FINANCIAL SERVICES IN INDIA: A REVIEW

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In this paper an attempt has been made to highlight the developments in the financial services market and evaluate its prospects in the context of capital market reforms.

INTRODUCTION

The meaning of the term financial services is broadly understood to include banking, insurance, building societies, stockbroking and investment services. But it also includes a wide range of other business and professional services like legal services, accountants, estate agency, architects and advertising.The term financial services has no formal definition (Anderton, 1995). This makes the task quite complicated as almost all types of activities which are of a financial nature could be brought under this head. Even in UK where a separate Act called Financal Services Act exists, no formal definition has been given by the Act. Therefore, the term financial services can be defined as " activities, benefits and satisfactions connected with the sale of money, that offer to users and customers, financial related value. Hence suppliers of financial services include the following type of institutions, namely banks, insurance companies, building societies, credit card issuers, investment trusts, stock exchanges, franchising and leasing companies, national savings, giro banks, unit trusts, finance companies and so on. Financial services serve industrial markets and ultimate consumers markets. These two markets can be sub-divided into five main types : the government and public sector, the private sector, the commercial sector, industry and the international markets. (Burton, 1994).

DEVELOPMENTS IN INDIA

Indian Financial Services market has undergone a sea change during the last three years. It has witnessed rapid changes since the launching of financial sector reforms in the year 1991-92. Many of the age old rules and regulations have been abolished. The market has been thrown open to private sector firms. Foreign financial institutions have also been permitted to enter the Indian financial service sector. One natural outcome of all these changes is the increased competition in the market. Customer tastes and preferences are also fast changing. The world over the financial institutions have increasingly started relying upon electronic media for carryoing out their operations. In such a millieu the Indian financial firms can no longer afford to be a spectator. Mere survival, let alone growth calls for not only being sensitive to such changes but also timely responding to withstand the emerging challenges (Bhole, 1997). In August 1991, a High Level Committee, headed by Shri M. Narasimham, was appointed by the Government to examine all aspects relating to the structure, organisation, function and procedures of the financial system. The Committee submitted its final report in November 1991, which contained a number of suggestions/recommendations for toning up the operational efficiency of the banking system.

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The Reserve Bank of India has ever since examined and implemented in a phased manner a large number of recommendations of the Committee, the most important of which relate to transparency and full disclosures (as envisaged by the International Accounting Standards Committee). The profitability concept based on proper recognition of Income and provisioning for bad debts based on prudential norms was intoduced in the year 1992-93 and under implementation ever since in a phased manner to cover not only the commercial banks but also the entire financial system. In line with the international standards, income recognition in respect of Non-Performing Assets (NPA) has, therefore, been based on record of recovery, as against accrual principle followed earlier. Similarly, bad debt provisioning has also been based on proper classification of assets into standards, sub-standard, doubtful and loss, as per NPA criterion and other considerations. The capital adequacy measures, in line with Basle Committee recommendation, have also been implemented so as to clean up the balance-sheets and improve the financial health/viability of banks/other financial institutions.

The reforms have brought in a sea-change in the ouitlook/functioning of banks/financial institutions all over. Today their balance-sheets and profit and loss accounts reflect a more realistic/transparent image, though the bottom lines of all of them have been badly hit in terms of the intrinsically sound and realistic accounting standards being followed/pursued the world over.

The reform process in the financial system has been aimed at improving the allocation and financial efficiency and also putting a diversified and competitive system. This also implied (a) removal of external constraints operating on the profitability of banks, (b) improving the financial health of banks and introducing greater transparency/disclosures in their balance-sheets and (c) injecting a greater element of competitive–ness and efficiency in the system. (Sastry, 1997)

Thus, there has been a re-orientation of the tools of monetary policy from direct control to indirect interventions. A new Department of Supervision was set up in the RBI during the year 1993, followed by consituting the Board of Financial Supervision (BFS) on November 11, 1994. The BFS exercises its powers of supervision over commercial banks, the NBFCs and the Financial Institutions (FIs). The Expert Group (Chairman Sjro P.R. Khanna) set up for recommending a framework for supervision of the financial companies has submitted its report in April 1996, which is under consideration. For effective and better regulation of the NBFCs, certain legislative changes are also under consideration.

