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Foreign Direct Investment's Effect on Banks' Performance

*1Dr. Sagar Sanwariya

*1Assistant Professor, EAFM, Govt. Girls College, Nathdwara, Rajasthan, India.

Abstract

Foreign Direct Investment is an investment between nations in the form of controlling ownership of a firm or organisation. This investment might be inorganic, in which a firm in the target nation is purchased, or organic, in which an existing company in the target country expands its activities. It consists of a number of strategies, such as establishing a partner firm in a foreign nation, purchasing controlling shares in a foreign-based company, or merging or forming a joint venture with a foreign-based company. The advantage of foreign direct investment is that there is control power, according to regulations established by the Organization for Economic Cooperation and Development (OECD). The guidelines establish a 10 percent stake in a foreign-based corporation as the starting point for foreign direct investment. Rather than capitalist economies, it is often a section where brilliant workforce or more normal development chances for financial specialists may be located. It may occasionally contain anything other than investment; it may include managerial structures and the integration of technology. The main component of foreign direct investment is control of a foreign enterprise in a foreign country. The aim of the study to examine the impact of foreign direct investment on the performance of Banks.

Keywords: Foreign direct investment, banks

Introduction

Foreign direct investment is defined as an investment undertaken to obtain a portion of management control in a firm operating in a nation other than the investor's own. In India, there is a large amount of manpower available, as well as adequate resources. The Indian economy can make significant development if capital is raised. Foreign direct investment is the simplest and least expensive approach to expand capital. There has also been a rise of foreign currency resources, which has boosted the value of the Indian rupee. Foreign direct investment policy is constantly being revised to make it more investor friendly. It arrived in India around the early 17th century, when the British East India Company was created. A British trader requested that the Mughal Emperor establish a factory in Surat. This was the first time it happened. This aided both British traders and Indians by laying the groundwork for trains and roadways, although for the advantage of simpler trade. These advances and inventions aided other European countries in establishing commerce with India. Following the Second World War, a huge number of Japanese industrial corporations entered the Indian market and strengthened their involvement in commercial operations in India. Following India's independence, policymakers saw the need to enhance FDI inflows since it would provide modern technology and foreign-based currency resources. As a result, more and more nations entered India, although with limitations, to build commercial links and economic concord. Foreign direct investment policies have changed over time, sometimes owing to economic situations, and sometimes due to the governments in power. Following the adoption of the industrial policy in 1965, there have been several changes in FDI policy. These reforms enabled MNCs to enter India through technological partnership. Due to later debt increases, the Indian government permitted additional equity purchase.

Foreign Direct Investment in the Indian Banking Industry

It was implemented in India in 1991 as part of the LPG programme, which was designed by then-finance minister Dr. Mahmohan Singh. It is a well-known reality that any government's policy actions take time to reveal key outcomes and consequences. So, in 1995, the first FDI into Indian banks occurred, and new private sector banks were founded (such as ICICI Bank, Axis Bank, and so on). The FDI limit was initially lower than the present trend, but following numerous stages of policy changes, the FDI ceiling in the banking industry reached its current level, which is 74 percent in private banks and 20 percent in PSBs. The government is now in discussions with the RBI and other financial experts to examine the merits and drawbacks of raising the cap to 100% in private banks and 49% in PSBs, which is the subject of the present research. There is one little catch: no one corporation may own more than 10% of the total shares available, barring out a single conglomerate purchasing a controlling holding in an Indian private or public bank.

Table 1: FDI Cap in Indian banking industry.

Sector	Percentage of FDI Cap	Entry Route
Private Sector	74%	Through automatic up to 49%, govt. route beyond 49% and up to a maximum of 74%
Public Sector	20%	Through govt. route

Source: FDI Policy 2017 (Published by DIPP)

***Corresponding Author:** Dr. Sagar Sanwariya

Advantages of Foreign Direct Investment

Despite its evident relevance in the banking business, it has not garnered as much attention in the literary sector as it has in other sectors such as manufacturing. In any event, a slew of research and ideas have been proposed in recent years to investigate the apparent consequences of it in the banking business. FDI in the banking business has mainly a positive impact, as it is in other industries, with the largest positive being the infusion of foreign-based capital. It has the following advantages:

- Technology Trade
- Better Risk Management
- Better Capitalization and Financial Stability

Total FDI Inflows in India

Following table presents Trend ratio, 3 yearly moving averages and CAGR total FDI inflows in India during 2011-12 to 2017-18.

Table 2: Total FDI Inflows in India.

Financial Year	Amount of FDI Inflows (Amount in Rs. Crores)	Trend Ratio (Base Year = 2011-12)	3 Yearly Moving Average	CAGR
2011-12	165145.50	186.56	N/A	**86.56**
2012-13	121906.74	137.72	N/A	**17.35**
2013-14	147517.79	166.65	144856.7	**18.56**
2014-15	189107.09	213.63	152843.9	**20.90**
2015-16	262321.59	296.34	199648.8	**24.27**
2016-17	291696.31	329.53	280968.8	**21.99**
2017-18	288888.51	326.36	247708.3	**18.41**

Source: Data compiled from DIPP reports and author compilation through Excel

In year 2011-12, growth in FDI inflows was 86.56% in comparison to year 2010-11, in year 2012-13, it was 37.72%, in year 2013-14, it was 66.65%, in year 2014-15, it was 113.63%, in year 2015-16, it was 196.34%, in year 2016-17, it was 229.53% and in year 2017-18, growth in FDI inflows was 226.36%, in year 2018-19 it was-53%, in year 2019-20 it was 20%, in year 2020-21 it was10%, in year 2021-22 it was 2% It is clear from this data that growth in FDI inflows had increased significantly.

