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FDI IN INDIAN BANKING SECTOR: A REVIEW (1978-2015)

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ABSTRACT

Foreign Direct Investment (FDI) is considered to be life blood of economic development especially for developing countries. FDI is used as the stimulus for growth in the most of developing countries including India. Globalisation has engulfed all the sectors into its fold, out of which banking sector is the crucial one. FDI in Indian Banking Sector has lot of opportunities as well as challenges. With the entry of other players and rise of economic transactions, the banking services befitted as crucial activities for any business, which led to high opportunity. The preceding chapter gives focus on various aspects to be studies. As the result of Liberalisation, Privatisation and Globalisation, Indian Banking System is going to be global and many global banks setting up business in India. The banking sector has been instrumental in shaping the pattern of economic development, requiring proper proportion of FDI in India. The present chapter highlights the past literature focuses on the role of FDI in Indian Banking Sector. Foreign Direct Investment (FDI) acts as a bridge to fulfill the gap between investment and saving. Against that background this chapter explores the past experience related to the role of FDI in the development of economics of Banking Sector in India.

KEYWORDS: *Foreign Direct Investment, Indian Banking Sector, Multi National Enterprisers.*

INTRODUCTION:

Foreign Direct Investment (FDI) plays a very important role in the development of the nation. Sometimes domestically available capital is inadequate for the purpose of overall development of the country. Foreign capital is seen as a way of filling in gaps between domestic savings and investment. India can attract much larger foreign investments than it has done the past. Foreign Direct Investment (FDI) is a type of investment into an enterprises in a country by another enterprises located in another country by buying a company in the target country or by expanding operations of an existing business in that country. In the era of globalization FDI takes vital part in the development of both developing and developed countries. FDI has associated with improved economic growth and development in the host countries which has led to the emergence of global competition to attract FDI. FDI offers number of benefits like introduction of new technology, innovative products, and extension of new markets, opportunities of employment and introduction of new skills etc., which reflect in the growth of income of any nation. Foreign Direct Investment is one of the measures of growing economic globalization. Investment has always been an issue for the developing economies such as India. Foreign Investment plays a significant role in development of any economy as like India. Many countries provide many incentives for attracting foreign direct investment (FDI). Need of FDI depend on saving and investment rate in any country. Foreign Direct Investment acts as a bridge to fulfill the gap between investment and saving. In the process of economic development foreign capital helps to cover the domestic saving constraint and provide access to the superior technology that promote efficiency and productivity of the existing production capacity and generate new production opportunity. India's recorded GDP growth throughout the last decade has lifted millions out of poverty & made the country a favoured destination for Foreign Direct Investment.

Banking is a prime mover in the economic development of a nation and research is so essential to improve its working results. The management without any right policy is like "building a house on sand". Foreign Direct Investment (FDI) is an investment made by Multi-National Enterprises (MNEs) or by a non-resident in an enterprise of host (receipient) countries over which they have a control and earn private return. It is important to note that the developing countries had significantly eased restrictions on FDI inflows and operations of MNEs in the early 1980s. This trend became even more widespread during the 1990s, which bought a significant FDI inflow into the developing countries. The role of FDI on the host economy is also subject to criticism. In the earlier stages studies has shown that foreign capital had a negative impact on the growth of the developing economies.

The policy maker for the Indian economy tried to join the competition for attracting more FDI as it is assumed that FDI has going to be a prominent factor to achieve higher growth of the Indian Banking Sector. It assumed that FDI could play a vital role as a source of capital, management and technology in Banking in India. It has been argued that FDI could bring technological diffusion to the economy through knowledge spillover and enhance a faster rate of growth in India. It is important to note that the gain in the national income also depended on the size of capital inflow, which could increase the technological and managerial inputs and transfers and spillover to local industry. It can be argued that the FDI may drive out the local firm because of their oligopolistic power and also, the repatriation of profit may drain out of the capital of the host country.

Indian Banking Sector has created very important platform in the development of economy of India and in forming wealth to the economy. In 2008, when United States of America and world economy got into trouble, the financial sector of India also got affected but only banking sector maintained its business because of the better controlled system and saving habits of Indian middle man. This is a need of Foreign Direct Investment in Indian Banking System.