An important offshoot of the financial sector reforms has been emergence of new instruments and institutions as part of liberliazation and globalisation of the Indian economy. Of course, branch licensing has continued to be re-oriented in consonance with the objectives of banking reforms. Opening of new bank branches has been tempered by major prudential criteria which include (i) compliance of the 8 per cent Capital Adequacy Ratio (CAR) with a certificate from banks' auditors to that effect, (ii) net profit for three consecutive years (iii) extent of non-performing assets (NPAs) not to exceed 15 per cent of total outstanding, (iv) mimimum net owned funds of Rs. 100 crore, (V) approval of the plan of opening brnaches by the Board of Director and (vi) submission of the plan to the RBI for approval. (Balachandran, 1995)

The instituional base of financial system has been rationalised/widened/broadened,

particularly with the entry of new banks/ financial instituions. Out of 12 "in principle" approvals, 10 private sector banks, viz., UTI Bank Ltd., Indus Bank Ltd., ICICI Banking Corporation Ltd., Global Trust Bank Ltd., Centurion Bank Ltd, HDFC Bank Ltd., Times Bank Ltd., Bank of Punjab Ltd., Development Credit Bank Ltd and IDBI Bank Ltd. became operational. Commercial banks were advised to set up at least one Specialised Agricultural Finance Branch (SAFB) in each State by the convenors of State Level Bankers' Committee (SLBC) to adequately deal with high-tech agricultural loans. 65 such SAFBs were opened throughout the country by end March 1996. Also, banks are required to operationalise 100 more specialised SSI branches during 1996-97, in addition to 136 branches which were already operationalised during 1995-96 as against the stipulated target of 100 for the year. In line with the Bhandari Committee's recommendations, the brach licensing policy for RRBs was modified: (a) 70 RRBs were freed from the Service Area obligations and given freedom to relocate their loss-making branches preferably within the same block or convert them into satellite/mobile offices. Two loss-making branches of the same RRB within five kilomerter were permitted to merge, (b) RRBs with Service Area obligations were free to relocate loss-making branches at "specified centres" within their Service Area. These loss making branches could be converted into satellite/mobile offices, provided such conversion would not impair their performance of Service Area Approach (SAA) obligations. Two branches of the same RRB within five kilometers in a geographically contiguous Sercie Area could be merged. New branches at "specified centres" were allowed to be opened within their area of operations. Incidentally, RRBs were advised to adopt income recognition and asset classification norms from 1995-96 and provisioning norms from 1996-97 onwards. During 1995-96, a sum of Rs. 223.57 crore was released by the Government for capital restructuirn gof select RRBs. Besides, the Union Budget for 1996-97 has made a provision of Rs. 200 crore for this purpose. The recipient RRBs on their part have to fulfill time-bound performance obligations and commitments on a number of key indicators of banking business.

The RBI set up in June 1995 an Expert Group (Chairman: Dr. N.K. Thingalaya) to examine major policy concerning the restructuring exercise of RRBs undertaken during 1994-95 and to monitor the progress of this exercise on an ongoing basis. Another Committee (Chairman: Shri K. Basu) set up by NABARD. With a view to promoting investment in commercial or high technology agriuclture and allied activities, state level agricultural finance institutions are proposed to be set up with NABARD as the chief promoter. The Union Budget 1996-97 propsed the setting-up of new private local area banks with jurisdiction over two or three contiguous districts in order to promote mobiliation and deployment of rural savings by local instituions. The RBI had constituted a Working Group (Chairman: Shri S.K. Kalia) for studying the functioning of Self-Help Groups (SHGs) and Non-Government Organisation (NGOs) with a view to expanding their activities and deepening their role in the rural sector. The recommendations of the Working Group have been generally accepted by the RBI and banks have been advised to implement them.

The Non-Banking Financial Companies (NBFCs) are growing segment of the Indian financial system. The registered NBFCs with net owned funds of Rs. 50 lakh and over were required to achieve a mimimum capital adequacy norm of 8 per cent by

March 31, 1996 and also obtain a mimimum credit rating from any one of the three credit rating agencies. Of over 1500 NBFCs, as at end March 1996, 779 having net owned funds of Rs. 50 lakh and over have got themselves registered with the Reserve Bank of India. (Jain & Shiva Kumar, 1996)

Mutual Funds are one of the fastest growing segments of Indian Financial Services. System during the last few years. A Mutual Fund is a professionally managed investment company that pools the money of many people whose goals are similar and invests this money in a wide variety of securities. Basically, Mutual Funds consist of four entities, vis., the sponsor, the trustee, the funds manager/asset management company and the custodian. All the four are linked and inter-related.

