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Recent Trends, Innovations and Growth in Indian Financial Sector

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ABSTRACT

Financial markets are a part of the changing business paradigms, across the globe. In fact, the financial markets are the first to unleash the creativity and imagination and lead the revolution. Today, globalization of competencies, thinking and perspectives has been the part of Strategic Action Plan of all the major players in the financial markets, globally. The cut throat competition across the market operators and the pressure to perform by the stakeholders has resulted in competition being fiercer than ever before. This paper argues that as a consequence of successive reforms over the past 20-25 years, there has been significant progress in Financial sector of India Considerable competition has been introduced in the banking sector through new private sector banks, but public sector banks continue have a dominant share in the market. Contractual savings systems have been improved, but pension funds in India are still in their infancy. Similarly, despite the introduction of new private sector insurance companies coverage of insurance can expand much further, which would also provide greater depth to the financial markets. The extent of development along all the segments of the financial market has not been uniform. While the equity market is quite developed, activities in the private debt market are predominantly confined to private placement form and continue to be limited to the blue chip companies. At the same time, while reforming the financial sector, the Indian authorities had to constantly keep the issues of equity and efficiency in mind.

I.INTRODUCTION

In India, reforms to perk up efficiency and accuracy of the financial sector started early in the reform cycle that commenced in 1991 - in some ways anticipating the gains that would amass from the resultant flexibility in product and factor markets. However, the process of intensification of the functioning of the financial institutions in terms of prudential framework, operational efficiency and regulatory / supervisory regimes has been ongoing. It was also aligned with the development of money, FOREX, Govt. securities and equity markets. The velocity of capital & credit reforms is brisk & is transforming the scenario. The existence of assortment of financial innovations with different terms & conditions, now endow with a wider choice of instruments that suits the investment portfolio needs.

II.OBJECTIVE OF THE STUDY

1. To study the recent reforms in Indian Financial Sector
2. To study the Innovative Financial trends in 2016-17

III. RECENT REFORMS IN FINANCIAL SECTOR

Financial sector is the mainstay of any economy and it contributes immensely in the mobilisation and distribution of resources.

The elements of the financial sector are Banks, Financial Institutions, Instruments and markets which mobilise the resources from the surplus sector and channelize the same to the different needy sectors in the economy. The process of accumulative capital growth through institutionalisation of savings and investment fosters economic growth. Reform of the financial sector was recognized, from the very beginning, as an integral part of the economic reforms initiated in 1991. The economic reform process occurred amidst two serious crisis involving the financial sector the balance of payments crisis that endangered the international credibility of the country and pushed it to the edge of default; and the grave threat of insolvency confronting the banking system which had for years concealed its problems with the help of faulty accounting strategies. Furthermore, some deep rooted problems of the Indian economy in the early nineties were also strongly related to the financial sector such as large scale pre-emption of resources from the banking system by the government to finance its fiscal deficit.

Major aims of the financial sector reforms are to allocate the resources proficiently, increasing the return on investment and hastened growth of the real sectors in the economy. The processes introduced by the Government of India under the reform process are intended to upturn the operational efficiency of each of the constituent of the financial sector. The major delineations of the financial sector reforms in India were found as under:

- Removal of the erstwhile existing financial repression.
- Creation of an efficient, productive and profitable financial sector.
- Enabling the process of price discovery by the market determination of interest rates that improves allocate efficiency of resources.
- Providing operational and functional autonomy to institutions.
- Preparing the financial system for increasing international competition.
- Opening the external sector in a calibrated manner.
- Promoting financial stability in the wake of domestic and external shocks.

At global level, financial sector reforms have been driven by two apparently contrary forces. The first is a thrust towards liberalization, which seeks to decrease, if not eliminate a number of direct controls over banks and other financial market participants. The second is a thrust in favour of strict regulation of the financial sector. This dual approach is also apparent in the reforms tried in India.

Financial and banking sector reforms are in following areas: Financial markets

- Regulators
- The banking system
- Non-banking finance companies
- The capital market
- Mutual funds
- Capital market developments

IV. REGULATORS

The Finance Ministry constantly formulated major strategies in the field of financial sector of the country. The Government acknowledged the important role of regulators. The Reserve Bank of India (RBI) has become more independent. Securities and Exchange Board of India (SEBI) and the Insurance Regulatory and Development Authority (IRDA) became important institutions. Some opinions are also there that there should be a super-regulator for the financial services sector instead of multiplicity of regulators.

