IMPACT OF FOREIGN DIRECT INVESTMENT ON INDIAN BANKING SECTOR-AN OVERVIEW

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ABSTRACT

Foreign direct investment has multiple effects on the economy of India. FDI influences the production, income, employment, exports, prices, imports, balance of payments, general welfare, and economic growth of the receiving economy. The reasons, motivating foreign direct investment in other countries, are constantly being studied. There are innumerable factors motivating this type of investment and it is more complicated when the investment comes from a developed country to a developing economy such as India. Several empirical studies have drawn considerable attention on the determinants of foreign direct investment in the E.C. Relatively fewer attempts have been made to model and empirically examine foreign direct investment in the developing countries. Rising interest rate environment has adversely affected the banking sector.

Key Words: Foreign Direct Investment, Banking Sector, Government Scheme, Economy

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INTRODUCTION

Foreign direct investment (FDI) is defined as "investment made to acquire lasting interest in Enterprises operating outside of the economy of the investor." The FDI relationship consists of a Parent enterprise and a foreign affiliate which together form a Multinational corporation (MNC). In order to qualify as FDI the investment must afford the parent enterprise control over its foreign affiliate. The UN defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment.

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 alliedsector. They would require FIPB approval. However, some statutory approvals of the Reserve Bank of India (RBI), country's central banking authority, would be required.

REVIEW OF LITERATURE

It was the insight of **Hymer (1960)** who by differentiating direct investment from portfolio investment created basis for studies on factors determining the FDI flows. **Hymer** highlighted certain facts and evidences on the basis of which he concluded that the nature of the direct and portfolio investment differs and therefore same theories cannot be applied to both types of investment. The key feature that **Hymer** identified for motivation of FDI was the level of control which a firm of home country gets through direct investment in host country. He also stressed upon market imperfections such as the ownership of knowledge not known to rivals, existence of differentiated products giving profit advantage to a firm investing abroad, problems related to licensing the product, etc., for supporting FDI decisions. However, the literature argues that his theory over-emphasized the role of structural market failure and ignored the transaction cost side of market failure **(Dunning and Rugman, 1985)**. Moreover, his theory did not explain the locational and dynamic aspect of FDI.

Later, Caves (1971) expanded upon **Hymer‟s** theory of direct investment and embedded it in the industrial organization literature. By differentiating horizontal and vertical FDI, he identified factors such as possession of superior knowledge or information, motives to avoid uncertainty in a market characterized by a few suppliers and objective of creating entry barriers, etc., as being responsible for rising FDI flows. With the rising presence of multinational enterprises in the global economy, the view on FDI was expanded with the internationalization theories of FDI that stressed on transaction costs **(Dunning and Rugman, 1985; Horaguchi nad Toyne, 1990).** The internationalization theory of FDI identified accumulation and internalisation of knowledge as the motivation for FDI, which bypasses intermediate product markets in knowledge **(Tolentino, 2001).**

The theorists such as **Horst (1972),** who stressed upon locational determinants of FDI, identified prevalence of natural resources as an important factor for FDI inflow. **Wheeler** and **Mody (1992)** identified ergodic and non-ergodic systems that determine the location of FDI. The ergodic system focussed on classical variables such as geographical features, labor costs, transport costs and market size as factors determining the FDI flows. Various empirical studies still rely on these variables to determine potential for FDI flows. The non-ergodic system focussed on externalities that emerge from investment in firms experiencing agglomeration economies, in other words, indicating the clustering effects of FDI. The studies such as **Venables (1996), Potter et al (2002)** explained spatial patterns of FDI in terms of these factors.