Among others, the following institutional arrangements emerged consequent to implementation of financial sector reforms:

a. Security Trading Corporation of India was set up in May 1994, with a view to developing secondary market in Government Securities.

b. The Working Group on Money Market under the Chairmanship of Shri. N. Vaghul recommended setting-up of money market mutual funds (MMMFs). Based on the recommendations of the Committee headed by Shri D. Basu, RBI issued guidelines for MMMFs in April 1992. MMMFs pool the short-term surpluses for investment in near - cash assets or assets of short-term maturities. In order to make the Scheme of MMMFs more flexible and also to provide greater liquidity and depth to the money. market, several changes were made in the scheme. Private sector institutions were allowed to set up MMMFs, the ceiling and minimum stipulation on the size of MMMFs was done away with, and the prescription of limits on investments in individual instruments by them was withdrawn. The restriction regarding the issue of units of MMMFs only to individuals was withdrawn and units could now be issued to corporates and others, on par with all other mutual funds. The mimimum lock in period for investment in MMMFs has also been reduced from 46 days to 30 days.

c. Guidelines for Primary Dealers (PDs) in Government Securities were issued on March 29, 1995. "In principle" approval for accreditation as PDs was granted on November 13, 1995 to six entities viz., Discount and Finance House of India (DEHI), Securities Trading Corporation of India (STCI), ICICI-Securities, SBI Gilts Ltd (Subsidiary of SBI), PNB Gilts Ltd., (Subsidiary of PNB) and Gilt Securities Trading Corpn Ltd., (Subsidiary of Canara Bank jointly with Bank of Baroda and Corporation Bank). Two PDs became operational from March 1, 1996 and the other four from June 1, 1996. With a view to providing incentives to PDs to develop the secondary market in Government Securities, the RBI decided to pay commission on primary purchases of Central Government Securities by PDs.

d. The Union Budget for 1996-97 has proposed the establishment of the infrastructure Development Finance Company (IDFC) with an authorised share capital of Rs. 5000 crore to be contributed by Central Government, the Reserve Bank and the financial instituions.

Setting up of (a) Discount and Finance House of India (DEHI) to provide a secondary market for the money market

instruments. (b) Securities and Exchange Board of India (SEBI) as a regulatory body for the capital markets, (c) CRISIL (Credit Rating and Information Services of India Ltd.). (d) Stock Holding Corporation of India. (e) Permitting entry of institutions as members of stock exchanges, removing ceiling on interest rate in call money market from May 1989, permitting issue of negotiable certificate of deposit by scheduled commercial banks, permitting issuance of commercial paper by corporates, creating off-shore funds for investment in the Indian Capital Market, etc. are some of the major developments that have taken place in the Indian financial sector. As a result of these institutional development, some of the bigger banks in India have made their foray into the financial services.

CONCLUSION

The Indian financial system has undergone phenomenal changes during the last 20 years. Many new types of services are bing introduced so as to meet the requirements of the globalised economy. But at the same time the general mood in the financial sector is gloomy. For finance companies the past year has been quite a dog. The depressed capital market and the ongoing liquidity crisis took the fizz out of their business during 1995-96 and flat state of affairs appears to be continuing even in the current year. There has been a clear down trend in profits, especially for those companies which depend substantially on the capital market. (Ethiraj, 1997)

In the overall gloominess, there are some points of light; companies focusing on fundbased business such as leasing or hire-purchase are relatively better off, with many of them reporting an improvement in net profit. Margins, have however, been under pressure, an outcome of the rising cost of funds. (Panchal, 1997)

The capital makret dependent companies have been adversely affected because of the irregularities and scams in almost all the segments of the financial sector. For example starting from Harshad Mehta episode till recently the Indian Bank, PLS technicals and CRB case. The collapse of CRB capital market has been the largest of its kind in the Indian financial services sector. (Sugata, 1997)

Activities of all those who provide financial services like merchant banks, mutual funds,

Name	Net Profit (in Crores)		Percentage drop in net profit
	1995-96	1994-95	
Kotak Mahindra Finance	45.37	64.20	29
ICICI Securities	2.20	20.80	89
Prime Securities	11.96	15.87	175
Mafatlal Securities	12.61	13.67	8
Autoriders Finance	9.55	16.60	42

Source : Business India, April 1997.

