FINANCIAL SERVICES IN INDIA- AN OVERVIEW

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ABSTRACT

The financial service sector in India has grown rapidly in the last decade. Its growth has in fact been higher than the growth in agriculture and manufacturing sector. Financial sector in India provided it meeting the required attention of the policy makers will emerge into a strong market which will be able to bear any shock and take the country on the path of growth. The paper focuses on the present financial system in India.

Introduction

Service sector has emerged as the largest and fastest-growing sector in the global economy in the last two decades, providing more than 60 per cent of global output and, in many countries, an even larger share of employment. The growth in services has also been accompanied by the rising share of services in world transactions. Testimony to the rise in international supply of services is the fact that trade in services has grown as fast as trade in goods in the period 1990-2003 (i.e., 6% per annum). Along with this, worldwide there has been a marked shift of FDI away from manufacturing sector towards services sector. The share of services in total FDI stock has now increased to around 60% since 2002 as compared to less than half in 1990 and only one quarter in 1970s.

In line with the global trend, service sector in India has also grown rapidly in the last decade. Its growth has in fact been higher than the growth in agriculture and manufacturing sector. It now contributes around 51 percent of GDP. In the trade mode, services trade has also grown at the same rate as goods trade over the 1990s (i.e., about 6.5 per cent) and its share in total trade has reached around 24 per cent. Growth of trade in services has also been accompanied by growth in the share of services in total inward FDI. FDI (approvals) into service sector constituted around 30 percent of total FDI approvals in 2003. Interestingly, outward FDI from India has also grown rapidly and in 2003 outward FDI stock in services constituted around 25 % of total.

Financial Services

The term financial services means services provided by banking and non-banking finance companies established under the Reserve Bank of India Act,1934, regulated by the Reserve Bank of India; insurance companies established under the Insurance Regulatory and Development Authority...
Act, 1999, regulated by the Insurance Regulatory and Development Authority, and other entities established under the Securities and Exchange Board of India Act, 1992, regulated by the Securities and Exchange Board of India.

Financial System in India

The present financial system in India can be classified as follows:

- Reserve Bank of India
- Commercial Banks
- Development financial institutions
- Insurance companies
- Public sector financial institutions
- Mutual funds
- Non-banking finance corporations
- Asset reconstruction companies
- Capital market intermediaries
- Credit information companies

Banking Scenario in India

The general banking scenario in India has become very dynamic now-a-days. Before pre-liberalization era, the picture of Indian Banking was completely different as the Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted into greater involvement of the state in different segments of the economy including banking and finance.

The Reserve Bank of India was nationalized on January 1, 1949 under the terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948. In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India." The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

By the 1960s, the Indian banking industry had become an important tool to facilitate the speed of development of the Indian economy. The Government of India issued an ordinance and nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. A second dose of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second dose of nationalization, the Government of India controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalised banks from 20 to 19. After this, until the 1990s, the nationalised banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy.

In the early 1990s, the then Narasimha Rao government embarked on a policy of liberalization, licensing a small number of private banks. The next stage for the Indian banking has been set up with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in
banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions.

The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India. People not just demanded more from their banks but also received more.

Commercial banks

A bank in India is a company formed under the Companies Act,1956 which carries on the business of ‘banking’ in accordance with the provisions of the Banking Regulation Act. Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise. Commercial banks includes public sector banks and private sector banks

Developmental Financial Institutions

A large number of financial institutions have been set up with the purpose of providing long-term finance to the industrial sector. Which includes

- Industrial Development Bank of India
- Industrial Finance Corporation of India
- The Industrial Credit and Investment Corporation of India
- State Financial Corporations
- State Industrial and Development Corporations

Insurance Companies

Insurance business in India is governed by the provisions of Insurance Act,1938(Insurance act). At present, the insurance sector is broadly controlled by two public sector companies: the Life Insurance Corporation of India and the General Insurance Corporation of India.