The research work of Dunning (1973, 1981) provided a comprehensive analysis of FDI based on ownership, location and the internationalization (OLI) paradigm. His eclectic theory of FDI highlighted various benefits emerging from FDI: the ownership-specific advantages which comprise access to spare capacity, economies of joint supply, greater access to markets and knowledge, diversification of risk, technology and trademarks, f s, firm size; specific advantages consisting of distribution of inputs and markets, costs of labor, materials and transport costs, government intervention and policies, commercial and legal infrastructure, etc.; internalization-specific advantages covering reduction in search, negotiation and monitoring costs, tariff avoidance, etc. The critics of eclectic theory of FDI have regarded it as a taxomony rather than a theory of FDI **(Ietto-Gillies, 1992)** as it covered a range of theories and employs a large number of variables. It has also been criticised for reformulation over time to incorporate new ideas and to reflect contemporary trends in FDI. The prior version of his theory ignored the role of strategy in determining the FDI flows. The role of strategic motivations, which was first analysed by **Knickerbocker (1973),** were extended by **Acocella (1992).** As per these strategic theories, the reasons behind strategic alliances included economies of scale, the reduction of risk and access to knowledge and expertise **(Inkpen, 2001).** The strategic alliances highlight the motivation for mergers and acquisitions taking place in the current era of M&A boom.

OBJECTIVES OF THE STUDY

1. Study about the growth of banking sector.
2. FDI in banking in India (Govt. decision)
3. Guidelines for investment in banking sector.
4. Problems faced by Indian banking sector.
5. Benefits on FDI in Banking sector in India.
6. Investment percentage banking sector

STATUTORY LIMITS

- Foreign direct investment (FDI) up to 49 percent is permitted in Indian private sector banks under “automatic route” which includes Initial Public Issue (IPO), Private Placements, ADR/GDRs; and Acquisition of shares from existing shareholders.
- Automatic route is not applicable to transfer of existing shares in a banking company from residents to non-residents. This category of investors require approval of FIPB, followed by “in principle” approval by Exchange Control Department (ECD), Reserve Bank of India (RBI).
- The “fair price” for transfer of existing shares is determined by RBI, broadly on the basis of Securities Exchange Board of India (SEBI) guidelines for listed shares and erstwhile CCI guidelines for unlisted shares. After receipt of “in principle” approval, the resident seller can receive funds and apply to ECD, RBI, for obtaining final permission for transfer of shares.
- Foreign banks having branch-presence in India are eligible for FDI in private sector banks subject to the overall cap of 49% with RBI approval.
- Issue of fresh shares under automatic route is not available to those foreign investors who have a financial or technical collaboration in the same or allied field. Those who fall under this category would require Foreign Investment Promotion Board (FIPB) approval for FDI in the Indian banking sector.

- Under the Insurance Act, the maximum foreign investment in an insurance company has been fixed at 26 percent. Application for foreign investment in banks which have joint Venture/subsidiary in insurance sector should be made to RBI. Such applications would be considered by RBI in consultation with Insurance regulatory and Development Authority (IRDA).
- FDI and Portfolio Investment in nationalized banks are subject to overall statutory limits of 20 percent.
- The 20 percent ceiling would apply in respect of such investments in State Bank of India and its associate banks.

VOTING RIGHTS OF FOREIGN INVESTORS

Private Sector Bank	Not more than 10 percent of the total voting rights of all the shareholders
Nationalized Banks	Not more than 1 percent of the total voting rights of all the shareholders of the nationalized bank
State Bank of India	Not more than 10 percent of the issued capital This does not apply to Reserve Bank of India (RBI) as a shareholder. However, government in consultation with RBI, ceiling for Foreign investors can be raised.
SBI Associates	Not more than 1 percent. This ceiling will not be applied to State Bank of India. If any person holds more

	than 200 shares, he/she will not be registered as a shareholder.

RBI APPROVAL

- Transfer of shares of 5 percent and more of the paid-up capital of a private sector bank requires prior acknowledgement of RBI.
- For FDI of 5 percent and more of the paid-up capital, the private sector bank has to apply in the prescribed form to RBI.
- Under the provision of Foreign Exchange Management Act (FEMA), 1999, any fresh issue of shares of a bank, either through the automatic route or with the specific approval of FIPB, does not require further approval of Exchange Control department (ECD) RBI from the
- Exchange control angle.