However, to analyze the trend of growth in FDI inflows, three yearly moving averages was calculated and accordingly an increasing trend in the growth of FDI inflows was observed during the study period. CAGR of FDI inflows in year 2011-12 was 86.56%, in year 2012-13 it was 17.35%, in year 2013-14 it was 18.56%, in year 2014-15 it was 20.90%, in year 2015-16 it was 24.27%, in year 2016-17 it was 21.99% and in year 2017-18 CAGR of FDI inflows was 18.41%. It is also revealed from the above graph that trend ratio has got increasing pace in year 2011-12 then dipped in year 2012-13. After then it had recovered somewhat in year 2013-14 and with a slight increase it has moved upward in year 2014-15. Then for two consecutive years 2015-16 and 2016-17 an increasing trend was observed. However, diminishing pace was again realized in next year 2017-18 in this regard. As a whole it can be stated that trend ratio was volatile in nature throughout study period.

Table 3: Top 5 Foreign Investment Holding in Private Banks in India as on 31st March 2018.

Sr. No.	Bank Name	Foreign Investment Holding (%)
1	HDFC Bank	71.97
2	Indsuiad Bank	59.43
3	ICICI Bank	57.55
4	Axis Bank	54.36
5	Kotak Mahindra Bank	44.22

Source: Data compiled from various annual report 2017-18.

It is clear that HDFC bank, along with other banks, have the balance sheet strength to fill up the vacuum left by the deterioration of the PSBs, and with their remarkable strength showed by these banks and their ever-growing reach and customer base, it can be safely said that PSBs, for the first time in their long and illustrious history, are in a battle for survival against these banks. The defining factor, as it can be appreciated, has been the FDI allowed. The problems that the private sector banks have been facing, along with the public-sector banks, is the capital convertibility, capital lock-ins and a lot of regulations. A significant portion of the investors have cited these factors as one of their key concerns regarding supplying capital to Indian banks. Also, up until quite recently, only half of the total population of India had a bank account. The Pradhan Mantri Jan-Dhan Yojana[6] was a masterstroke by the NDA government in 2017, opening up around 1.01 crore bank accounts in private banks, with a massive INR 2216.78 crores in deposits, issuing 94 lakh Rupay Debit Cards in the process. This humongous achievement did bring banking to the grassroots, allowing banks to put the FDI capital in various other uses, such as better technology, more branches, more priority sector investment, more products and services and reduction in NPAs.

FDI Inflows in Indian Banking Industry

Following table presents FDI inflows in Indian banking industry during 2010-11 to 2017-18.

Table 4: FDI Inflows in Indian Banking Industry.

Financial Year	Amount of FDI Inflows (In Rs. Crores)	Trend Ratio (Base Year = 2010-11)	3 Yearly Moving Average	CAGR
2010-11	1169.16	100.00	N/A	-
2011-12	162.87	13.93	625.81	**-86.07**
2012-13	545.41	46.65	1197.03	**-31.70**
2013-14	2882.80	246.57	1176.05	**35.10**
2014-15	99.93	8.55	998.33	**-45.93**
2015-16	12.27	1.05	2662.30	**-59.80**
2016-17	7874.69	673.53	5530.83	**37.42**
2017-18	8705.54	744.60	N/A	**33.22**

In year 2011-12, growth of FDI inflows in Indian banking industry was-86.07% in comparison to year 2010-11, in year 2012-13, it was-46.65%, in year 2013-14, it was 146.57%, in year 2014-15, it was-91.45%, in year 2015-16, it was-98.95%, in year 2016-17, it was 573.53% and in year 2017-18, growth in FDI inflows was 644.60%. It is clear from this data that growth in FDI inflows in Indian banking industry had declined drastically till year 2015-16 which had a great uplift in year 2016-17 where 573.53% and 644.60% hike was recorded in next two consecutive years.

However, to analyze the trend of growth in FDI inflows, three yearly moving average was calculated and accordingly an increasing trend in the growth of FDI inflows in Indian banking industry was observed for year 2012-13, 2015-16 and 2016-17 during the study period. CAGR of FDI inflows in year 2011-12 was-86.07%, in year 2012-13 it was-31.70%, in year 2013-14 it was 35.10%, in year 2014-15 it was-45.93%, in year 2015-16 it was-59.80%, in year 2016-17 it was 37.42% and in year 2017-18 CAGR of FDI inflows was 33.22%.

Conclusion

The study assesses and compare the profitability of selected banks and to analyze the impact of foreign direct investment on profitability during the selected period finds out correlation between quantum of foreign direct investment in Indian banking industry and total profitability of selected Indian banks. The data collected have been analyzed using appropriate statistical tools according to the objectives and are presented in a sequential manner along with the interpretations. This study is relevant to overseas venture in Indian banking sector puts forward the magnitude of foreign investment in Indian banks and endeavors to estimate the impact thereof. It can be accomplished that, undeniably, FDI policy has revealed significant impact on the performance of Indian banking industry as a whole. This would show the way to the overall development of the performance of banking sector and carry it to global standards.

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