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Impact of Foreign Direct Investment on the Indian Banks

Palak Bhargava, Anjali lawaniya, Yashwani Gaur
University of Rajasthan, Jaipur, India

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ABSTRACT
The Foreign Direct Investment (FDI) environment in India has undergone a drastic change since the economic reforms in 1991. The positive changes can be particularly attributed to the evolving policy framework. Impact of Foreign Direct Investment on the Performance of Indian Banks With the initiation of globalization, developing countries, particularly those in Asia, have been witnessing a immense surge of FDI inflows during the past two decades. Even though India has been a latecomer to the FDI scene compared to other East Asian countries, its considerable market potential and a liberalized policy regime has sustained its attraction as a favourable destination for foreign investors. This research paper aims to examine the impact of FDI on the Indian Banks, particularly after two decades of economic reforms, and analyzes the challenges to position itself favourably in the global competition for FDI.
Keywords: Foreign direct investment (FDI), Banking Sector, Economy, Profitability, Productivity

I. INTRODUCTION

The banking sector plays an important role in the economic development of a country. It supplies the money that supports and fosters growth in all the industries. Indian banks going global and many global banks setting up business in India, as a result of Liberalization, Privatization and Globalization mode. Since 1991, foreign direct investment has become a main source of foreign capital flow for Indian economies and a leading source of external financing. The term FDI refers to a long-term investment made by a foreign investor whose aim is to have a controlling stake in the operations of the business. They share both risks and returns of the business. In other words, foreign direct investment means the investment in to the business of a country by a company which is situated in another country.

Today we can see that the developing economies are opening their economies by leaps and bounds to the foreign direct investment. Any industry needs capital and quality- enhancing competition. FDI is one such source which brings in both. Foreign direct investments help in developing the economy bygenerating employment to the unemployed, Generating revenues in the form of tax and incomes, Financial stability to the government, development of infrastructure, backward and forward linkages to the domestic firms for the requirements of raw materials, tools, business infrastructure, and act as support for financial system. FDI is a tool for economic growth through its strengthening of domestic capital, productivity and employment. FDI also plays a vital role in the up gradation of technology, skills and managerial capabilities in various sectors of the economy. 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. It can provide a firm with new markets channels, cheaper production facilities, access to new technology, products, skills and financing. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. It helps in transferring of financial resources, technology and innovative and improved management techniques along with raising productivity. An Indian company may receive Foreign Direct Investment either through automatic route or government route. FDI have helped India to attain a financial stability and economic growth with the help of investments in different sectors. After liberalization of Trade policies in India, there has been a positive GDP growth rate in Indian economy. Foreign investments mean both foreign portfolio investments and foreign direct investments. FDI brings better technology and management,

marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers.

Meaning of Foreign Direct Investment

Foreign direct investment (FDI) is when a company takes controlling ownership in a business entity in another country. With FDI, foreign companies are directly involved with day-to-day operations in the other country. This means they aren't just bringing money with them, but also knowledge, skills and technology.International Monetary Fund (IMF) and Organization for Economic Cooperation and Development (OECD) define FDI similarly as a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a 'lasting interest' in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise.

Components of Foreign Direct Investment

There are three components of FDI, equity capital, reinvested earnings and intra company loans.

➢ Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than his own country.

➢ Reinvested earnings comprise the direct investor's share (in proportion to direct equity participation) if earnings not distributed as dividends by affiliated or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.

➢ Intra company loans or intra-company debt transactions refer to short or long term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises.

Areas of Performance Measurement

Performance analysts often assess firm's production and productivity performance, profitability performance, liquidity performance, working capital performance, fixed assets performance, fund flow performance and social performance. However, in the present study performance of banks are measured from the following perspectives:

1. Profitability Analysis
2. Productivity Analysis

FDI in Indian banking sector

In banking sector, FDI can solve various problems. Such as: innovative financial products, technical developments in the foreign markets, problem of inefficient management, non-performing assets, financial instability and poor capitalization. If we take into consideration the root cause of these problems, the reason is low-capital base and all the problems are the outcome of the transactions carried over in a bank without a substantial capital base. In a nutshell, we can say that, as the FDI is a non- debt inflow, which will directly solve the problem of capital base.

