Foreign Investment in Indian Banking Sector: A Comparative Overview

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Abstract

Banking system is the pivot around which a nation's economy revolves. A healthy banking system is the backbone of any economy. The significance and role of banks in the growth and development of any economy is undisputable. This doesn't needs to be re-emphasized. The Indian banking system has transformed radically since the liberalization and 1991 reforms and today, Indian banks have travelled a long way, beyond its conventional areas of functioning. The opening-up of the Indian banking sector for foreign participation was one of the key decision within a broader reform policy. Though the decision of entry of the foreign capital in the Indian banking sector was controversial, but it shows the dramatic change in the attitude of the policy-makers from conservative to a liberal one. Currently, India allows an aggregate foreign investment in private banks from all sources of up to a maximum limit of 74 percent of paid up share capital while this limit is capped at 20 percent for public sector banks. It has been more than a decade that the Indian banking sector was opened-up for foreign participation since 2005, thus, it becomes essential to investigate the emerging trends of foreign investment in the Indian banking sector. In light of this, the present paper adopts descriptive cum analytical approach to comparatively analyse the trends and pattern of foreign investment in the Indian banking sector since 2005.

KEYWORDS: Foreign Investment, Indian Banking Sector, Foreign Direct Investment (FDI), Private Banks, Public Sector Banks

Introduction

Banking system is the pivot around which a nation's economy revolves. A healthy banking system is the backbone of any economy. The significance and role of banks in the growth and development of any economy is undisputable. This doesn't needs to be re-emphasized. Finance is the life blood of the entire banking system. The entire banking system will shatter in the absence of finance. This was the case with India.

During the pre-liberalization period, India followed a fairly restrictive foreign investment policy. It became really difficult for India meet even its short-term debts as the international creditors held their hands up. The lack capital and finance prompted the policy-makers to rethink about the mode of financing the deficits. Thus, the Rangaranjan Committee recommended to shift the dependence from the debt-creating capital flows to the non-debt creating capital flows such as foreign direct investment (FDI) andforeign portfolio investment(FPI).Consequently, the Indian banking system has transformed radically since the liberalization and 1991 reforms and today, Indian banks have travelled a long way, beyond its conventional areas of functioning.

The opening-up of the Indian banking sector for foreign participation was one of the key decision within a broader reform policy. Though the decision of entry of the foreign capital in the Indian banking sector was controversial, but it shows the dramatic change in the attitude of the policy-makers from conservative to a liberal one. Currently, India allows an aggregate foreign investment in private banks from all sources of up to a maximum limit of 74 percent of paid up share capital while this limit is capped at 20 percent for public sector banks. It has been more than a decade that the Indian banking sector was opened-up for foreign participation since 2005, thus, it becomes essential to investigate the emerging trends of foreign investment in the Indian banking sector. In light of this, the present paper adopts descriptive cum analytical approach to comparatively analyse the trends and pattern of foreign investment in the Indian banking sector since 2005.

Review of Literature

A lot of literature is available on foreign direct investment (FDI) in India but very few have focused on foreign direct investment (FDI) andforeign portfolio investment(FPI) in the Indian banking sector. Few of the studies in context of foreign investment in banking sector in India which have been taken for review are the following:

Anwar (2017) examined the emerging trends in FDI in banking sector in 2015. Further its impact on private sector banks in India was analysed. The study concluded that FDI in banking gives a great rise in providing infrastructure and basic amenities to India. The current trends of FDI in banks leads to industrial growth.

Yadav & Dular (2017) analysed the FDI inflows in Indian banking sector for the period of 15 years from January, 2000 to June, 2015. The study concluded that FDI in banking sector provides the benefit of technology transfer, better risk management, financial stability, innovative products and employment. The study found that the FDI inflows in Indian banking sector has increased on annual basis. In 2013 FDI inflows in Indian banking sector accounted a very high share of total FDI in service sector in India.

Balrambhai & Gopalakrishna (2014) explored the opportunities for FDI in Indian banking sector as well as its various forms. The study also investigated the trends in FDI in Indian banking sector. The study concluded that though there is a wide scope for foreign banks in India but the RBI's favoured WOS a mode of presence has not seen yet.

Grag (2013) discussed the role of FDI in Indian banking sector. The study administered that FDI in Indian banking sector can directly solve the problem of capital base of the Indian banks and also provide the benefit of technology transfer, better risk management, financial stability, innovative financial products, improve the efficiency of banks, make the banks adaptive to the changing condition in financial market and employment.