Indian Banking System is totally different from the other nations because India's unique geographical, social, economical conditions. Indian has a large volume of land size and approx 1250 million populations and a diverse culture. India has an unbalanced system of and come and expenditure. There are high levels of illiteracy among a big percentage of Indian population but at the equal time, the country has a large role changer and revolutionary talents in management and technology. In India near about 30 to 35 percent of population live in metro cities and urban areas and rest of 60-65 percent spread in several semi-urban and rural area between about 30 and 35 percent of the population resides in metro and urban cities and the rest is spread in several semi-urban and rural centres. Foreign Direct Investment acts as a bridge to fulfill the gap between investment and saving. In the process of economic development in India, FDI is painstaking as a developmental instrument, which is capable of help in achieving independence in different areas of the economy.

India is considered to be the third most preferred investment destination in the world. It is observed that service sector is one of the dominating sectors in attracting more FDI inflows. Further, FDI in Banking Sector provide benefits of Technology Transfer, Better Risk Management, Financial Stability, Innovative Products and Employment. Interestingly, FDI inflows in Banking Sectors have been increasing year by year. It is found that, during period from January to Jun 2016 Banking Sector received FDI inflows Rs. 1702.03 crores which amount for 17.06 percent of total FDI in Service Sector. It is very high FDI inflows in Banking Sector when compared to the same period of other calendar years.

LITERATURE REVIEW

FDI and Productivity

Mahapatrqa and Mohanty, (2011) expressed that the Indian Public Sector Banks possess the urgent position in the nation's managing an account geology yet its piece of the pie has declined to some degree as of late because of the development of private part and outside banks.

Uppal R.K. (2010) the key undertaking of the bank is not exclusively to make and win an ever increasing number of clients additionally to hold them through compelling client benefit. Clients are pulled in through guarantees and are held through fulfillment of desires, needs and FDI in more volume.

C.P. Chandrasekhar and Jayanti Ghosh (2012) have pointed out that an important objective of promoting FDI has been to promote efficiency in Banking Sectors. However, any increase in the equity stake of the foreign investors in existing joint ventures or purchase of a share of equity by them in domestic firms would not automatically change the orientation of the firm. That is, "the aim of such FDI investors would be to benefit from the profit earned in the Indian Banks.

Laghane B.K. (2007) 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.

Kunal & Medha (2011) have studied that India has sought to increase inflows of FDI with a much liberal policy since 1991 after decade cautious attitude. The 1990's have witnessed a sustained rise in annual inflows to India. They rightly pointed out that the present scenario looks more closely at the paradigm 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.

Patil Usa. N. (2012), The Government of India was initially very apprehensive of the introduction of the Foreign Policy Investment in the Banking Sector in India.This paper highlight is Introduction & Definition of Retail Banking FDI Policy in India, FDI Policy with regard to Banking in India, Foreign Investor's concern regarding FDI in Banking Sector.

Kumar, Anil; Honnakeri, P.M. (2012) The Indian Banking industry is one of the sunrise sectors with huge growth potential. According to the Investment Commission of India, the Banking sector is expected to grow. However, in spite of, the recent development in Banking, and its immense contribution to the economy, Banking continues to be the least evolved industries and the growth of Banking in India has been much slower. This dismal situation of the Banking sector, despite the ongoing wave of incessant liberalization and globalization, stems from the absence of an FDI encouraging policy in the Indian Banking Sector. In this context, the present paper attempts to analyse the strategic issues concerning the influx of Foreign Direct Investment in the Indian Banking Industry.

C.P. Chandrasekhar and Jayanti Ghosh (2002) have point out that an important objective of promoting FDI has been to promote efficiency in production and increase performance. However, any increase in the equity stake of the foreign investors in existing joint ventures or purchase of a share of equity by them in domestic firms would not automatically change the orientation of the firm. That is, "the aim of such FDI investors would be to benefit from the profit earned in the Indian market."

FDI AND DEVELOPMENT

Gupta and Singh (2010) studied the inter-relationship between FDI and economic growth, net FDI inflows and GDP series are used. The sample countries for the analysis are all five BRICS nations individually.

Bajaj (2007) in his work "Globalization in the Indian Banking Industry FDI spillovers and implications on Domestic Productivity: 1991-2007," made an attempt to analyze and study the impact of globalization in the Banking industry and FDI spillovers in various forms to the domestic Banking Industry in terms of domestic productivity and competitiveness etc.

Shah (2008) gave his view regarding bank profitability and productivity. He has expressed conern about increased expenses and overheads. Slow growth in productivity and efficiency is due to wasteful work of the banks. He concludes that the higher profitability can be result from increased spread and innovations have a limited role. He favored Foreign Investment for improvement of staff productivity. He also emphasized for improving bank profitability and productivity.

