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EMERGING TRENDS IN FINANCIAL MARKETS

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The rapid growth and globalisation of financial markets is perhaps one of the most significant developments in the world economy. This development has far reaching consequences, not only for financial markets per se but the growth and direction of world business. No other development has contributed so much to growth of interdependence among the nations. Total volume of funds made available through these markets far exceed the flow of the UN sponsored international financial institutions. The author has examined the relative contribution of foreign direct investment, euro bonds and portfolio investment to the Indian financial market.

Introduction

Globalisation of financial markets has resulted in greater competition between banks and non-banking Financial Institutions, an increase in the complexity of international banking and capital market operations, a broadening of product range, and an emphasis on greater operational flexibility. With Financial Institutions compelled to meet stringent capital adequacy norms, capital market related relations have becomes increasingly dominant in the overall portfolio of institutional activity.

Concurrently, international capital markets have also undergone dramatic change. The emergence of debt trading as the single largest component of the capital market has provided a fillip for the development of an increasing, and often bewildering, array of instruments, hybrids and derivatives. In turn, this has resulted in a dual trust towards enhanced regulatory requirements and greater technological sophistication of operating systems. The purpose of this paper is to examine the developments in the global financial markets. This paper is based on secondary data collected from Annual reports of World Bank, IMF and various Indian Govt. publications.

The growth in the volume of international financial transactions has mainly its roots in the growth of world output and trade. Another factor was the emergency of large capital surpluses in Germany and Japan in the Eighties. However, perhaps the most important single factor in bringing about integration in financial markets is the break-down of geographical borders to the movement of capital across borders. Also, there has been a break-down of functional barriers amongst the financial intermediaries. Today, banks are no longer only purveyors of debt and trend towards securitisation of debt has coincided with the resurgence of the international bond markets and the increasing involvement of non-bank financial interme-

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diaries in market transactions. A related development has been the progressive liberalisation of domestic financial markets in most countries with a widening of the area of competition, both amongst the domestic financial intermediaries, and increasingly with foreign entities as more and more countries permitted transitional international financial intermediaries to operate in domestic markets.

Over the last two years, the Governments of LDC's took several steps to liberalize the real sector of the economy. With these steps, the trade and industry will need more funds. The requirements for these funds can not be met only by internal resources. The external resources become indispensable. The external debts have already reached a level of saturation point. The inflow of foreign capital is to be encouraged through other means. For this purpose linking up of our financial system with that of the rest of the world becomes essential.

In a world where costs, efficiency and effectiveness are the key words for maintaining competitive edge over the rivals, the divergence between domestic and global financial markets in these respects may prove a serious handicap. Thus, in order to make our financial system competitive and efficient, it should necessarily be linked with the financial systems of other countries, particularly, the countries known for their strong currency.

Globalisation of financial markets in developing economies, would need to be viewed in the context of emerging international trends which have placed capital markets at the central stage of the global financial system, While other countries of the world are internationalising their capital market, India can't shy away from this reality and thus will have to globalise its capital markets.

Over the past several years the global financial system has undergone very significant change. Increasing economic interdependence among nations has resulted in enhanced cross border financial transactions. In turn this has necessitated financial institutions to comply with international standards of accounting and coverage to common prudential norms, irrespective of their country of domicile.

The foreign resources flows in two ways :

(1) Foreign Direct Investment.
(2) Portfolio Investment.
 (a) Foreign Institutional Investors.
 (b) Euro-equities.

Foreign Direct Investment

The urgency to ensure a steady flow of foreign direct investment is very essential and of strategic nature because aid commitments are gradually dwindling and borrowings abroad have become scares. The inflow of equity will have advantages of reducing repayment burden. Foreign Direct Invest-

ment (FDI) thus has a great potential in the years of nineties.