Shrivastava (2015) examined foreign direct investment in Indian banking sector as well as the benefits of FDI in banking sector in India. The study considers FDI in banking sector can address the issues like development of new financial and unique product, risk taking ability, efficiency, etc.

Malla (2014) analysed the FDI inflows in Indian banking sector for the period of 13 years from January, 2000 to June, 2013.The study revealed that FDI equity inflows in Indian banking sector showed an increasing trend. It has been concluded that FDI inflows in Indian banking sector can solve the issue such as inefficient management, non-performing assets, financial instability and poor capitalization.

A lot of literature is available on Foreign Direct Investment (FDI) in India but there is very few study in context of Foreign Direct Investment (FDI) in the Indian banking sector. Thus, the present study is expected to fill this gap. The present study is mainly endeavour to explore the current trends, pattern and policies of Foreign Direct Investment in the Indian Banking sector.

Objectives of The Study

The main objectives of the study are:

·To comparatively analyze the trends and pattern of the inflows of foreign investment in the banking sector in India (since 2005).

·To review the current foreign investment policy in Indian banking sector.

Research Methodology

·Research Design: The present study is mainly empirical in nature which employs the research techniques which is descriptive cum analytical in nature.

·Scope of the Study: The scope of the study is vast as it extends to analyze the trends and pattern of Foreign Investment inflow in the whole Indian banking sector.Keeping in view with the objectives of the study, the present study aims to evaluate thetrends and pattern of Foreign Investment inflow in 21 public sector banks and 16 private sector banks in India.

·Type of Data and Data Collection: The present study is based on secondary data which has been gatheredfrom various sources such as reports of RBI and Indian public and private sector banks, published literature, journals, articles, newspapers, websites,circulars, manuals, newsletters, bulletins and factsheets, etc.

·Period of the Study: The present study comparesforeign investment in the banking sector in 2004-05 with that of 2016-17.

·Tools Used: For the purpose of the study various statistical tools such as percentage, tables and graphs has been used.

Foreign Investment Policy Of Indian Banking Sector

Table 1 depicts the FDI caps of Indian banking sector along with the entry routes and other conditions thereof.

Table 1: FDI Policy of Indian Banking Sector

Sector/Activity	% of Equity/ FDI Cap	Entry Route	Other Conditions
Banking- Public Sector subject to Banking Companies (Acquisition & Transfer of Undertakings) Acts 1970/80.	20%	Government	This ceiling (20%) is also applicable to the State Bank of India and its associate Banks.
Banking- Private Sector	74%	Automatic up to 49% Government route beyond 49% and up to 74%	(1) This 74% limit will include investment under the Portfolio Investment Scheme (PIS) by FIIs/FPIs, NRIs and shares acquired prior to September 16, 2003 by erstwhile OCBs, and continue to include IPOs, Private placements, GDR/ADRs and acquisition of shares from existing shareholders. (2) The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74 per cent of the paid up capital of the Bank. At all times, at least 26 per cent of the paid up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank. (3) The stipulations as above will be applicable to all investments in existing private sector banks also.

			(4) Other conditions in respect of permissible limits under portfolio investment schemes through stock exchanges for FIIs/FPIs and NRIs, setting -up of a subsidiary by foreign banks and limits in respect of voting rights are at Annexure-9.

Source: Consolidated FDI Policy Circular 2017, DIPP (www.dipp.nic.in)

The permissible limits under portfolio investment schemes through stock exchanges for FIIs/FPIs and NRIs (as stated in Consolidated FDI Policy Circular 2017, DIPP August 28, 2017) will be as follows:

(i) "In the case of FIIs/FPIs, as hitherto, individual FII/FPI holding is restricted to below 10 per cent of the total paid-up capital, aggregate limit for all FIIs/FPIs cannot exceed 24 per cent of the total paid-up capital, which can be raised up to sectoral limit of 74 percent of the total paid-up capital by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body.

(a) In the case of NRIs, as hitherto, individual holding is restricted to 5 per cent of the total paid-up capital both on repatriation and non-repatriation basis and aggregate limit cannot exceed 10 per cent of the total paid-up capital both on repatriation and non-repatriation basis. However, NRI holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to that effect in the General Body.

