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A critical study of performance evaluation of Indian FDI and Non-FDI banks

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Abstract
The present analysis studied the impact of FDI Policy on Indian Banking Sector. The impact is measured by two ways. First, it gauges the impact on the banking sector as a whole by studying public sector and private sectors banks together and then by studying public sector and private sector banks separately in the light of FDI. Second, the study also further categorizes the banks as Old and New, both in the private and public sector, and tries to gauge the impact of FDI liberalization. It was discussed and now allowed to deregulate FDI restrictions further, e.g. by allowing FDI in retail trade etc. Policymakers in India as well as external observers attach high expectations to FDI. "FDI worked wonders in China and can do so in India". The impact is measured through two main parameters i.e., productivity and profitability of FDI and Non-FDI banks, both in the public and private sectors.

Keywords: Light of FDI, old and new, deregulate FDI, high expectations, productivity and profitability

Introduction
Indian banking has undergone a sea change after liberalization and reforms. Liberalization and reforms paved the way to foreign direct investment into Indian Banking Sector. It is more than a decade now that have we have received Foreign Direct Investment (FDI) in Banking and hence it is important to see the impact on the Indian Banking. The present study is dedicated to analyze and evaluate the performance of Indian FDI and Non-FDI banks in the post liberalization era.
FDI is considered as important source of financing the growth of LDCs. It was advised by policy makers in India to throw wide open the doors to FDI which is supposed to bring 'huge advantages with little or no downside".
FDI is considered to be important contributor to the performance of firms. Also that the performance of FDI is companies are better than that of non-FDI companies and however FDI companies' contribution to exports is not great and their import propensity is quite high.

Importance of FDI
It is well accepted fact that external inflows like FDI can supplement domestic savings at least in the short run. There are divergent views on the long run impact of FDI on domestic savings and findings of empirical studies are not uniform. However, FDI can play important role in improving the capacity of the host country to respond to the emerging opportunities.
The benefits of FDI can occur to domestic labour in the form of higher wages, to consumer by way of higher output and lower prices, to government through higher tax revenue, and most importantly of external economies. For a developing, FDI is significant for employment generation and improving its productivity as well. Hence, the international flow of capital is considered as an alternative to labour migration from the poor countries. FDI brings to the recipient country not only foreign capital but also efficient management, superior technology and innovation in products and marketing technique, which are generally in short supply in the developing countries. Thus, access to foreign capital helps overcome the managerial and technological gaps in the host country. Further, foreign firms can increase competition in domestic markets, reduce monopoly profits and improve quality of products and services.

FDI and India
The 1991 reforms brought changes in three broad areas, collectively known as liberalization, privatization and globalization. Liberalization did away with regulatory hurdles and minimized licensing requirements. Privatization reduced the role of the state and public

sector in business.

Globalization made it easier for the MNCs to operate in India. India's direct investment abroad was initiated in 1992. Streamlining of the procedures and substantial liberalization has been done since 1995. As of now, Indian corporate is allowed to invest abroad up to 100% of their net worth and is permitted to make overseas investments in business activity.

The following Table No. 1. gives major features of four phases of Indian FDI policy, which is depicting liberalization of FDI policies, phase wise in India over a period of time. Today, India is the fourth-largest economy in the world and one of the most sought for destination for FDI. This has led to India’s services sector boom. India has strength in information technology and other significant areas such as auto components, chemicals, apparels, pharmaceuticals and Jewellery. India has always held promise for global investors, but its rigid FDI policies were a significant hindrance in this regard. However, as a result of a series of ambitious and positive economic reforms aimed at deregulating the economy and stimulating foreign investment, India has positioned itself as one of the front-runners of the rapidly growing Asia Pacific Region. India has a large pool of skilled managerial and technical expertise. The size of the middle-class population at 300 million exceeds the population of both the US and the EU, and represents a powerful consumer market.