In the decades of the eighties, foreign investment policy had played a very limited role in the process of growth and development. During the period 1986-90, there has been Rs. 900 crore foreign direct investment flow to India which comes to Rs. 180 crore per annum. This reveals that during the decade of eighties, LDC's followed a restrictive foreign investment policy. Foreign direct investment, moreover, was permitted in areas of high-tech sophisticated technologies and substantial exports. Foreign equity participation was restricted to 40 per cent of the total capital.

Since the adoption of new foreign direct investment policy, FDI flow to India has recorded 25 times increase. The approvals of direct foreign investment proposals rose from US $ 73 million (Rs. 128 crore) in 1990 to US$ 235 million (Rs. 535 crore) in 1991, to US $ 1318 million (Rs. 3888 crore) in 1992 and to US $ 2091 million (Rs. 6577 crore) during Jan. October 1993 of which 90 per cent has gone to high priority areas.

In the area of technical collaboration more than 80 per cent foreign investment is confined to high priority areas. The bigger chunk of FDI is allowed in the vital sectors of the economy namely, power, oil, food processing, chemicals, tele-communication, electrical and electronic equipment, transportation, industrial machinery and hotel and tourism industry. Now, seeing the FDI as an effective tool of rapid economic progress of the economy, government is trying hard to make FDI policy further simple and liberalised so that FDI flows could be attracted on the increasing scale for further developmental process in the economy.

Euro Bonds

A Eurobond is sold in countries other than the country of the currency in which the issues are denominated. Eurobonds have been very popular during the last decade as a means of attracting long-term funds. Eurobonds are underwritten by a multinational syndicate of investment banks and sold in more than one country.

In an international market the need of a fund raiser may not always match with the desires of the fund providers. Borrowers want funds that do not expose them to any cost over and above those associated with the coupon and redemption of their bonds. investors tend to prefer investing in currencies that they are familiar with. Eurobonds, as the leading method for raising international finance, are issued in all the major currencies, though the U.S. dollar is most popular. In 1989, the share of the U.S. dollar was 48 per cent.

Some of the major currencies of issue for Eurobonds are the U.S. dollar (introduced in 1963), Deutsche Mark (introduced in 1968), Canadian dollar (introduced in 1974), Japanese Yen (introduced in 1977), Australian dollar (introduced in 1972) etc.

The pattern of direct investment outflows reflected differences in the cyclincal position of investor countries. A strong expansion in flows from the

United States and the United Kingdom was combined with significant declines in flows from the rest of the industrial world. The sum of US and UK outflows rose by over $ 22 billion and accounted for half of total industrial country outflows.

Japanese investment abroad fall once again. The apparently very poor rate of return earned on earlier investments may have discouraged further investment. According to balance-of-payments statistics, total investment earnings in recent years have averaged only $ 8 billion annually, on a cumulative FDI stock put at $ 250 billion. The US recovery did not prevent Japanese owned affiliates in the United States from suffering further losses in 1993. According to estimates by MITI, returns on Japanese investment in Asian countries have consistently been much higher, the strengthening of the yen has further stimulated investment in low-wage Asian countries, notably China.

Cyclical factors also led to a sharp rise in investment in the United States, but inflows remained well below the heavy rates seen in the late 1980s. As European inflows declined, gross inflows into the industrial world came to about $ 100 billion. The most significant development in 1993 was the boom in foreign direct investment in the developing world. Preliminary estimates suggest total inflows of about $ 75 billion, making FDI the largest single source of external finance for developing countries. FDI increased from $ 148 million in 1991-92 to US $ 1785 million in April-December, 1993-94 (see Table-I).

Table-II gives the estimated net financing in international markets. In the international bond market, increased public sector borrowings in the traditional fixed rate sector on the one hand and repayments of equity related paper on the other resulted in a 7.5 per cent rate of growth in the total outstanding. Despite the easing of long-term interest rates, which encouraged lock in at prevailing rates, the market suffered from the ready availability of other sources of funds, in particular through the Euro Medium Term Note (EMTN) facilities.