In the private banking sector of India, FDI is allowed up to a maximum limit of 74 % of the paid-up capital of the bank through the entry route of automatic up to 49%, government route beyond 49% and up to 74%. On the other hand, Foreign Direct Investment and Portfolio Investment in the public or nationalized banks in India are subjected to a limit of 20 % in totality through the entry route of government. This ceiling is also applicable to the investments in the State Bank of India and its associate banks. FDI limits in the banking sector of India were increased with the aim to bring in more FDI inflows in the country along with the incorporation of advanced technology and management practices. The objective was to make the Indian banking sector more competitive.

An Indian company may receive Foreign Direct Investment under the two routes as given under:

1. Automatic Route: FDI in sectors /activities to the extent permitted under the automatic route does not require any prior approval either of the Government or the Reserve Bank of India.
2. Government Route: FDI in activities not covered under the automatic route requires prior approval of the Government which is considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs and Ministry of Finance.

II. REVIEW OF LITERATURE

Banga, Rashmi (2010) in the empirical Paper "The Export-Diversifying Impact of Japanese and us Foreign Direct Investments in the Indian Manufacturing Sector" highlighted the export-diversifying impact of FDIs in a developing economy. According to him, foreign direct investments may lead to export diversification in the host country if it positively affects the export intensity of industries .that have a low share in world exports. Indirectly, foreign direct investments may encourage export diversification through spillover effects: that is, the presence of foreign direct investments in an industry may increase the export intensity of domestic firms. The empirical results for the Indian economy in the post- liberalization period show that foreign direct investments from the US has led to diversification of Indiaand its exports, both directly and indirectly.

However, Japanese foreign direct investments had no significant impact on India and its exports.

Boopath, Deepak (2014) in his study "Foreign Direct Investment in Print Media" revealed that the Press Council of India has commented on synergic alliance or equity participation by way of Foreign Direct Investment. The council opined that Foreign Direct Investment should be allowed to break or halt the growing monopoly of a few media giants in India who offer uneven playground and unhealthy competition to small and medium papers.

Laghane, B.K (2011) in his study "Foreign Direct Investment & Indian Banking Sector" empirically examined the impact of FDI model on borrower account, bank branches, time deposits and profitability of domestic and foreign banks. In the study, he suggested that FDI must be considered in poverty reduction, unemployment reduction and primary education and priority sectors of banking. Finally, he concluded that the LPG sponsored FDI model's impact on foreign banks and Indian bank's profitability is positive. The impact of FDI on Indian banking sector is negative except profitability.

Pradhan, J.P. (2009) in the research paper "Rise of Service Sector and Outward Foreign Direct Investment from Indian Economy: Trends, Patterns and Determinant" reviewed the recent trends and patterns and has identified determinants of such investments. At the level of the individual company, the foreign direct investment behavior of the firms in the service sector was observed to be non- linearly related to the firm age and size, both relationship following inverted U-shaped curves. Firm's innovation, export orientation and profitability were also found to be important explicators in the rise of foreign direct investment at the firm level. The import of Capital goods, however, appeared to have a negative impact on trans-border expansion of service sector firms.

Pradhan, Rudra (2007) in the paper "Are the Asian Foreign Direct Investment Inflows Co-integrated with the Indian Foreign Direct Investment Inflows? Empirical Research Findings" investigated the linkage of foreign direct investment inflows between India and four other Asian countries, viz., Japan, Hong Kong, Singapore and Malaysia. The empirical investigation follows annual data of foreign direct investment Inflows during 1970-71 to 2005-06. The technique employed for the same is co-integration test, which is followed by the unit root test. The empirical results clarify that foreign direct investment inflows of four Asian countries along with India, have a unit root at the level data, but found to be stationary at the first difference level. The implication of this finding is that the foreign direct investment inflows of India can be used to predict the Foreign Direct Investment inflows of Japan, Singapore, Hong Kong and Malaysia.

Singh, R.K. and Kulkarni, V.S. (2006) in an edited book "Foreign Direct Investments and Economic Development" have highlighted in detail the increasing role of foreign direct investment in the economic development of a developing country like India. This study also focuses on the impact of globalization on the foreign direct investment. The main findings were that total inflow of foreign direct investment is short of the expected target, the SEZs should be developed as the most competitive destination for export related Foreign Direct Investment in the world and infrastructure development and a strategic and more effective Foreign Direct Investment policy by the government to target foreign direct investment in areas where the country has dynamic comparative advantage.