Table 1: Major features of Indian FDI policies during the four phases

Phase I	Phase II	Phase III	Phase IV
1950-67	**1968-80**	**1980-90**	**1991 Onwards**
Receptive Attitude or Cautious welcome.	**Restrictive Attitude**	**Gradual Liberalization**	**Open Door Policy.**
Non-discriminatory Treatment to FDI	Restriction on FDI without technology	Higher foreign equity in export-oriented unitsallowed.	Liberal policies relating to technology collaboration, foreignTrade and foreign exchange.
No restrictions on and dividends.Remittance of profits	Above 40% stake not allowed	Procedure for remittance of royalty And technical fees	Encouraging FDI in core and infrastructure industries
	Allowed only in priority area	Liberalized	FERA replaced with FEMA
Ownership and Control with Indians	FDI controlled by FERA	Fast channel for FDI clearance.	Procedures transparent Liberal approach for NRI investments
	Discriminating Power in sanctioning The projects		FDI need not be accompanied by technology
			FDI through M&AFDI in services & Financial Sector-banks,NBFCs, Insurance

Source: Jeromi P.D. (2002)

Review of Literature

Mathur (2006) [9] examined the mythology of banking ownership and he described the success story of the Indian banking system and also challenges some conclusions on the issue of state ownership of banks. Contrary to the conclusions arrived at by several cross-country studies, the Indian banking system, despite maintaining significant state ownership, has increased bank productivity and efficiency, and enhanced credit access.

Ram Mohan (2005) [13] analyzed the foreign institutional investor inflows into the Indian stock market have conferred several benefits - in terms of lower cost of equity, securities market reforms and corporate governance. However, more receipts are unlikely to increase these benefits, while the downside is the potential volatility in exchange rates arising from the fact that participatory notes constitute a large component. They were not sure about the origins of funds that go into participatory notes and do not know whether they are permanent in nature. It is possible to derive the benefits of FII investment without having to put up with the uncertainties created by PNs.

Datar (1999) [4] analyzes developing capital markets in era of direct financial institutions (DFIs). DFIs were set up because banks were unable to meet the requirements of industry for long-term finance. Capital markets have since developed, offering industry an alternative source of funds. DFIs' own source of funds has changed. His article assessed the debate on universal banking and examines the future role of DFIs.

Kurup (1994) [8] examined the muddle of partial privatization of banks and argued that the banks which are eager to go to the market to raise capital are mostly those which have already achieved the prescribed capital adequacy ratio. Further, though legislation has been enacted to enable banks to issue shares to the public, many practical difficulties have cropped up.

Satyanarayana (1994) [4] analyzed the capital adequacy position of all the public sector banks and a sample of 14 private sector banks. Both the apparent and real financial positions of these banks are brought out with the help of a few visible ratios. He also estimates the capital adequacy gap for each of the banks in terms of the time schedule prescribed by the RBI for 1994 and 1996 and analyses the possible options available to them

Need for financial reforms in india

Until 1991, India witnessed financial repression in the closed economy. There was existence of administered interest rates, large preemption of resources by the authorities and existence of micro regulations directing the major portion of flow of funds to and from financial intermediaries. During financial repression, private business, not only find themselves with limited access to credit, but also with less capability of self-financing, because high inflation makes accumulating enough savings to maintain stable real value more difficult. Under those conditions, private investment decreases and when the cost of credit decreases too much, the quality of investment often deteriorates. The characteristics described as credit market segmentation, disintermediation in the regulated segment, scarcity of savings and investment, and low capital productivity- identify financially repressed economies. This shows that if financial repression exists, it furnishes negative long-term effect.

Role of FDI in banking and reforms in FDI policy

FDI Policy in India

Total FDI allowed in Banking was 49% in the since 2001.

Limit for FDI under automatic route in private sector banks

a) In terms of the Press Note No.4 (2001 Series) dated May 21, 2001 issued by Ministry of Commerce & Industry, Government of India, FDI up to 49 per cent from all sources will be permitted in private sector banks under the automatic route, subject to conformity with the guidelines issued by RBI from time to time.
b) For the purpose of determining the above-mentioned ceiling of 49 per cent FDI under the “automatic route” in respect of private sector banks, the following category of shares will be included:

i. IPOs,
ii. Private Placements,
iii. ADRs/ GDRs, and
iv. Acquisition of shares from existing shareholders

Limit for FDI in public sector banks

FDI and Portfolio Investment in nationalized banks are subject to overall statutory limits of 20 per cent as provided under Section 3 (2D) of the Banking Companies (Acquisition & Transfer of Undertakings) Acts, 1970/80. The same ceiling would also apply in respect of such investments in State Bank of India and its associate banks.