Saxena (2008) analysed that "Improvement in the systems and procedures of inspection of stocks, maintenance of stock register is required. Reforms should be initiated in extension of sponsorship schemes, recovery, and consultancy." This can be supporting tools for banks. Apart from this has given focus on outside investment.

Kulkarni (2008) examined his study on developmental responsibility and profitability of banks stated that while considering banks costs and profits-social benefits arising out of bank operations cannot be ignored. He claimed that profit maximization approach is out of place while referring to profitability of banks. He recognized that while fulfilling the social responsibility, banks should try to make the developing business as successful as possible, to reduce costs, improve banking system and increase the overall productivity through more FDI.

Venkatachalam (2011) give the reasons for erosion in bank profits and profitability in recent years. This study is purely based on published figures. They argued that there is a trade-off between social obligations to be performed by the banks and increasing profits, but without inflow of Foreign Direct Investment it cannot increase more.

Subrahmanyam (2008) has discussed conceptual issues in productivity measurement approach to inter-bank and inter-temporal productivity comparisons. He has highlighted some of the conceptual issues that are faced in the Total Factor Productivity (TFP) measurement associated with neutral technique progress.

Joshi (1986) has examined the various reasons for declining trends in profitability. His study is based on published data. He has suggested profits planning both at micro and macro levels for the banking industry to overcome the declining trends in profitability.

Gupta and Goswami (1999) in their study introduced some radial change in measurement of profitability of commercial banks. They indicated the major cause for declining profitability as the enormous increase in establishment costs. They gave focus on the introduction of FDI in Commercial Banks.

Balkrishna (2004) gave his view on regional banking disparities. He observed that "disparities cannot be eliminated completely because of differences in topography, population and range of FDI etc. If commercial banks maintain their tempo in future years then these disparities can further be eliminated to a greater extent."

Ojha (2003), in his paper made an international comparison of productivity and profitability of public sector banks of India making comparison on the basis of per employee indicators and taking the example of State Bank of India Group and Punjab National Bank noted that Indian banks are the lowest on all the accounts. However, such an international comparison will not be fair for number of reasons. He also made an inter-bank/inter-country comparison by relating per capita assets in terms of per capital income of the country concerned. However he was not satisfied with the results. Analyzing the productivity of public sector banks he observed that there has been substantial growth in productivity per employee since 1999, calculated at current prices. Analysis indicated an unsatisfactory position in the case of Regional Rural Banks (RRBs) and relatively lower productivity in the private sector banks. He gave emphasis of Foreign Direct Investment for improving productivity.

Batra (2012) examined the impact of policy constraints on the profitability of Indian Scheduled Commercial Banks for the period 1990-2010. The profit function approach has been used in the analysis. Previous bank profitability studies have been, in several ways, limited and confined in their scope of enquiry to questions of either 'operational' or 'technical' efficiency. The study provides a comparative view on pre and post nationalization periods of Indian banking. It indicates the importance of Foreign Direct Investment in Indian Banks for bank development.

Ramappa's (2008) argued, "there is nothing inherently non-viable about banking in rural areas. Inadequate management competence in individual bank is la major cause of the non-viability of rural branches of many public sector banks." The biggest ever-challenge that the banking industry now faces is low FDI. However, there is nothing to lose hope about it.

Sarker and Das (2006) compared performance public, private and foreign banks for the year 1994-95 by using measures of profitability, productivity and financial management. They found that Public Sector Banks compare poorly without FDI.

Kumar Jam (2008) The Government must get down to planning a phased programme to remove the burden of non-performing assets from the banking sector. This would not only increase the liquidity of the banks but will also result a more effective, albeit, slightly, costlier, credit delivery system to the priority sector." Apart from this he has given focus on inflow of maximum amount of Foreign Investment in Indian Banking.

Kohli (2004) emphasized on the importance of technology an issues emerging from this technology. According to him, technology is emerging as a key-driver of business in the financial services industry. The advancement in computing and telecommunications has revolutionized the financial industry and banking on the net is fast catching on. As e-commerce gets transformed into e-commerce with the increasing use of technologies like WAP, banking business is in for a major, overhaul, which require more inflow of Foreign Direct Investment.

