI | **TAMIL NADU, PONDICHERRY** | 15,252 **(2,807)** | 12,595 **(2,116)** | 5,612 **(938)** | 71,17 **(14,135)** | 6 |
| 4 | BANGALORE | **KARNATAKA** | 5,553 **(1,023)** | 11,422 **(1,892)** | 2,27 **(405)** | 63,294 **(13,081)** | 6 |
| 5 | AHMEDABAD | **GUJARAT** | 2,676 **(493)** | 5,282 **(860)** | 1,246 **(209)** | 45,2**(9,719 )** | 4 |
| 6 | HYDERABAD | **ANDHRA PRADESH** | 6,290 **(1,159)** | 4,024 **(678)** | 4,245 **(709)** | 45,160 **(9,355)** | 4 |
| 7 | KOLKATA | **WEST BENGAL, SIKKIM, ANDAMAN & NICOBAR ISLANDS** | 2,319 **(424)** | 2,659 **(436)** | 421 **(70)** | 13,584 **(2,812)** | 1 |
| 8 | CHANDIGAR H` | **CHANDIGARH, PUNJAB,HA RYANA,HI MACHAL PRADESH** | 255 **(47)** | 562 **(91)** | 100 **(17)** | 6,227 **(1,309)** | 0.6 |
| 9 | JAIPUR | **RAJASTHAN** | 714 **(132)** | 233 **(38)** | 3,065 **(513)** | 6,623 **(1236)** | 0.5 |
| 10. | BHOPAL | **MADHYAPRADES H, CHATTISGARH** | 1,208 **(220)** | 708 **(119)** | 600 **(100)** | 6,095 **(1,215)** | 0.5 |
| 11 | KOCHI | **KERALA, LAKSHADWEEP** | 390 **(72)** | 411 **(70)** | 161 **(27)** | 4,893 **(1,008)** | 0.4 |
| 12 | PANAJI | **GOA** | 47 **(9)** | 103 **(17)** | 3 **(9)** | 3,710 **(797)** | 0.4 |
| 13 | KANPUR | **UTTAR PRADESH,UTT RANCHAL** | 167 **(31)** | 150 **(25)** | 200 **(33)** | 1,965 **(406)** | 0.2 |
| 14 | BHUBANESH WAR | **ORISSA** | 285 **(52)** | 288 **(48)** | 20 **(3)** | 1,926 **(392)** | 0.2 |
| 15 | GUWAHATI | **ASSAM, ARUNACHAL PRADESH, MANIPUR, MEGHALAYA, MIZORAM, NAGALAND, TRIPURA** | 27 **(5)** | 4 **(0.6)** | 0 **(0)** | 352 **(79)** | 0 |
| 16 | PATNA | **BIHAR, JHARKHAND** | 41 **(8)** | 9 **(1)** | 48 **(8)** | 247 **(47)** | 0 |
| 17 | JAMMU | **JAMMU &** | 0 | 1 | 25 | 26 | 0 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| | | **KASHMIR** | **(0)** | **(0.2)** | **(4)** | **(4)** | |
| 18 | REGION NOT INDICATED[3] | | **21,833 (4,004)** | **50,283 (8,245)** | 22,390 **(3,752)** | 292,906 **(58,442** | 26.06 |
| | | **SUB. TOTAL** | **121,907 (22,424)** | **147,518 (24,299** | **64,193 (10,736)** | **1,108,091 (228,317)** | **100.00** |

**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..

**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 nationalized 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.

**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

**Problems 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

**FDI and Economic Development**
FDI is considered to be the life blood and an important vehicle of for economic development as far as the developing nations are concerned. The important effect of FDI is its contribution to the growth of the economy. 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

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markets, access to international quality goods and services and augmenting employment opportunities. The reliance on FDI is rising heavily due to its al round contributions to the growth of the economy. FDI to developing countries since 1990's is the leading source of external financing. The rise in FDI volume is accompanied by marked change in its composition.

**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. 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.. 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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