Portfolio Investment In India

The process of globalisation has opened the ways for foreign institutions to participate in the capital market. With a view to facilitating the entry of FIIs into the country, SEBI has simplified the procedures. The entry of FIIs is also facilitated by increasing the role of foreign brokers in the transactions of FIIs. Foreign brokers are allowed to assist FII's and operate on their behalf by transacting orders to buy or sell securities to members of the Indian Stock Exchanges. The foreign brokers have been permitted to open bank and custodial accounts for this purpose. Government have also allowed some firms to set up joint ventures in the financial sector.

TABLE-1 : Foreign Investment Flows (US $ million)

	1991-92	1992-93	1993-94* Apr-Jun	Jul-Sep	Oct-Dec	Apr-Dec
A. Direct Investment	148.0	343.5	161.4	137.5	126.4	425.3
(a) RBI Automatic Route	0.2	42.6	4.0	18.6	26.8	50.3
(b) SIA/FIPB Route	85.4	239.9	89.6	75.9	50.2	215.7
(c) NRIs (40% and 100% Scheme)	62.4	61.0	66.9	43.0	49.4	159.3
B. Portfolio Investment	-	241.5	45.5	263.8	1050.7	1360.0
(a) FIs	-	1.0	45.5	194.8	761.7*	1002.0
(b) Euro Equities	-	240.5	0.0	69.0	289.0	358.0
Total (A+B)	148.0	585.0	206.9	401.3	1177.1	1785.3

Source: Economic Survey, Government of India, 1993-94, p. 76.

TABLE-II : Estimated Net Financing in International Markets

Components of Net International Stock Financing	1987	1988	1989	1990	1991	1992	1993 (in billion US dollars)
Total Cross-border claims of Reporting banks (2)	601.8	436.1	684.9	-608.3	-54.7	180.5	6197.6
Local claims in foreign currency	163.0	74.8	122.2	105.9	-48.7	-24.7	1154.0
Minus : Interbank redeposition	444.8	250.9	397.1	249.2	-183.4	-39.2	3691.6
A = Net International Bank Credit (3)	320.0	260.0	410.0	465.0	80.0	195.0	3660.0
B = Net Euro-note placements	23.4	19.5	6.9	30.9	32.5	37.5	176.9
Total completed international bond issues	180.5	221.6	264.7	239.8	319.7	340.0	
Minus : Redemptions and repurchases	72.6	82.5	89.4	107.9	170.4	175.5	1687.2
C = Net International Bond Financing	107.9	139.1	175.3	131.9	170.4	117.5	1687.2
D = A+B+C = Total International Financing	451.3	418.3	592.2	627.8	282.9	350.0	5524.1
Minus : Double counting (4)	51.3	68.6	77.2	77.8	37.9	70.0	584.1
E = Total net international financing	400.0	350.0	515.0	550.0	245.0	280.0	4940.0

There has been continuous increase in the number of FII's registered with SEBI and the volume of investments affected by them in India. Till the middle of January 1994, SEBI had registered 134 FII's who have 175 broad based institutional fund under them, about US $ 1 billion dollars have already been invested by the FII's. The size of the inflow of investment funds and the increase in FIIs indicative of the growing confidence of the international investing community in Indian markets and their regulatory mechanism.

During 1992-93, portfolio investment in the country was $ 241.5 million which sent upto 1.120 billion dollars till the end of December 1993, aggregate total FIIs stood at $ 1.36 billion at the and of December 1993, which is 1/3 of the total domestic market inflow in the stock market. This clearly indicate that market has been attracting the attention of FII's. Indian companies too have been accessing Euro issues. Twelve companies have entered the capital market till December 1993.

Industrywise FDI Flows

Till the end of March 1993, the power and oil refinery units have attracted maximum foreign direct investment. Table-III reveals that nearly 47 per cent of the total amount till March 1993 flowed in power and oil refinery sector. On the other side, services sector and Hotel and Tourism got the least attention getting only 2.35 per cent and 2.36 per cent FDI flow. In fact the focus of the government has been to develop power and infrastructure sector for overall development of the economy.