Kaveri (2004) examine to extend the study conducted by the Verma Committee more specifically to ascertain whether enough signals of weakness were indicated much before the event. This study considers nine efficiency parameters. These parameters include: Capital Adequacy Ratio, Net Non-Performance Assets/Net Adequacy; Net Profit/Total Assets; Gross Profit/Working Funds, Net Interest Income/Total Assets; Interest Expanded/Total Assets, Intermediation Cost/Total Assets; and Provisions and Contingencies/Total Assets and introduction of maximum FDI inflow in Indian Banks.

Janki (2009) pointed the effect of technology on labor productivity and amount of FDI. There is no doubt that banking needs to increase FDI to improve operating efficiency, and customer services. The study concludes that harnessing employee technology synergy is crucial for unleashing productivity and reaching out to the huge base of retail customers, who are also dispersed in rural and semi-urban areas. Banks can use technology to address customer needs and improve their interaction with customers, keeping in touch through telephone and the internet. The study predicts that focus on technology will increase like never before to add value to customer service, develop new products, strengthen risk management, asset liability management and improve profitability. But it cautions that technology is only an enabling tool and whether banks actually achieve what they want to achieve will be determined by the drive and motivation of their work force and response of the staff, which cannot be possible without FDI in India.

FDI AND PERFORMANCE

Vatsala, M. (1978) made a unique attempt to study the impact of foreign capital in the economic development of India during the pre and post independent period. The study elaborates the factors determining the trends in capital movements such as ocean transport cost, free mobility of labour, protectionist policy (tariff), unfavorable colonial policy as well as exchange rate fluctuations, political factors, unfamiliarity with the socio-economic climate etc. She had pointed out that distribution of foreign investment in pre-independence period was in resource-oriented export industries.

Subramanian Ravi, Sachdeva Charu, (2010) discusses the trends in India's outward FDI and finds out the determinants for the same. They found that Indian companies preferred 'acquisition mode' for investing abroad and also found that high distribution expenses and need for resources had a very positive influence on foreign investment. It also ascertains the growth of Indian businesses, as they are looking forward to invest in other countries to expand their businesses.

Thakur Shrinivas (1982) predicted the importance of foreign aid and foreign borrowings to bridge the gap between the domestic savings and high investment required for accelerating the rate of capital formation. He had suggested that instead after an elusive goal of self reliance, it would be more rational to open doors selectively to foreign aid and private foreign capital.

Bhalla V.K. (1994) describes the policies adopted before and after liberalization period to promote trade, industrial, financial policies. He described that the overall strategy was to rely less on commercial borrowings and more on foreign investment for financing the current account deficit. At the same time he has described various shortfalls in our economy which may prove as a hindrance in accelerating FDI.

FDI AND PROFITABILITY

Maathai K. Mathiyazhagan (2005) in his study tried to examine the long run relationship of FDI with gross output, export and labour productivity in the economy at the sectoral level. The researcher found the results demonstrate that the flow of FDI into the sector has helped to raise the output, labour productivity and export in some sector but expected outcome is yet to come. The researcher also found that there is no significant co-integrating relationship among variables like FDI, Gross output, Export and Labour productivity in the core sector of economy.

Malhotra (2014) in his study tried to study the trends and pattern of FDI along with assessing the determinant of FDI inflows. In his study he found that Indian economy has a tremendous potential and FDI has a positive impact. Further he found that FDI inflow supplements domestic capital along with technological development and efficiency.

Singh S., Singh M. (2011) "Trends and Prospects of FDI in India" This study investigates the trend of FDI inflow to India, during 2000-2015 using time series data. This paper aims to study the reasons behind the fluctuations of the FDI inflow in Indian Banking Industry and to search the cause that is responsible for the fluctuations of the trends of FDI.

Singh Y., Bhatnagar A. (2011)[57], "FDI in Indian Banking Sector: An Analysis" The study found that private banks enjoy health rates of growth but FDI inflow in nationalized bank is still low.

Agarwal G., Khan M.A. (2011)[58] "Impact of FDI on GDP: A Comparative Study of China and India," the study found that 1% increase in FDI would result in 0.07% increase in GDP of China and 0.02% increase in GDP of India. We also found that China's growth is more affected by FDI, than India's growth.

Saini Ahmad A.H. (2010)[59], "FDI and economic growth: New evidence on the role of Banking Sector", it was proved that the positive impact of FDI on growth "kicks in" only after Banking Sector development exceeds a threshold level. Until then, the benefit of FDI is non-existent.

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