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Impact of FDI on the Indian Banking Sector

The Foreign Direct Investment (FDI) environment in India's sector of banking and finance has undergone a series of changes and transformations since 1991. The crucial point is that FDI was introduced in India in the form of the Foreign Exchange Management Act (FEMA), which was then believed to be the crucial determinant for the further formation of stable financial institutions and markets, especially the ones for money and government securities. Therefore, India back in 1991 recognized and constitutionalized the need for advanced technology to enter the state, resulting in the proclamation of India's role as essential within the framework of international finance.

After a plethora of unnecessary laws and regulations in relation to trade and finance were removed, the liberal environment for foreign investment was opened for India. Alongside the opening up of the FDI's regiment in India, the government took decisive steps to allow foreign portfolio investments into the Indian stock market through the mechanism of foreign institutions. Consequently, most Indian banks went global, at the same time, transitioning themselves to an exclusively new level in the context of the Indian banking system (Sekar 2). Even though one may point out that the FDI is overestimated and unjustly emphasized concerning the Indian

banking sector, its impact in the form of strengthening the domestic capital, risk management, better capitalization capacities, and the transformation of financial market conditions should be considered as the primary element of the FDI's impact on India's banking sector.

Foreign and Domestic Banks

From a broader perspective, the FDI's equity inflows, which emerged in 1991, were distributed variously in the structure of India's economy. Yet, the banking sector stood out as the second segment of the investment. Therefore, the liberalization of the business environment in India, which was previously catastrophic in terms of appetites of foreign investors, had one of the most crucial impacts on the banking sector. As pointed out by Sekar (2015), FDI plays an important role in the development of infrastructure, at the same time presenting decent results in the banking sector (1). Notwithstanding, a series of reforms that were implemented to liberalize the state of the national economy took some time, meaning that the FDI's impact on the banking sector should be reviewed from the long-term perspective.

More precisely, one of the most noticeable features of the FDI in the Indian banking sector is the representation of the number of foreign banks which entered the Indian markets, the number of subsequent bank branches, and asset share in the total banking system. The number of foreign banks through the time frame of 1980-2013 had increased from 13 to 43, which is a decent demonstration of how the banking sector adapted the FDI's influences (Massand and Gopalakrishna 6). Besides, most foreign banks were prone to opening branches of their banks, which is a potent indicator of international preferences in relation to the Indian banking sector environment. Considering another vital factor—which is the extent of foreign investment in

private banks and public sector banks in India—one may indicate the importance of the existing limit of 20% for foreign investment within public sector banks; however, private banks in India received from 30 up to 70% of foreign investment in 2013 (Massand and Gopalakrishna 8).

Having reviewed the direct impact of the FDI, it becomes apparent that foreign banks improved profitability and asset quality, although still being slightly underrepresented in the whole structure of the Indian banking sector.

Better Risk Management and Capitalization

Since the primary function of the FDI's impact on the Indian banking sector was the FDI's equity inflow, two implications stand out: risk management and capitalization. In particular, Indian banks adopted the policy of expanding the area of operation by simultaneously changing strategies to compete with foreign branches and any external pressures (Yadav 27). India was even characterized as the second-most favorable destination for the inflow of the FDI in terms of the banking sector, which in turn had an impact on the ways through which the banking sector developed risk resilience (Massand and Gopalakrishna 10). Since the additional information from the foreign consultants and experts in the field was adopted, the external pressures were mitigated by implementing strategic frameworks for risk management (Yadav 28). Hence, the FDI's capabilities to provide information sharing, comprehensive training programs, and any other related forms of technical assistance were crucial for skyrocketing the tools of risk management among Indian banks.