V. INDIAN BANKING SECTOR AND FINANCIAL REFORMS

The main intent of banking sector reforms was to uphold a diversified, efficient and competitive financial system with the aim of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional solidification.

As early as August 1991, the government selected a high level Committee on the Financial System (the Narasimham Committee) to look into all facets of the financial system and make comprehensive recommendations for improvements. The Committee submitted its report in November 1991, making several recommendations for reforms in the banking sector and also in the capital market. Soon thereafter, the government announced broad acceptance of the approach of the Narasimham Committee and a process of gradualist reform in the banking sector and in the capital market was set in motion, a process that has now been under way for more than six year.

VI. THE MAJOR REFORMS RELATING TO THE BANKING SYSTEM WERE:

- Capital base of the banks were strengthened by recapitalization, public equity issues and subordinated debt.
- Prudential norms were introduced and progressively tightened for income recognition, classification of assets, provisioning of bad debts, marking to market of investments.
- Pre-emption of bank resources by the government was reduced sharply.
- New private sector banks were licensed and branch licensing restrictions were relaxed.

VII. SIMILARLY, SEVERAL OPERATIONAL REFORMS WERE INTRODUCED IN THE AREA OF CREDIT POLICY:

- Detailed regulations relating to Maximum Permissible Bank Finance were abolished.
- Consortium regulations were relaxed substantially.

- Credit delivery was shifted away from cash credit to loan method.

Many reports signified that the initial steps have been taken in the form of allowing new banks to set up shop. Private Corporates, public sector entities and Non-Banking Finance Companies with a strong track record can now apply to set up new banks and the Reserve bank of India will consider these applications in the coming months. The addition of new banks will mean more competition for this sector in the country and it will lead to a development in services for the end customer. It is anticipated to increase financial enclosure as more and more people across the country will be able to access banking facilities. In reforms for the existing banks the public sector banks have been allowed to increase or decrease the authorised capital without the presence of an overall ceiling. This will provide greater flexibility to the banks to conduct their fund raising activities as per the requirements. The strict restriction of voting rights in banks will also be relaxed and this will aid the banking sector to develop, as large investors will be able to get a bigger voice in the coming days in the banks and the manner in which they operate.

VIII. FOREX MARKET REFORM

Forex market reform took place in 1993 and the successive adoption of current account convertibility were the acmes of the forex reforms introduced in the Indian market. Under these reforms, authorised dealers of foreign exchange as well as banks have been given greater sovereignty to perform in activities and numerous operations. Additionally, the entry of new companies have been allowed in the market. The capital account has become effectively adaptable for non-residents but still has some reservations for residents.

IX. CAPITAL MARKET REFORM

Capital market is defined as a financial market that works as a channel for demand and supply of debt and equity capital. It channels the money provided by savers and depository institutions (banks, credit unions, insurance companies, etc.) to borrowers and investees through a variety of financial instruments (bonds, notes, shares) called securities.

In the agenda of financial sector reforms, Improvement of the capital market is important area and action has been taken parallel with reforms in banking. India has experienced functioning in capital markets the Bombay Stock Exchange (BSE) for over a hundred years but until the 1980s, the volume of activity in the capital market was relatively limited. Capital market activity extended rapidly in the 1980s and the market capitalization of companies registered in the BSE rose from 5 per cent of GDP in 1980 to 13 per cent in 1990. It is observed that the Indian capital market has perceived major reforms in the decade of 1990s and thereafter. It is on the edge of the growth. Thus, the Government of India and SEBI took numerous measures in order to improve the working of the Indian stock exchanges and to make it more progressive and energetic. The Securities and Exchange Board of India (SEBI) was well-known in 1988. It got a legal status in 1992. SEBI was principally set up to control the activities of the commercial banks, to control the operations of mutual funds, to work as a promoter of the stock exchange activities and to act as a regulatory authority of new issue activities of companies. The SEBI was established with the vital objective, "to protect the interest of investors in securities market and for matters connected therewith or incidental thereto." The main functions of SEBI are as follows:

- To control the business of the stock market and other securities market.
- To promote and regulate the self-regulatory organizations.
- To forbid fraudulent and unfair trade practices in securities market.
- To promote awareness among investors and training of intermediaries about safety of market.
- To prohibit insider trading in securities market.
- To regulate huge acquisition of shares and takeover of companies.