(b) Applications for foreign direct investment in private banks having joint venture/subsidiary in insurance sector may be addressed to the Reserve Bank of India (RBI) for consideration in consultation with the Insurance Regulatory and Development Authority of India (IRDAI) in order to ensure that the 49 per cent limit of foreign shareholding applicable for the insurance sector is not being breached.

(c) Transfer of shares under FDI from residents to non-residents will continue to require approval of RBI and Government as per para 3.4.2 above as applicable.

(d) The policies and procedures prescribed from time to time by RBI and other institutions such as SEBI, Minsitry of Corporate Affairs and IRDAI on these matters will continue to apply.

(e) RBI guidelines relating to acquisition by purchase or otherwise of shares of a private bank, if such acquisition results in any person owning or controlling 5 per cent or more of the paid up capital of the private bank will apply to non-resident investors as well.

(ii) Setting up of a subsidiary by foreign banks

(a) Foreign banks will be permitted to either have branches or subsidiaries but not both.

(b) Foreign banks regulated by banking supervisory authority in the home country and meeting Reserve Bank's licensing criteria will be allowed to hold 100 per cent paid up capital to enable them to set up a wholly-owned subsidiary in India.

(c) A foreign bank may operate in India through only one of the three channels viz., (i) branches (ii) a wholly-owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank.

(d) A foreign bank will be permitted to establish a wholly-owned subsidiary either through conversion of existing branches into a subsidiary or through a fresh banking license. A foreign bank will be permitted to establish a subsidiary through acquisition of shares of an existing private sector bank provided at least 26 per cent of the paid capital of the private sector bank is held by residents at all times consistent with para (i) (b) above.

(e) A subsidiary of a foreign bank will be subject to the licensing requirements and conditions broadly consistent with those for new private sector banks.

(f) Guidelines for setting up a wholly-owned subsidiary of a foreign bank will be issued separately by RBI.

(g) All applications by a foreign bank for setting up a subsidiary or for conversion of their existing branches to subsidiary in India will have to be made to the RBI.

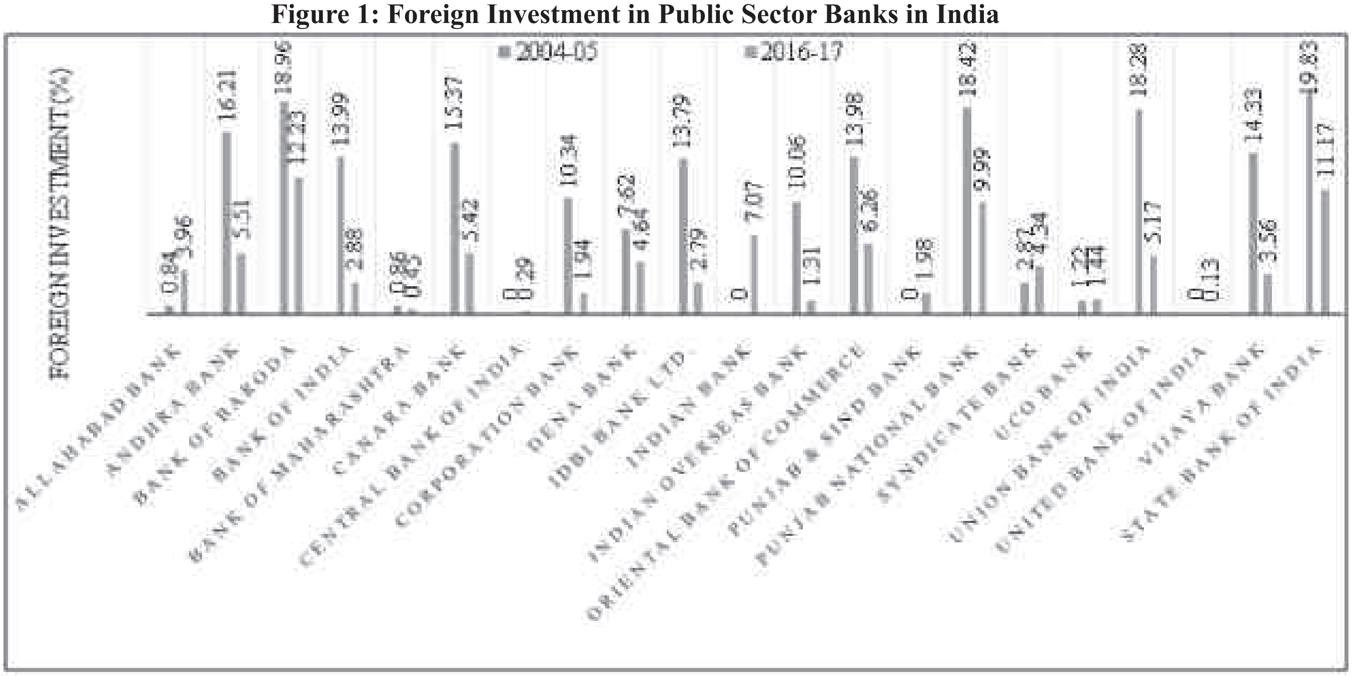
(iii) At present there is a limit of ten per cent on voting rights in respect of banking companies, and this should be noted by potential investor. Any change in the ceiling can be brought about only after final policy decisions and appropriate Parliamentary approvals."