The Indian banking company is only required to undertake two-stage reporting to the ECD of RBI as follows: (1) the Indian company has to submit a report within 30 days of the date of receipt of amount of consideration indicating the name and address of foreign investors, date of receipt of funds and their rupee equivalent, name of bank through whom funds were received and details of govt. approval, if any. (2) Indian banking company is required to file within 30 days from the date of issue of shares, a report in form FC-GPR (Annexure II) together with a certificate from the company secretary of the concerned company certifying that various regulations have been complied with.

DIVESTMENT BY FOREIGN INVESTORS

Sale of shares by non-residents on a stock exchange and remittance of the proceeds there of through an authorized dealer does not require RBI approval.

- Sale of shares by private arrangement requires RBI’s prior approval.
- Sale of shares by non-residents on a stock exchange and remittance of the proceeds thereof through an authorized dealer does not require RBI approval.

A foreign bank or its wholly owned subsidiary regulated by a financial sector regulator in the host country can now invest up to 100% in an Indian private sector bank. This option of 100%

FDI will be only available to a regulated wholly owned subsidiary of a foreign bank and not any investment companies. Other foreign investors can invest up to 74% in an Indian private sector bank, through direct or portfolio investment. The Government has also permitted foreign banks to set up wholly owned subsidiaries in India. The government, however, has not taken any decision on raising voting rights beyond the present 10% cap to the extent of shareholding.
All entities making FDI in private sector banks will be mandatory required to have credit rating. The increase in foreign investment limit in the banking sector to 74% includes portfolio investment [i.e., foreign institutional investors (FIIs) and non-resident Indians (NRIs)], IPO's, private placement, ADRs or GDRs and acquisition of shares from the existing shareholders.

I.CUMULATIVE FDI FLOWS INTO INDIA (2000-UPTO JULY, 2013)

Table 1 : TOTAL FDI INFLOWS (From April, 2000 to July, 2013)

1.	**CUMULATIVE FDI INFLOWS** **(Equity inflows+ 'Re-invested earnings' +'Other capital')***	**-**	**US $ 301,787 Million**
2.	**CUMULATIVE AMOUNT OF FDI EQUITY INFLOWS** **(excluding, amount remitted through RBI's-+NRI Schemes)**	**Rs 936,311 Crore**	**US $ 200,335 million**

Table 2: FDI INFLOWS DURING FINANCIAL YEAR 2013-14 (from April,2013 to July,2013):

1.	**TOTAL FDI INFLOWS INTO INDIA** **(Equity inflows +'Re-invested earnings' +other capital')** (**as per RBI's Monthly bulletin dated: 10.07.2013).**	**-**	**US $ 11709 million**
2.	**FDI EQUITY INFLOWS**	**Rs.39,931 Crore**	**US $ 7053 million**

Table 3: FDI EQUITY INFLOWS (MONTH-WISE) DURING THE FINANCIAL YEAR 2013-14:

Financial Year 2013-14 (April-March)		Amount of FDI Equity Inflows	
		(In Rs. Crore)	(In US $ mn)
1.	April,2013	12,623	2,322
2.	May,2013	8,974	1,631
3.	June,2014	8,432	1,444
4.	July,2014	9,903	1,657
2013-14 (from April,2013 to July,2013)#		39,932	7,054
2012-13 (from April, 2012 to July,2012)#		32,002	5,902
%age growth over last year		(+)25%	(+)20%

Table 4: FDI EQUITY INFLOWS(MONTH-WISE)DURING THE CALENDER YEAR 2013:

Calendar Year 2013 (Jan.-Dec.)		Amount of FDI Equity Inflows	
		(In Rs. Crore)	(In US $ mn)
1.	January,2013	11,719	2,157
2.	February,2013	9,654	1,795
3.	March,2013	8,297	1,525
4.	April,2013	12,623	2,321
5	May,2013	8,974	1,631
6	June,2013	8,432	1,444
7	July,2013	9,903	1,657

Year 2013 (up to July,2013)#	**69,602**	**12,530**
Year 2012 (up to July,2012)#	**61,357**	**11,746**
%age growth over last year	**(+)13%**	**(+)07%**

Note: Country &Sector specific analysis is a available from the year 2000 onwards, as a Company- wise details are provided by RBI From April,2000 onwards only.