The practice of reform of the capital market was started in 1992 along the lines recommended by the Narasimham Committee. It was intended to remove direct government control and replacing it by a regulatory framework based on transparency and disclosure supervised by an independent regulator. The first step was taken in 1992 when the Securities and Exchange Board of India (SEBI), which was initially established as a non-statutory body in 1988, was raised to a complete capital market regulator with statutory powers in 1992. The requirement of prior government permission for accessing capital markets and for prior approval of issue pricing was stopped and companies were permissible to access markets and price issues freely, subject only to disclosure norms laid down by SEBI.

X.THE REGULATORY FRAMEWORK

As the time passed, SEBI has implemented a modern regulatory framework with rules and regulations to control the behaviour of major market participants such as stock exchanges, brokers, merchant bankers, and mutual funds. It has also sought to control activities such as takeovers and insider trading which have implications for investor protection. The governing structure of stock exchanges has been changed to make the boards, of the exchanges more broad based and less dominated by brokers. The new regulatory framework intended to support investor protection by ensuring disclosure and transparency rather than through direct control. SEBI acts as a supervisor of the system undertaking supervision of the activities of various participants including stock exchanges and mutual funds and violations of the rules are punishable by SEBI.

The regulatory framework is new and there is a need to be advanced with experience gained and also as gaps and insufficiencies are identified. SEBI needs to be further strengthened in some areas and its disciplinary powers.

XI. OPENING THE CAPITAL MARKET TO FOREIGN INVESTORS

Significant policy initiative in 1993 was the opening of the capital market to foreign institutional investors (FIIs) and allowing Indian companies to raise capital abroad by issue of equity in the form of global depository receipts (GDRs).

XII. MODERNIZATION OF TRADING AND SETTLEMENT SYSTEMS

Major developments occurred in trading methods which were highly antiquated earlier. The National Stock Exchange (NSE) was established in 1994 as an automated electronic exchange. It empowered brokers in 220 cities all over the country to link up with the NSE computers via VSATs and trade in a unified exchange with automatic matching of buy and sell orders with price time priority, thus ensuring maximum transparency for investors. The initiation of electronic trading by the NSE generated competitive pressure which forced the BSE to also introduce electronic trading in 1995.
The settlement system was old-fashioned which involved physical delivery of share certificates to the buyer who then had to deliver them to a company registrar to record change of ownership after which the certificates had to be returned to the buyer. This process was consuming and also had significant risks for investors. The first step towards paperless trading was put in place by enacting legislation which allowed dematerialization of share certificates with settlement by electronic transfer of ownership from one account to another within a depository. The National Securities Depository Ltd (NSDL) opened for business in 1996.

XIII. FUTURES TRADING

Currently, an important gap in India's capital market is future markets. Good market in index futures would help in risk management and provide greater liquidity to the market. A decision to present futures trading has been taken and the legislative changes needed to implement this decision have been submitted to parliament.

XIV.MUTUAL FUNDS

Presently, the mutual funds industry is controlled under the SEBI (Mutual Funds) Regulations, 1996 and amendments thereto. With the issuance of SEBI rules, the industry had a framework for the setting up of many more companies, both Indian and foreign firms. The Unit Trust of India is biggest mutual fund controlling a quantity of nearly Rs.70,000 crores, but its share is going down. With the growth in the securities markets and tax advantages granted for investment in mutual fund units, mutual funds became widespread. The foreign owned AMCs are the ones which are now setting the pace for the industry. They are introducing new products, setting new standards of customer service, improving disclosure standards and experimenting with new types of distribution.

XV. REFORM OF THE INSURANCE SECTOR

The Insurance sector in India directed by Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and General Insurance Business (Nationalisation) Act, 1972, Insurance Regulatory and Development Authority (IRDA) Act, 1999 and other related Acts. The basis of liberalizing the banking system and encouraging competition among the three major participants' viz. public sector banks, Indian private sector banks, and foreign banks, applies equally to insurance. There is a strong case for ending the public sector monopoly in insurance and opening it up to private sector participants subject to suitable prudential regulation.

Innovative Trends of Financial Sector: 2016-17

As the year comes to a close, we put together the top 5 developments that we believe have shaped the Indian financial system in 2016.
Below are our picks:

Withdrawal of Legal Tender Status for Rs 500 and Rs 1000 Notes

“To break the grip of corruption and black money, we have decided that the five hundred rupee and thousand rupee currency notes presently in use will no longer be legal tender from midnight tonight, that is 8th November

2016….” With these words the Indian Prime Minister in one stroke announced the withdrawal of what constituted 86% of Indian currency (by value) in circulation at that point in time.

