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NEED/IMPORTANCE OF THE STUDY

STATEMENT OF THE PROBLEM

OBJECTIVES

HYPOTHESES

RESEARCH METHODOLOGY

RESULTS & DISCUSSION

FINDINGS

RECOMMENDATIONS/SUGGESTIONS

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A STUDY OF FDI AND INDIAN BANKING**DR. G. S. GAUD****S. A.****STATE BANK OF INDIA****NANDED****DR. GIRISH KUMAR PAINOLI****HEAD****DEPARTMENT OF BUSINESS MANAGEMENT****VIJAY RURAL ENGINEERING COLLEGE****MANIK BHANDAR****ABSTRACT**

The global banking industry worn unstable 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 a solution to the financial sector troubles that have overwhelmed many other emerging economies. Owing to at least a decade of reforms, the banking sector in India has seen outstanding development 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. Now a day, foreign commercial and investment banks have gently begun picking up public sector bank's bond issues. Bankers said that the funds were coming into these bonds; some of the foreign banks were also using the banks' bonds as an arbitrage opportunity in view of the increasing liquidity. As due to the globalization local banks are competing in the global market, where innovative financial products of multinational banks is the key limiting factor in the development of local bank. More efficient allocation of credit in the financial sector, better capitalization and wider diversification of foreign banks along with the access of local operations to parent funding, may reduce the sensitivity of the host country banking system and lead towards financial stability.

KEYWORDS

FDI, Banking, Impact of FDI.

1. INTRODUCTION

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. FDI in the banking sector has been liberalized by raising FDI limit in private sector banks to 74 per cent under automatic route including investment by foreign investment in India. The aggregate foreign investment in a private bank from all sources will be 74 per cent of paid-up capital of the bank.

1.1 THE PRESENT BANKING & FINANCIAL SCENARIO

In recent times economy is been pushing to increase the role of multi-national banks in the banking and insurance sector, despite, the concern expressed by the left communist parties are opposing the finance minister move to raise overseas investment limits in the insurance business. The government wants to fulfill a pledge to allow companies like New York Life Insurance, Met Life Insurance to raise investment in local companies to 49 per cent from 26 per cent. But it is opposed on the front that it will lead to state run insurers losing business and workers their job. Left does not want foreign investors to have greater voting rights in private banks and oppose the privatization of state run pension fund. There are several reasons why such move is fraught with dangers. When domestic or foreign investors acquire a large share holding in any bank and exercise proportionate voting rights, it creates potential problems not only of excessive concentration in the banking sector but also can expose the economy to more intensive financial crises at the slightest hint of panic. Opposition is not considering the need of present situation.

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%.

2. OBJECTIVES

1. To understand about FDI and its need
2. To know about impact of FDI on Indian Banking sector
3. To understand how FDI affects Financial Sector of India

3. METHODOLOGY

Secondary data is widely used from all the available sources i.e. published and unpublished literature related to the present study and other relevant sources useful to this study

4. LIMITATIONS OF FDI IN BANKING SECTOR

- i) Innovative Financial Products
- ii) Technical Developments in the Foreign Markets
- iii) Problem of Inefficient Management
- iv) Non-performing Assets
- v) Financial Instability
- vi) Poor Capitalization

vii) Changing Financial Market Conditions

If we consider the root cause of these problems, the reason is low-capital base and all the problems is the outcome of the transactions carried over in a bank without a substantial capital base.

Therefore, we can say that, as the FDI is a non-debt inflow, which will directly solve the problem of capital base. Along with that it entails the following benefits such as –