***Data on 'Re-invested earnings'&'Other capital', are the estimates on an average basis, based upon data for the previous two years, published by RBI in monthly bulletin dated:10.12.2012.**

#Figures are provisional, subject to reconciliation with RBI, Mumbai.

Table 5: SHARE OF TOP INVESTING COUNTRIES FDIINFLOWS (Financial Years):

Ranks	Country	2011-12 (April-March)	2012-13 (April-March)	2013-14 (April-July, 2013)	Cumulative Inflows (April '00-July '13)	%age to total Inflows (in terms of US $)
1.	MAURITIUS	46,710 (9,942)	51,654 (9,497)	10,629 (1,853)	351,754 (75,519)	38%
2.	SINGAPORE	24,712 (5,257)	12,594 (2,308)	12,403 (2,214)	102,585 (21674)	11%
3.	U.K.	36,428 (7,874)	5,797 (1,080)	416 (73)	80,874 (17,622)	9%
4.	JAPAN	14,089 (2,972)	12,243 (2,237)	1,339 (234)	71,433 (14,785)	7%

5.	U.S.A	5,347 (1,115)	3,033 (557)	2,090 (371)	53,013 (11,492)	6%
6.	NETHERLANDS	6,698 (1,409)	10,054 (1,856)	2,968 (520)	45,346 (9,486)	5%
7.	CYPRUS	7,722 (1,587)	2,658 (490)	805 (141)	33,133 (7,030)	4%
8.	GERMANY	7,452 (1,622)	4,684 (860)	2,865 (518)	28,377 (5,998)	3%
9.	FRANCE	3,110 (663)	3,487 (646)	639 (112)	17,503 (3,685)	2%
10.	U.A.E.	1,728 (353)	987 (180)	372 (65)	11,679 (2,488)	1%
TOTAL FDI INFLOWS FROM ALL COUNTRIES*		165,146 (35,121)	121,907 (22,423)	39,931 (7,053)	936,844 (200,457)	-

***Includes Inflows under NRI Schemes of RBI.**

<u>Note :</u>(i) Cumulative Country-wise FDI Equity Inflows(from April,2000 to July,2013)

(ii)%age worked out in US $ terms &FDI inflows received through FIPB/SIA+RBI's Automatic Route + Acquisition of existing shares only.

Table 6: SECTOR ATTRACTING HIGHEST FDI EQUITY INFLOWS:

Ranks	Sector	<u>2011-12</u> (April-March)	<u>2012-13</u> (April-March)	<u>2013-2014</u> (April-July,2013)	<u>Cumulative Inflows</u> (April' 00-July'13)	% age to total Inflows (In terms of US $)
1.	SERVICES SECTOR**	24,656 (5,216)	26,306 (4,833)	5,770 (1,021)	178,046 (38,255)	19%