RESEARCH GAP

The above review of literature proves beneficial in identifying the research issues and the research gaps. As it is clear from the review and analysis of past studies that a number of studies have looked at the trends and impacts of FDI on Indian economy. Also many studies are reviewed pertaining to the performance of Indian banking industry. Many a research studies have been conducted on FDI in general but so far as FDI in banking sector is concerned we come across very few studies in this area in particular. Moreover, performance of Indian banking under the light of FDI is quite under researched area. Hence, sincere and modest attempt is been made to magnify this aspect to know the performance of banks after the advent of FDI and reforms in Indian banking industry. The present study is an attempt to analyze the pattern, potential drivers and implications of FDI on the Indian banking sector. The present study differs from earlier studies from the view point that it focuses on the performance analysis of banks in India by the recipient of FDI.

SIGNIFICANCE OF THE STUDY

It is believed the FDI firms are better performers than Non-FDI firm in international economies. It is more than two decades that FDI is introduced in the Indian banking industry as a bundle of reforms. Therefore, the impact of FDI on performance of Indian banking needs to be studied. So it become necessary to check if there was an impact of FDI and liberalized FDI policy on the Indian banking industry. Need of the study is to

find out the role played by FDI in Indian banking industry in India and also to find out the impact of FDI in Indian banking on economic growth and to find out the various economic benefits derived from this industry. FDI brings the promotion of economic growth, technology transfer and the creation of employment. In recent years, Indian banking industries have undergone both huge technological changes so it will be an attempt to study current international investment in Indian banking industry through the adoption of appropriate measurement methodology to evaluate the performance of Indian banking Sector. Moreover, this study will present a theoretical model to increase the equity cap from the present 20% to 49% in public sector banks and from 74% to 100% in private sector banks which is the need of the present market conditions. It is why the need of this study has been felt and the researcher has selected this title for the research.

Transfer of technology from overseas countries to the domestic markets. Ensure better and improved risk management in the banking sector of India. Assure better capitalization in the banking sector of India.Offers financial stability in the banking sector of India.

OBJECTIVES OF THE STUDY

The present study will be based on the following objectives:

➢ To study the guidelines for foreign direct investment in banking sector of India.

➢ To study the benefits and costs of foreign direct investment in banking sector of India.

➢ To study and analysis to the trends and pattern of FDI inflows in banking sector of India.

➢ To find out correlation between foreign direct investment and profitability, productivity of selected banks in India.

➢ To study and assess the impact of foreign direct investment inflows on profitability and productivity of selected banks in India.

➢ To suggest the strategy for policy measures to attract more FDI into the banking sector of India.

RESEARCH DESIGN

The research design is the conceptual framework within which researcher study is conducted and it constructs the blue print for collection of data and measurement of data.

a. Collection of Data: There are two sources of data Primary and secondary data. Our research is mainly based on secondary data. Secondary data refers to those data that has already been collected and analyzed by someone else. The secondary data will be collected from various sources such as Journals, Articles, RBI publications, Ministry of Finance publications, Department of Industrial Policy& Promotion publications, Annual reports of banks, Newspapers and other published books will also be taken into consideration.

b. Tools and Techniques for Data Analysis: These hypotheses will be statistically tested through applications of relevant statistical tools as well as financial tools to derive pertinent objective inferences. Various accounting techniques such as Comparative analysis, Trend analysis and Ratio analysis may be used. Various Statistical techniques such as Diagrams, Graphs, Measures of Central Tendency, Measures of Dispersion, Correlation analysis, t Test and F Test (ANOVA) may be used.

III. CONCLUSION:

India's Foreign Direct Investment (FDI) policy has been gradually liberalised to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report.

FDI has a significant positive impact on total business, business per employee (BPE), and total income of the banks. Today Indian Banks are as technology savvy as their counter parts in developed countries.FDI is a tool for economic growth through its strengthening of domestic capital, productivity and employment. FDI off course might be one of the important sources of financing the economic development. However, one should not forget that FDI alone is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. Policy makers need to ensure transparency and consistency in policy making along with comprehensive long term development strategy.

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