"The revision in FDI limit will create an enabling environment for higher FDI inflows along with infusion of new technology and management practices resulting in enhanced competitiveness", (Finance Minister on the changes in Banking Policy, Dec 2004). It is proposed to make 40% and 100% FDI in banking in near future for the existing banks in public and private sector respectively. This would lead to higher foreign flows in banks, particularly private players and the large private banks would receive greater attention of foreign investors. This could assist the banks to improve services and meet its capital requirement.

Foreign Investment In Indian Banking Sector

Figure 1 graphically shows a comparative overview of foreign investment in 21 public sector banks in India in 2005 and 2017. In Figure 1, the banks has been represented by Y axis and corresponding to this the foreign investment (%) has been represented by X axis. It is obvious from the figure 1 that the share of foreign investors in public sector banks has declined in 2017 as compared to that in 2005. In 2017, Bank of Baroda, State Bank of India and Punjab National Bank have acquired higher foreign capital than the rest of the public sector banks in India. Whereas, the United Bank of India, Central Bank of India and Bank of Maharashtra are receiving least amount of foreign capital.However, in 2005, State Bank of India, Bank of Baroda and Punjab National Bank have acquired around 19 percent of their capital from non-resident. There are banks like Central Bank of India, Indian Bank, Punjab & Sind Bank and United Bank of India having no foreign investment till 2005.

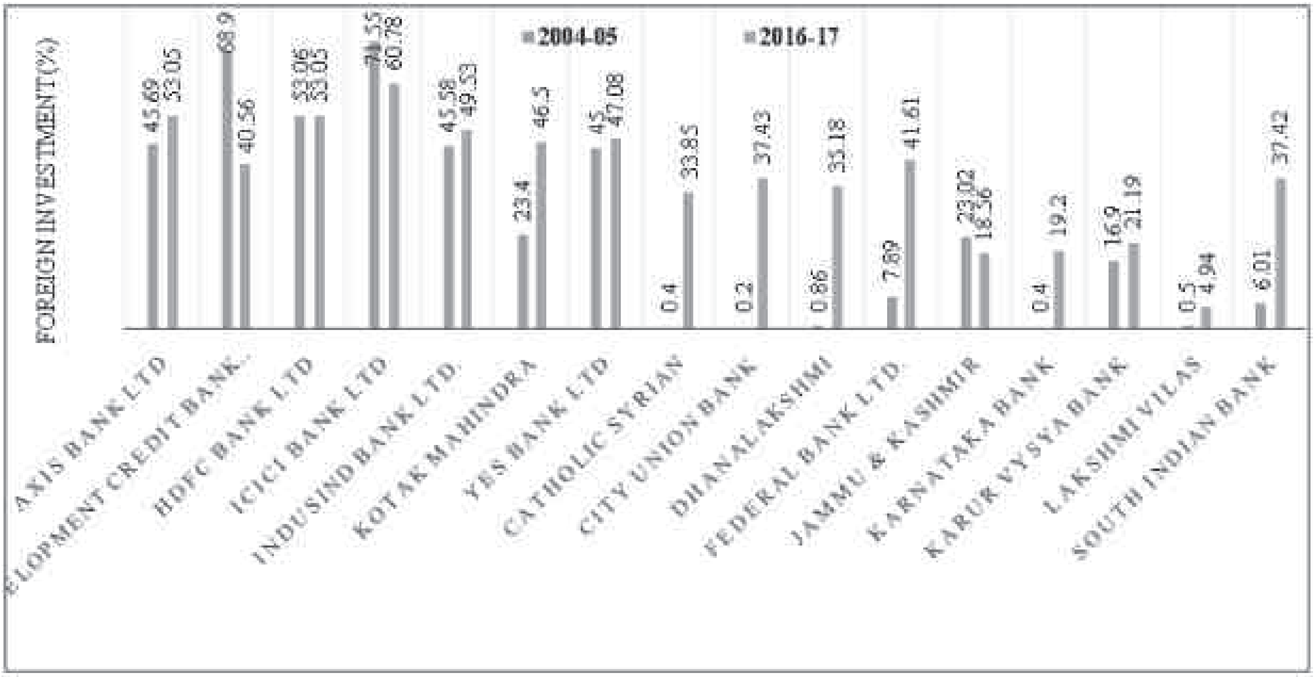
Figure 1: Foreign Investment in Public Sector Banks in India