Public Sector Financial Institutions

A wide variety of public sector financial institutions were existed in India. Some of the important institutions are

- **Post Office Savings Bank**- operated by the post and telegraph department
- **National Bank for Agriculture and Rural Development (NABARD)**- to provide agricultural financial assistance through various regional, state level and field level institutions like the Regional Rural Banks, State Cooperative Banks, etc
- **National Housing Bank (NHB)**-to promote market potentials and to serve the housing needs of all segments of the population
- **Small Industries Development Bank of India (SIDBI)**-to co-ordinate the functions of the institutions engaged in the promotion and financing or developing the industry in the small scale sector
- **Export Import Bank of India (EXIM)**-to help Indian companies in their export and import activities by offering a broad variety of products and services
Mutual Funds

Unit Trust of India (UTI) was the first mutual fund set up in India in the year 1963. A mutual fund is set up in the form of a trust, which has sponsor, trustees, Asset Management Company (AMC) and custodian. The trust is established by a sponsor, who is promoter of a company. The trustees of the mutual fund hold its property for the benefit of the unit holders. AMC manages the funds by making investments in various types of securities. Custodian holds the securities of various schemes of the fund in its custody.

Non-banking Finance Corporations

NBFC is a company registered under the Companies Act under the regulation of RBI. Its principal activities are receiving deposits under any scheme or arrangement or any other manner, or lending in any manner.

Asset Reconstruction Companies

ARC formed under the Companies Act and registered with RBI under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 for the purpose of carrying on the business of securitization and asset reconstruction.

Capital Market Intermediaries

Some of the important capital market intermediaries, regulated by SEBI are:

- Custodian of Securities governed by SEBI(Custodian of Securities) Regulation,1996
- Collective Investment Schemes governed by SEBI Regulation,1999
- Merchant Bankers governed by SEBI Regulation, 1992
- Debenture Trustee governed by SEBI Regulation, 1993
- Depositories governed by SEBI Regulation, 1996
- Intermediaries governed by SEBI Regulations, 2008
- Portfolio Managers governed by SEBI Regulations, 1993
- Underwriters governed by SEBI Regulations, 1993
- Stock Brokers/Sub-Brokers governed by SEBI Regulations, 1992

Credit Information Companies

Credit Information Companies are formed under the Credit information Companies (Regulation) Act, 2005 and registered with RBI to carry on the business of credit information only.

Previous and Current WTO Negotiations on Financial Services

The WTO agreement on financial services reached in December 1997 (as part of negotiations which were a continuation of the Uruguay Round agreed to avoid the widespread exemptions from MFN likely, had the negotiations been terminated earlier) is generally regarded as having contributed to more transparent policy regimes in the organization is member countries. But its contribution to the opening of markets to foreign suppliers varied greatly among the different parties to the agreement. Success under the first heading was virtually assured by the exhaustive examination of issues related to market access and national treatment in financial services during the negotiation of the framework agreement, the General Agreement on Trade in Services (GATS), and by the lengthy horse-trading over
countries’ commitments which followed. The heterogeneous quality of countries’ commitments as to liberalization was likewise a predictable consequence of differences among countries in their interests at stake.

Particularly important here was an asymmetry in negotiating objectives between developed countries, on the one hand, and several developing countries, on the other. Developed countries, especially those with large financial sectors, perceived their interests primarily as exporters of financial services and aggressively pursued the objective of market opening. In this pursuit they were backed by a powerful lobby of economists and other commentators working for official and private institutions who trumpeted the case for cross-border financial liberalization undertaken over a fairly short horizon subject to only limited safeguards. Developing countries, on the other hand, in many cases were more defensive. Few are exporters of financial services on a large scale. Moreover several have recently undergone the painful experience of bouts of financial instability where difficulties affecting domestic banking systems were typically accompanied by balance-of-payments crises requiring macroeconomic retrenchment and resulting in major setbacks to economic growth and living standards. This experience had a large role in determining their negotiating stance.

Progress in the new negotiations on financial services has been slow, reflecting that of the round as a whole. Submission of initial requests was originally scheduled for mid-2002 and that of formal offers as part of the negotiation of commitments by the end of March 2003. The response to these deadlines appears to have fallen short of expectations. However, the submissions and discussions so far during the negotiations indicate the principal concerns of many countries and features they would like to see in the final outcome.

Conclusion

The Indian financial system comprises of financial institutions, financial markets, financial instruments and financial services. The major players in this market are IDFC, IL&FS, IDBI, ICICI, L&T etc. At present, the growth of Indian financial sector is nearly 8.5% per year.

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