The industry ministry has decided to go ahead with its proposal to give automatic clearance for foreign equity investment upto 75 per cent against the level of 51 per cent permitted earlier. It has also plan to abolish the condition of balancing capital goods import with foreign equity. Besides increasing the limit of automatic clearance, the government has also decided to enlarge the list of 34 industries where foreign investment proposal will receive automatic clearance.

How To Globalise Financial Markets

To transform Financial system into a globally competitive forces would require the infusion of a large quantum of resource. But, despite a high rate of domestic savings it is evident that we would also need to access overseas markets for resources. Thus, at one level, globalisation of financial system implies enabling financial institutions to access to international markets to meet domestic requirements. At another level it requires domestic financial institutions to develop the capacity to compete effectively in an increasingly internationalised market.

Conclusions

Liberalisation of the financial sector throws up the need for several financial

markets and services. Indian financial services companies should be able to provide fund based services such as leasing, hire purchase, financing for take over and loan syndication and non fund based services, such as portfolio management, investment advice, financial engineering and restructuring and issue management in order to ensure globalisation of financial markets.

Foreign investment flows has drastically changed the financial market scenario. Till the end of eighties Indian Industry had been facing severe foreign currency crunch resulting in incapacity to import sophisticated technology because competitive environment for the industry could not be created. Industry was dependent on foreign currency loans which were marked by a number of limitations including heavy repayment burden.

Due to liberalisation, foreign investments have increased. It is far more easy for Indian Industry to meet the foreign currency requirements and to import sophisticated technology and cheap raw material. There is no denying the fact that, with the Foreign Direct Investment and Portfolio Investment, Industrial Sector is in very comfortable position, but the implications may not be as bright as they look like or are being projected by the Government.

Table-III : Industrywise FDI Flows

Industry	Amount of FDI (Rs. in Million)
Power	17393
Oil Refinery	16172
Food Processing	8794
Chemicals	6119
Electrical Equipments	5026
Hotel and Tourism	2159
Service Sector	1772
Textile	1719
Transportation	1714
Tele-communication	1337
Others	10514
Total	72719

Source: The Hindustan Times, New Delhi, June 22, 1993.

One of the basic objective of planning during last four decades has been balanced regional development which is likely to be reversed. It is amply clear from MDUs signed till the end of March 1993 that FDI are flowing to the States which have been industrially prosperous. Foreign investors like any other prudent entrepreneur, would primarily like to invest in the sectors and states

where benefit would accrue to them and the priorities of our country may be secondary consideration for them. It is pertinent to mention that the problems of Indian economy are different from that of erstwhile U.S.S.R. or majority of the South East Asian Countries.

The process of reforms in the capital market in LDCs needs to be deepened to bring about speedier conclusion of transactions, greater transparency in operations, improved services to investors and greater investor protection while at the same time encouraging the corporate sector to raise resources directly from the market on an increasing scale. Major modernisation of the stock exchange to bring them in line with world standards in terms of transparency and reliability is also necessary if foreign capital is to be attracted on any significant scale.

The promotion of foreign investment by government through various measures like allowing foreign equity participation even upto 100 per cent in specified cases, raising of ceiling on equity holding of NRI's and overseas corporate bodies in companies and throwing open the houses to foreign institutional investors is an indication that LDCs no longer want to isolate themselves from the rest of the world. In fact, LDCs may not have any other option also. But there is need for caution, any step taken in this direction shall not completely disregarded the policies pursued in the past.

The quality of services rendered by the capital market needs also to be substantially upgraded and this would be possible only with the technological change that has become inevitable and can no longer be postponed. The market also needs to develop supporting structures and hopefully of course, some of them are already in the process of being evolved.

As the global integration of financial markets and institutions gathers momentum, and as economic development in developing countries continues to surge, it is expected that developing countries seize the initiative and open its financial markets. To do otherwise, would involve the risk of being left far behind in the wake of continued dramatic growth which the country can hopefully enjoy in the years to come. Hence, financial markets in India are in transition.

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