Source: Author's compilation from various websites

Figure 2 graphically shows a comparative overview of foreign investment in 16 private sector banks in India in 2005 and 2017. In Figure 2, the banks has been represented by Y axis and corresponding to this the foreign investment (%) has been represented by X axis.

Figure 2: Foreign Investment (in percentage) in Private Sector Banks in India



Source: Author's compilation from various websites

It is obvious from the figure 2 that the share of foreign investors in private sector banks has increased in 2017 as compared to that in 2005. In 2017, ICICI Bank Ltd, Axis Bank Ltd and HDFC Bank Ltd have acquired higher foreign capital (more than 50 percent) than the rest of the private sector banks in India. Whereas, the Lakshmi Vilas Bank, Jammu & Kashmir Bank and Karnataka Bank are receiving least amount of foreign capital. However, in 2005, ICICI Bank Ltd, Development Credit Bank Ltd, and HDFC Bank Ltd have acquired more than 50 percent of their capital from non-resident. There are banks like Catholic Syrian Bank Ltd, City Union Bank Ltd, Karnataka Bank and Lakshmi Vilas Bank having no foreign investment till 2005. Thereafter, there has been a significant upsurge in the foreign investment in these banks in 2017 as shown in Figure 2.

FINDINGS OF THE STUDY

Following are the major findings of the study:

·There has been a rising trend in the foreign investment especially in private banking sector as compared to public sector banks between 2005 (when the guidelines came into force) and 2017.

A comparative overview of foreign investment in 2017 as compared to that in 2005 revealed a noteworthy rise in the share of foreign investors in private sector banks.

·On the other hand, the share of foreign investors in public sector banks has declined in 2017 as compared to that in 2005.

·Bank of Baroda, State Bank of India and Punjab National Bank have acquired higher foreign capital than the rest of the public sector banks in India both in 2005 and in 2017 as well.

Whereas, there are banks like Central Bank of India, Indian Bank, Punjab & Sind Bank and United Bank of India having no foreign investment till 2005 but they managed to attract foreign investors later though received least amount of foreign capital in 2017 (namely the United Bank of India, Central Bank of India and Bank of Maharashtra).

ICICI Bank Ltd and HDFC Bank Ltd have acquired higher foreign capital (more than 50 percent) than the rest of the private sector banks in India both in 2005 and in 2017 as well.

There are banks like Catholic Syrian Bank Ltd, City Union Bank Ltd, Karnataka Bank and Lakshmi Vilas Bank having no foreign investment till 2005. Whereas, the Lakshmi Vilas Bank, Jammu & Kashmir Bank and Karnataka Bank are receiving least amount of foreign capital in 2017.

CONCLUSION

Banking has grown as an important infrastructure for social and economic development of the country. Today, in the era of innovation and information technology, the availability of banking services in all parts of the country has become essential. The current foreign investment policy for banking sector provide a wide scope for investment in banks from abroad. As a result of steps taken by the Government over years, banking sector has shown positive signs of growth and has been able to attract foreign investment through various routes. There has been a rising trend in the foreign investment especially in private banking sector as compared to public sector banks between 2005 (when the guidelines came into force) and 2017. An insight into the analysis revealed that this emerging trend of foreign investment can be attributed to restrictive limit of 20 percent on foreign investment in public sector banks since 2005. Due to liberalised FDI policy of India, the foreign investors preferred to invest in private sector banks in India. It can be concluded from the study that there is a need to improve and make available the banking services in every areas of the country. The government should take proper steps to ensure continuous flow of foreign investment in banking sector.

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