2.	**CONSTRUCTION DEVOLOPEMENT**	**15,236 (3,141)**	**7,248 (1,332)**	**2,092 (359)**	**103,141 (22,439)**	**11%**
3.	**TELECOMMUNIC-- -ATION**	**9,012 (1,997)**	**1,654 (304)**	**66 (12)**	**58,798 (12,868)**	**6%**
4.	**COPUTER SOFTWARE&HAR DWARE**	**3,804 (796)**	**2,656 (486)**	**1,244 (215)**	**54,019 (11,906)**	**6%**
5.	**DRUGS &PHARMACEUTIC ALS**	**14,605 (3,232)**	**6,011 (1,123)**	**5453 (1,002)**	**54,333 (11,320)**	**6%**
6.	**CHEMICALS(OTH ERTHAN FERTILISERS)**	**18,422 (4,041)**	**1,596 (292)**	**2,069 (354)**	**42,746 (9,235)**	**5%**
7.	**AUTOMOBILE INDURSTRY**	**4327 (923)**	**8,324 (1,537)**	**3,576 (637)**	**42,746 (8,043)**	**4%**
8.	**METALLURGICAL INDURSTRIES**	**8,348 (1,738)**	**7,878 (1,466)**	**1,090 (190)**	**35,904 (7,697)**	**4%**
9.	**POWER**	**7,678 (1,652)**	**2,923 (536)**	**1,199 (208)**	**37,336 (8,043)**	**4%**
10.	**HOTEL & TOURISM**	**4,754 (993)**	**17,777 (3,259)**	**694 (123)**	**33,954 (6,755)**	**3%**

Note: (i) **Services Sector includes Financial, Banking, Insurance, Non-Financial /Business, Outsourcing, R&D, Courier, Technology Testing and Analysis.

(ii) Cumulative Sector-wise FDI equity inflows (from April,2000 to 2013) .

(iii) FDI Sector data has been revalidated / reconciled in line with the RBI which reflects minor charges in the FDI figures (increased/decreased) as compared to the earlier published sectoral data.

Table 7: STATEMENT ON RBI'S REGIONAL OFFICES RECEIVED FDI EQUITY INFLOW (from April, 2000 to July, 2013):

S. No	RBI's Regional Office		2011-12 (April-March)	2012-13 (April-March)	2013-14 (April-July,2013)	Cumulative Inflows (April '00-July '13)	%age to total Inflows (in terms of US $)
1.	MUMBAI		44,664 (9,553)	47,359 (8,716)	8,059 (1,410)	301,553 (64,746)	32
2.	NEW DELHI		37,403 (7,983)	17,490 (3,222)	4,018 (708)	172,599 (37,002)	18
3.	CHENNAI		6,711 (1,422)	15,252 (2,807)	5,586 (990)	58,397 (12,071)	6
4.	BANGALORE		7,235 (1,533)	5,553 (1,023)	3,770 (661)	53,215 (11,446)	6
5.	AHMEDABAD		4,730 (1,001)	6,290 (1,159)	1,660 (297)	38,551 (8,265)	4
6.	HYDERABAD		4,039 (848)	6,290 (1,159)	1,660 (297)	38,551 (8,265)	4
7.	KOLKATA		1,817 (394)	2,319 (424)	5,888 (104)	11,092 (2,409)	1
8.	CHANDIGARH		624 (130)	255 (47)	90 (16)	5,654 (1,217)	1
9.	BHOPAL		569 (123)	1,208 (220)	693 (116)	5,480 (1,113)	0.6
10.	KOCHI		2274 (471)	390 (72)	268 (47)	4,589 (958)	0.5

11.	**PANAJI**	**181 (38)**	**47 (9)**	**43 (8)**	**3,597 (779)**	**0.4**
12.	**JAIPUR**	**161 (33)**	**714 (132)**	**40 (7)**	**3,364 (692)**	**0.4**
13.	**REGION NOT INDICATED**	**53,851 (11,399)**	**21,833 (4,004)**	**13,635 (2,436)**	**233,868 (49,930)**	**25**
SUB. TOTAL		**165,146 (35,121)**	**121,907 (22,424)**	**39,931 (7,053)**	**936,311 (200,335)**	**100**
14.	**RBI'S-NRI SCHEMES (from 2000 to 2002)**	**0**	**0**	**0**	**533**	**-**
GRAND TOTAL		**165,146 (35,121)**	**121,907 (22,423)**	**39,931 (7,053)**	**936,844 (200,456)**	**-**

CONCLUSSION

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

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