*Available online www.jsaer.com*

*Journal of Scientific and Engineering Research*, 2023, 10(6):241-244

**Research Article**

**ISSN: 2394-2630**
**CODEN(USA): JSERBR**

# An Analysis of the significance of foreign direct investment in the banking industry

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**Abstract** Foreign direct investment is an investment that takes the form of controlling ownership of a business or organization. This investment may be inorganic, where a company in the target nation is acquired, or organic, where an existing business there expands its activities. It involves a range of strategies, such as establishing a partner firm overseas, buying the majority of the stock of a company with a foreign base, merging with that company, or establishing a joint venture. The Organization for Economic Cooperation and Development (OECD) rules state that foreign direct investment benefits from control authority. The criteria provide that a foreign direct investment must begin with a 10 percent ownership position in a foreign firm. It is sometimes a region where excellent workforce or more common development opportunities for financial professionals may be found, as opposed to capitalist economies. It may occasionally incorporate management structures and the incorporation of technology in addition to investments. Control of a foreign company in a foreign nation is the key element of foreign direct investment. The study's goal was to look at how foreign direct investment affected the performance of banks.

**Keywords** Banks, foreign direct investment

## 1. Introduction

Investments made to achieve a percentage of management control in a company operating in a country other than the investor's own are referred to as foreign direct investments. Both sufficient resources and a lot of labour are available in India. If funding is raised, the Indian economy will grow significantly. The easiest and least expensive method of capital expansion is through foreign direct investment. The value of the Indian rupee has increased as a result of the rise of foreign currency resources. 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, an increasing number of countries entered India, albeit with restrictions, in an effort to develop trade relations and economic harmony. Foreign direct investment regulations have evolved throughout time, sometimes as a result of political and sometimes as a result of economic factors. There have been a number of modifications to FDI policy since the industrial strategy was adopted in 1965. Through technology partnerships, these changes made it possible for MNCs to enter India. The Indian government approved further stock purchases due to later debt growth.

**2. Direct foreign investment in India's banking sector**

It was introduced in India in 1991 as a part of the LPG programme, which was created by Dr. Mahmohan Singh, the country's finance minister at the time. It is a well-known fact that it takes time for a government's policy decisions to manifest their most important effects. As a result, new private sector banks were established and the first FDI into Indian banks happened in 1995. (such as ICICI Bank, Axis Bank, and so on). The FDI ceiling in the banking sector eventually reached its current level, which is 74 percent in private banks and 20 percent in PSBs, but it was originally lower than the current trend. 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. With one exception—a single conglomerate buying a controlling stake in an Indian private or public bank—no firm may own more than 10% of the total shares available.

**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)

**3. Foreign direct investment benefits**

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

**4. 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** |

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 Yojana6 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.

### 5. 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%.

## 6. Conclusion

The study evaluates and compares the profitability of particular banks and, in order to assess the effect of foreign direct investment on profitability during a particular period, determines a correlation between the volume of FDI in the Indian banking sector and the overall profitability of particular Indian banks. According to the objectives, the acquired data have been examined using the proper statistical methods, and they are given sequentially along with the interpretations. This research, which relates to foreign investment in the Indian banking industry, presents the level of foreign investment in Indian banks and tries to calculate its effects. Unquestionably, the FDI policy has had a considerable influence on the overall performance of the Indian banking sector. This will pave the road for the banking industry's performance to advance overall and reach international norms.

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