Withdrawal of legal tender of such a magnitude has obviously brought focus on digital transactions with the Government claiming a 400-1000% increase in them since the withdrawal was announced. The RBI on its part released provisional data for electronic payments in November 2016, which in its present form is not entirely comparable when contrasted with the October data, as it comes with caveats that do not convey the full picture for digital transactions in November – [Mobile Banking data – is of 5 banks; Cards data – is of 4 banks; PPI data – is of only 8 non-bank issuers for goods and services transactions.

For data that is comparable we have put together the below table that provides a perspective on the actual volume & value of transactions in the October-November period.

	Oct-16		**Nov-16***	
	Volume (Million)	**Value (Rs. Billion)**	**Volume (Million)**	**Value (Rs. Billion)**
IMPS	42.09	343.6	36.2	324.8
RTGS	9.01	97554.3	7.9	78479.2
NEFT	133.21	9504.5	123	8807.8
NACH	169.39	768.4	152.5	606.6
CTS	82.04	5974.1	87.1	5419.2

Source: RBI; * – Provisional data; NACH – National Automated Clearing House; Colour red indicating negative growth as compared to the previous month.

Passage of The Goods & Services Tax Bill

Aimed at doing away with a host of Central and State taxes and ushering in a one tax regime for the entire country, both the Houses of Parliament passed the Goods & Services Tax Bill in August 2016, with the President giving his assent in September. Subsuming most of the Central and State taxes such as the Value Added Tax (VAT), excise duty, service tax, central sales tax, additional customs duty and special additional duty of customs, GST would lead to a uniform consumption-based tax structure across the land for almost all goods and services and the government has set a deadline of April 1, 2017 to roll this out. GST implementation would integrate the economy and provide for a common national market that enables businesses to leverage a simplified tax regime.

Passage of the Insolvency and Bankruptcy Code

In May 2016, both Houses of the Parliament passed the Insolvency and Bankruptcy Code that set in motion a national bankruptcy law to deal with insolvencies. The new law, which does away with at least 12 different legislations, some of which are centuries old, is expected to usher in an effective bankruptcy resolution system that improves the ease of doing business in India. The legislation seeks to create time-bound processes for insolvency resolution of companies and individuals. It will cover individuals, companies, limited liability partnerships and partnership firms and amend laws including the Companies Act to become the overarching legislation to deal with corporate insolvency. The Central Government in December notified the final regulations related to the insolvency resolution process under the Insolvency and Bankruptcy Code 2016, paving way for the operationalization of the 10-member Insolvency and Bankruptcy Board (IBBI).

Thrust towards digitisation of Government payments

2016 saw wide-ranging measures to incentivise greater adoption of digital payments with an all-round push by different Ministries and regulators. For instance, the Ministry of Electronics and Information Technology (MeitY) laid out Guidelines for Adoption of Electronic Payments and Receipts in November 2016 that covers a time-bound process for the integration of digital payments and receipts involving all Government departments. It has set an ambitious deadline of 31 December 2016 by which 90% of payments and receipts of all Government Departments are to be made online.

In addition the year saw a slew of Committees being set up by the Government such as the Watal Committee on Digital Payments that has come up with a series of recommendations and a roadmap for digital payments that are to be implemented. Likewise in November, Niti Aayog constituted a Committee of Chief Ministers to examine and implement measures for promoting digital payment systems in the country. RBI in June set up the Sudarshan Sen-headed Working Group to study the entire gamut of regulatory issues relating to Fin Tech and Digital Banking in India.

CONCLUSION

It is assessed that since last many years, there have seen major improvements in the working of various financial market contributors. The government and the regulatory authorities have followed a step-by-step approach. The entry of foreign companies has helped in the start of international practices and systems.

To summarize, the financial sector is main element of the Indian economic system. Financial experts suggested that there is a need for effective reforms to ensure that this remains competitive and attractive for investors from across the world. The economic reforms have preferred the need for changing the policy objective to promotion of industries and the formation of more integrated infrastructural facilities. Financial sector reforms are centre point of the economic liberalization that was introduced in India in mid-1991. It was witnessed that national financial liberalisation has brought about the deregulation of interest rates, dismantling of directed credit, improving the banking system, enhancing the functioning of the capital market that include the government securities market.

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