1. Technology Transfer
2. Better Risk Management
3. Financial Stability and Better Capitalization

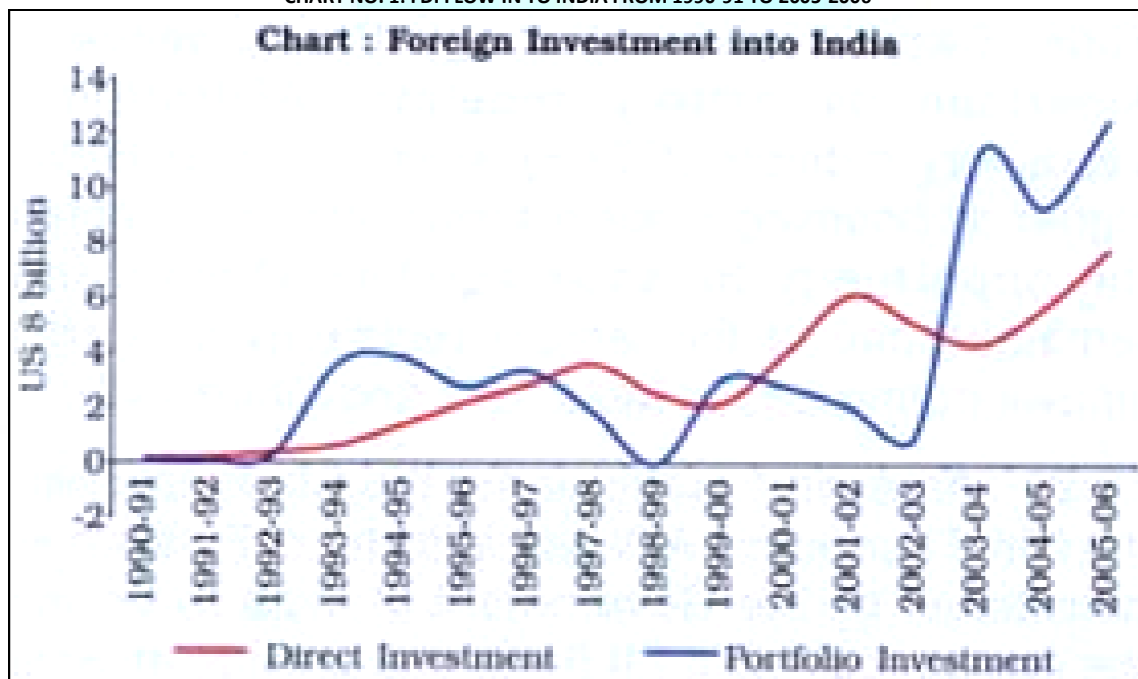
5. ANALYSIS

TABLE NO. 1: COUNTRY-WISE AND INDUSTRY -WISE FDI FLOW INTO INDIA

Table 1.76: Foreign Direct Investment to India: Country-wise and Industry-wise*			
	(US \$ million)		
Source/Industry	2003-04	2004-05	2005-06 P
1	2	3	4
Total FDI Flows	1,462	2,320	3,358
Country-wise Inflows			
Mauritius	381	820	1,363
USA	297	469	346
UK	157	84	261
Germany	69	143	45
Netherlands	197	196	50
Japan	67	122	86
France	34	44	12
Singapore	15	64	166
Switzerland	5	64	68
South Korea	22	14	61
Others	218	300	901

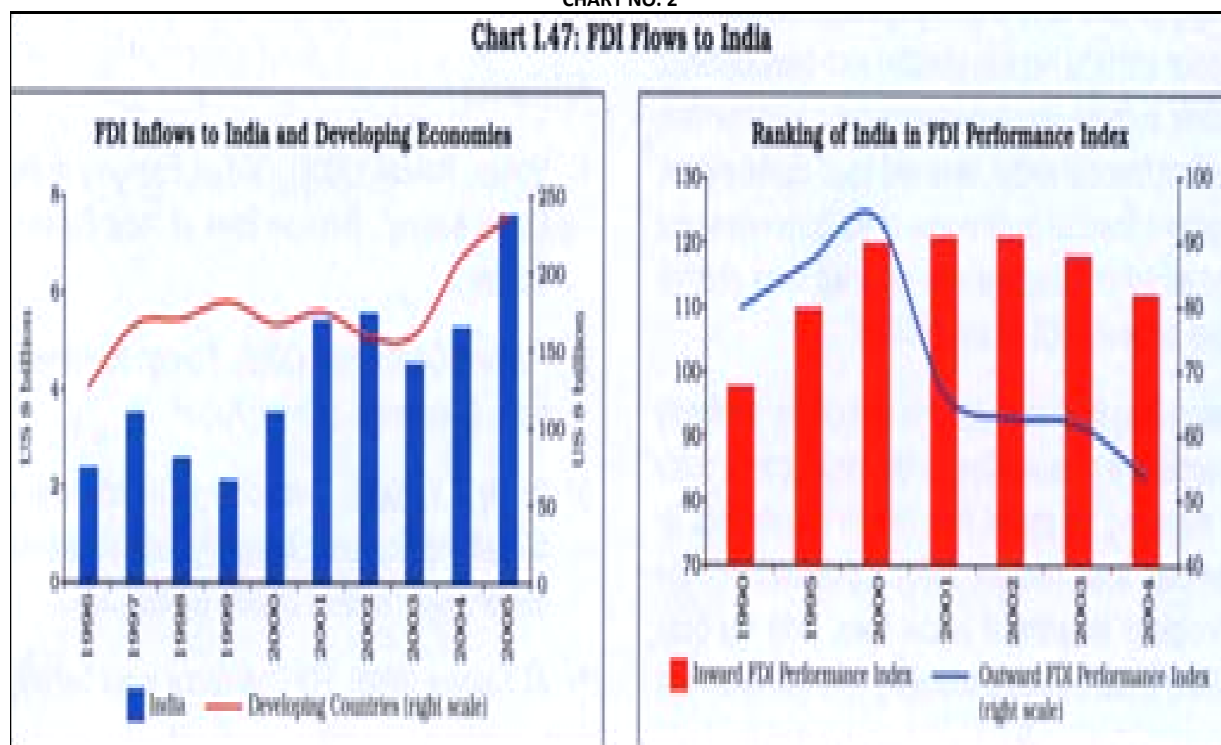
Source: "Economic Review", RBI Annual Report 2005-06.