Presumably, the most remarkable example of risk management innovations is the introduction of Basel II, which is a set of banking laws and regulations. Having adopted the

essentials of Basel II, the Indian banking sector ultimately strengthened its approach towards safety measures (Yadav 28). Having identified the precautions in relation to risk management, one may also highlight the increased awareness concerning capitalization. At the core of FDI practices, the immediate benefits towards the host state's banking sectors seem to be both expected and demanded. Besides, as it was partially analyzed above, the impact of the FDI investment is most accurately measured in the long-term perspective, meaning that the Indian banking sector increased its capitalization through the course of a few decades. Presumably, the most obvious implication of the FDI on the capitalization in the context of the Indian banking sector was the adoption of wider diversification, coupled with the more efficient allocation of credit in the financial structure of India (Yadav 28). Considering this particular vector of influence, the Indian banking sector was led by the FDI towards financial stability and stable growth, both quantitatively and qualitatively.

Transformation of the Financial Market Conditions

The merger of the earlier unveiled capitalization, risk management, and FDI's equity inflows was the factor that had a profound impact on the Indian banking system, meaning that the in-depth structural changes were applied to liberalize and modernize the banking sector as a whole.

Judging from the report by Sekar (2015), the set of reforms related to the FDI was the turning point in the development of the banking sector. Even though the study reveals that the Indian share in the global proportion of the FDI is still relatively low, the increased capitalization and better risk management, coupled with the increase of the foreign banks in India, are the noticeable benefits of the FDI's impact on the banking sector. The crucial point is that the

incorporation of the underlined benefits has led to a broader extent of transformations, which took place in the Indian banking sector.

Most importantly, it is quite clear from the outcomes of the present reforms that the FDI's policy on the Indian banking sector resulted in the intensification of the foreign banks' role in the broad scope of the banking sector (Massand and Gopalakrishna 10). Under no circumstances should the existing rapid development of the FDI's policy be disregarded while reviewing the liberalization patterns in the banking field. Therefore, the vast majority of factors, which were implemented starting from 1991, had proven to be useful for the in-depth structural transformations of the Indian banking sector. The role of India as one of the most preferred investment environments across the globe should be associated with the constant development of the banking industry. While analyzing the data related to the FDI's inflow, India became attractive for foreign investments into the banking sector, especially concerning the general increase in domestic capital and economic growth. The core of the structural reforms was focused on the elimination of red tape regulations, which earlier disabled India from entering the international banking sector. Hence, the FDI's inflow at the sectoral level of the banking sphere tended to be appreciated by both the global investors and domestic banks. Further application of reforms regarding the liberalization and modernization of the banking industry allows the Indian banking sector to receive even more FDI inflows in the long-term perspective. The better economic growth and balanced development are the paramount determinants for Indian policymakers to plan the development directions of the banking sector.

Final Remarks

Even though the subject of the FDI's investment in the structure of the Indian banking sector is a vast field, which may be discussed variously, one of the most remarkable features of the FDI was the beneficial impact on the Indian banking field. In some sense, India had a prolonged approach towards the application of liberalization reforms, which disabled the immediate impact of the FDI on the banking system. Notwithstanding, further embracement of the structural transformations resulted in a series of favorable accomplishments, including the strengthening of domestic capital, risk management, better capitalization capacities, and the development of financial market conditions. From a broader perspective, India still has to conduct drastic efforts to attract even more FDI inflows to the banking sector, at the same time maintaining the cooperation with the WTO and foreign investors' institutions.

Considering the scale of the reforms from 1991, it became possible for the banking system of India to accomplish flexibility regarding the FDI, which is the indicator of the system's stability. However, a series of reforms related to the growth of capitalization and the implementation of better risk management efforts was unquestionably a consequence of the FDI's emergence in the banking sector. Under no circumstances would the Indian banking system experience the implications of crucial transformations without the reforms, which enabled the FDI back in 1991. Further efforts to adapt to the conventional realities are compulsory elements of the banking system's growth in both quantity and quality. Seeking innovation and corresponding to the international experience are the factors that were mostly fostered by the FDI. With regards to the underlined vectors of influence, it becomes noticeable that the further direction under the scope of liberalization would be beneficial. The analysis of the already conducted reforms and their subsequent outcomes presents convincing facts for

policymakers, which are to be maintained or even increased for ensuring the stability of the FDI's inflows to the Indian banking sector.

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