Voting rights of foreign investors

In terms of the statutory provisions under the various banking acts, the voting rights, when exercised, have been stipulated which are indicated as under:

- Private Sector Banks – [Section 12(2) of Banking Regulation Act, 1949] No person holding shares, in respect of any share held by him, shall exercise voting rights on poll in excess of ten percent of the total voting rights of all the shareholders.
- Nationalized Banks – [Section 3(2E) of Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80] No shareholder, other than the Central Government, shall be entitled to exercise voting rights in respect of any shares held by him in excess of one percent of the total voting rights of all the shareholders of the nationalized bank.
- State Bank of India (SBI) - (Section 11 of State Bank of India Act,1955) No shareholder, other than RBI, shall be entitled to exercise voting rights in excess of ten percent of the issued capital, (Government, in consultation with RBI can raise the above voting right to more than ten percent).
- SBI Associates - [Section 19(1) and (2) of SBI (Subsidiary Bank) Act, 1959] No person shall be registered as a shareholder in respect of any shares held by him in excess of two hundred shares. No shareholder, other than SBI, shall be entitled to exercise voting rights in excess of one percent of the issued capital of the subsidiary bank concerned.

Private sector banking

The FDI Cap is Administrative -74 per cent from all sources on the automatic route subject to guidelines issued from RBI from time to time. Public Sector Banks-The FDI Cap is Statutory - 20 per cent from all sources Inclusive. The Current limit is 20 per cent inclusive of FDI. The Proposed limit is 40 per cent inclusive of FDI. Private Sector Banking- The FDI Cap is Administrative. Total investment allowed is 74 per cent from all sources on the automatic route. It is proposed to make 100% FDI in banking in near future for the existing banks in private sector. Also it is to be noted that RBI is about to issue 12 new license to new private sector banks but with FDI limit of 74%.

Need for the study

It is found that in the contemporary literature reviewed that it is believed the FDI firms are better performers that Non-FDI firm in international economics. 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 productivity, profitability and efficiency of Indian banking needs to be studied. There is a liberalization of FDI policy from 49% to 74% in 2005, so it become necessary to check if there was an impact of FDI and liberalized FDI policy on the Indian banking industry.

Operational definition for FDI and Non-FDI banks

The present study undertakes FDI and Non-FDI Indian Commercial Banks’ performance evaluation. The FDI definition includes FDI and FII both as FDI to show the impact of Foreign Investment as an impact of FDI Policy. FDI Banks are Indian Commercial Banks that have significant level of total foreign investment FDI and FII. The significant level of FDI taken as more than that of the 50 percent of total allowed FDI limits in each private sector

(37% i.e., fifty percent of 74%) and for each public sector banks (10% i.e., fifty per cent of 20%). Therefore, for the present study, Public sectors FDI banks are those banks which have more than 10% FDI and are called as FDI banks. Private sector FDI banks are those banks, which have, more than 37% and are therefore called as FDI banks. Non-FDI Banks are the Indian Commercial Banks having non-significant level of total foreign investment including FDI and FII. Indian Private sector Banks are allowed to have up to 74% of foreign investment according to the Indian FDI Policy.

- For Public sector Non-FDI banks are those banks which have less than 10% FDI.
- For Private sector Non-FDI banks are those banks which have less than 37%

Objectives of the study

- To study the general impact of liberalized FDI policy on Indian banking industry.
- To study the productivity of FDI and Non-FDI banks in India post liberalization.
- To study the profitability of FDI and Non-FDI banks in India post liberalization.

Research Methodology

The study has extensively used secondary sources of data. Data used is yearly data for a financial year from April 2000-March 2001 to April 2011-March 2012. Data pertaining to banking sector is collected from Reserve Bank of India’s published data. Data pertaining to individual bank is collected from Indian Bank’s Association, Mumbai. Also important data related to foreign investment in individual banks is sought by Right to Information Act query by the scholar.

Scope of the study

The scope of the study is limited to the Indian public sector and private sector banks. The study is limited to yearly data available from 1991-2012 from RBI and IBA, purely secondary sources of data. The study is hence limited to the time, data availability and reliability of data and sources. The study is further limited to the analysis of Indian banking industry in the advent of FDI policy.

Conclusion

This studies pertaining to foreign investment in Indian Banking sector suggests the importance of foreign investment in Indian banks and tries to gauge the impact thereof. It can be concluded that, indeed, FDI policy and FDI content have shown significant impact on the performance variables of Indian banking industry. As FDI has positive impact on managerial effectiveness, capital, banking products, productivity, bank coverage and expansion, new technology and technical knowhow and latest banking trends, etc, FDI may be encouraged in this sector. This would lead to the overall improvement of the performance of this sector and bring it to international standards.

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