CHART NO. 1: FDI FLOW IN TO INDIA FROM 1990-91 TO 2005-2006



Source: "Economic Review", RBI Annual Report 2005-06.

CHART NO. 2



Source: "Economic Review", RBI Annual Report 2005-06.

'FDI & FII have risen sharply during the 1990s reflecting the policies to attract non-debt creating flows. Cumulative foreign investment flows have amounted to US \$ 106 billion since 1990-91 and almost evenly balanced between direct invest flows (US \$ 49 bn) and portfolio flows (US \$ 57 bn).

Since 1993-94, FDI flows have exceeded portfolio flows in the 5 years while portfolio flows have exceeded FDI in the remaining 8 years. As a proportion to FDI flows to emerging market and developing countries, FDI flows to India have shown a consistent rise from 1.6% in 1998 to 3.7% in 2005¹.

India's FDI growth of above 30% during past 2 years is encouraging. Although the FDI inflows into India are small as compared to other emerging markets, their size is growing on the back of growing interest by many of the world's leading multinationals.

India has improved its rank from fifteenth (in 2002) to become the second most likely FDI destination after China in 2005.

6. THE IMF STUDY REPORT

The IMF's study is in supportive to the above-discussed features of FDI. This study talks about the optimism over India emanates from a contribution of following factors.

1. India contributed nearly one fifth of Asian domestic demand growth over 2000-05. Looking forward, India slated to be the second largest demand driver in the region, after China.
2. India accounts for almost one quarter of the global portfolio flows to emerging market economies, nearly \$ 12 bn in 2005.
3. India is the world's leading recipient of remittances, accounting for about 20% of the global flows.

7. COLCLUSIONS

- Now a day, foreign commercial and investment banks have quietly begun picking up public sector bank's bond issues.
- Bankers said that the funds were coming into these bonds; some of the foreign banks were also using the banks' bonds as an arbitrage opportunity in view of the increasing liquidity.
- FIIs have exceeded the FDI and in portfolio investment into India since 2003-04 reflect both domestic and global factors.
- Compared with FII always FDI has a greater and long-term effect on the Indian market due to the whimsical nature of FII.
- The present scenario looks more closely at the pattern of exponential growth and laments that India's role as an engine for global growth has been limited by the still relatively closed nature of its economy.
- As due to the globalization local banks are competing in the global market, where innovative financial products of multinational banks is the key limiting factor in the development of local bank.
- Now a day bank has been prominent and prudent in the rapid expansion of consumer lending in domestic as well as in foreign markets.
- It may need additional information and techniques to monitor for financial vulnerabilities. FDI's tech transfers, information sharing, training programs and other forms of technical assistance may help meet this need.
- As the banks are expanding their area of operation, there is a need to change their strategies put forth competitive pressures and demonstration effect on local institutions.
- Through FDI, the host countries will know efficient management technique. The best example is Basel II. Most of the banks are opting Basel II for making their financial system safer.
- Host countries may benefit immediately. From foreign entry, if the foreign bank re-capitalize a struggling local institution. In the process also provides needed balance of payment finance.
- More efficient allocation of credit in the financial sector, better capitalization and wider diversification of foreign banks along with the access of local operations to parent funding, may reduce the sensitivity of the host country banking system and lead towards financial stability.
- Even though above discussed factors are fair enough for the development of economy. But it is a noted fact that, economy drivers are reluctant towards more liberalization for FDI in the banking sector.
- As the ceiling rates are not increased, FDI in Financial Sector is not getting a wholesome environment. But the foreign investment is finding its own way to come in the economy, May be the way of FII.

Therefore 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.

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