NBFCs and banks have been affected. It is obvious from the fact that of the 1,000 odd merchant banks in the country, only 472 handled any issues during 1996-97. According to Delhi-based Prime Database, only 261 of the 472 merchant banks which managed issues were appointed as lead managers, a status which entitles them to a much larger percentage of the total issue management fee. As a result several small merchant banks will have to close shop and the big ones will battle hard to survive. A dull capital market have eaten up their profits. (Indicated in the table below)

The investment banks have focused all their energies on earning their profits from one activity that of raising funds from the capital market. In contrast, most NBFCs have a finger in every pie, ranging from retail products to corporate loan products and fee-based activities such as co-managing issues. Doesn't it make more sense to have a diverse range of income service to reduce risks?

Hence, comparatively NBFs are in a better position. For example Sundaram Finance (hire-purchase of vehicles), Lloyds Finance (car financing) etc have experienced an increase in the net profits. (Indicated in the table below)

But recenlty, the top NBFCs have reported a 30-35% slow down in fresh funds inflows. The reason, a liquidity surge in the system. Leading NBFCs like Lioyds Finance, Kotak Mahindra and Apple Industries have openly admitted a slowdown in inflow of funds (a similar slowdown in car finance business). According to them we had a big push in 1996-97, from Rs 260 crore to Rs 565 crore but this month we have slowed down. But the good news is that we are able to explore a host of other fund raising options like external commerical borrowings, FCNR (B) borrowings, and NCDs. At the same time, NBFCs were likely to depend less and less on traditional sources of funding.' (Moorthy, 1997)

The credit rating agencies are also going through a rough year. Their creditbility is now being questioned. The system has breed in an unhealthy competition among the credit rating agencies who are still scrambling among themselves the fledgling rating market. The size of such a market is yet to develop since it is still not mandatory for the NBFCs to get their

Name	Net Profit (in Crores)		Percentage drop in net profit
	1995-96	1994-95	
Sundaram Finance	64.92	50.45	29
Lioyds Finance	47.33	41.08	15
Reliance Capital	110.92	46.37	139
CRB Cap Markets	52.32	45.68	15
Wipro Finance	16.76	15.30	10

Source : Business India, April 1997.

schemes rated. Only finance companies keen on RBI relaxation are interested in getting a rating. The CRB fiasco, has forced agencies to be more conservative and thereby to evolve a new rating system. The ministry of finance has reportedly summoned the high profile credit rating committee of Credit Analysis & Research Ltd (CARE) regarding the CRB scandal. Since it had given higher rating to CRB fixed deposit instruments after it failed to obtain a satisfatory grade from another domestic agency. The Rs 200 crore FD program of CRB was intially assigned A+ (high safety grade), the scheme now has a "C" rating (high investment risk). (Tushar, 1996)

It may be mentioned, unlike the usual practice in advanced countries, the system on unsolicited rating is non-existent in the country. The system entails that an agency cannot announce a rating unless it is accepted by the concerned company. As a result, finance companies floating fixed deposit schemes shop around until they get designed rating from the agency. The RBI Governor, and the deputy governor had met the finance secretary and senior officials of the banking department to review the entire situation and decide on the future course of action. (Gajra, 1997)

Another fallout of the CRB fiasco is the Mutual Funds. SEBI has asked mutual funds to put on hold launches of all new schemes Such tough stand is being taken so as to ensure stricter compliance by funds. (Sharma, 1997)

Banks have also contributed in every scandal, some bank or the other have had a hand in it. For example State Bank of India was held responsible in the CRB case. Recently the Union Bank of India former Chairman is being prosecuted over the controversial New Tobacco Company. Therefore, presently the entire financial services sector is dull and gloomy.

There is no dearth of securities law. But most of them need fine tuning to be effective and their enforcement is currently neglected, moreover the unnecessary political interference in the regulation of securities markets is also questioned. The recent CRB scandal clearly brought out the ineffectiveness of both the regulators, SEBI and RBI Recognizing some of the its own inadequacies, SEBI had already on 28th February, set up a five-member committee under the Chairmanship of Justice (Retired) D.R. Dhanuka, a former Bombay High Court Judge.

The committee is expected to recommend amendments in the existing laws and regulations governing the functioning of the capital markets; and the steps to be taken to improve SEBI's effectivenss with companies. The committee has been deluged with representations from stock exchanges, merchant bankers, mutual funds and other market participants, and has three more months to submit a report.

Once the Dhanuka Committee completes its task, it will be a small step for the securities market towards sorting out its problems and delays. To transform that into a grand leap, the government and regulator will have to show their willingness to act swiftly and without fear or favour.

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