INNOVATIONS IN FINANCIAL SECTOR - A CRITICAL OVERVIEW

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ABSTRACT:-

Today, the Indian financial system is in need of some innovations. The country has been trying to continuously evaluate and find new ways to have a better economic growth through some techniques. As we know the innovations can be good as well as bad, fortunately in the present scenario amongst the various innovations in the banking and finance sectors there are good innovations over bad ones. In the recent years there were many new innovations in financial sector which are generated in order increase the economic growth of the country Government of India tries to imply some new technique on the financial sector to enhance the economic growth of the countries. But at same time, some steps that are suggested by Government of India's Committee on Financial Sector Reforms (CFSR) create problems rather than finding solutions. India has half a dozen of regulators and several government agencies which have regulatory powers. This leads to major confusion when regulations of different agencies apply on a single financial service. This has to be streamlined to avoid gaps, inconsistencies and overlap. The current government has already started the scheme of financial inclusion. Under this scheme, the government has already opened accounts of people under public sector banks. Indian markets are primarily run by the retail investors. But the capabilities of institutional investors are to be harnessed to develop the markets further. Including bigger players will give the economy a certain boost. They even tried to minimize some regulations as Prime Minister’s key Economic Advisor Mr. Rangarajan says “too many norms can impede financial innovations”.

This paper studies critically and analyze the importance of innovations in the financial sector in India and at the same time the remedies to overcome the bad innovations. Also we will discuss some innovations in technology under banking sector like satellite banking, biometrics, etc.

Key words: Financial Innovations, economic growth, impediment.

INTRODUCTION:-

When body wags the tail there is more balance and more control on the tail from the body but when tail wags the body, both the body and the tail fails and there is great amount of distress. This essentially sums up the financial turmoil triggered by the collapse of Lehmann brothers in 2008. What started as “hedging instrument” which was generally off balance sheet item started creeping into the balance sheet and caused tremendous event of credit risk and exposure to those who replaced need with greed.

India’s financial sector is a diversified financial sector which mainly comprises of commercial banks, insurance companies, non - banking financial companies, stock market, mutual funds, etc. Majorly it’s a bank dominated financial sector where commercial banks accounts for over 60 percent of the total assets of the financial sector. The major parts of Indian financial system are regulated by Reserve Bank of India (RBI). The supervisory role is played RBI but many financial institutions, in turn, regulate other financial institution in the financial sector.

The role of the financial system in India, until the early 1990s, was primarily restricted to the function of channelizing resources from the surplus to deficit sectors. Whereas the financial system performed this role reasonably well, its operations came to be marked by some serious deficiencies over the years. The banking sector suffered from lack of competition, low capital base, low productivity and high intermediation cost.

There are many reforms that have taken place since the stage of economic liberalization in 1991. The major concern of today’s economy is to how to regulate these reforms so that it leads the country towards the economic growth. In this paper we will begin with the summary of financial sector reforms since 1991, regulators of Indian financial system, Regulations in stock market and other important segments of banking like Basel II and Basel III.

Review of Literature:

Published academic research on the innovational aspects of Indian Regulatory framework in financial system. The study starts with research of the background of financial reforms from the 2008 crisis, the study was supported by two papers; one is Vikalpa (Jayanth R Verma) and other is from Lok Sabha Secretariats Office. Vikalpa described about the condition of countries before and after the 2008 crisis. LSSO Paper also demonstrated the state of countries and also the regulatory bodies who governs the regulations to minimize the effects of crisis.

Anand Sinha (2011) reviewed about the equity stock market and also about the Basel II and Basel III norms and about the competition in the market and regulatory frameworks that governs the competition in the stock market.

Organization of Economic and Cooperation Development(OECD), included the detailed description of trade facilitation agreement the flaws of WTO and demands of India from the agreement are vastly covered under the research done by OECD officials.

The study on financial inclusion was reviewed by Anand Sinha. The new schemes and Jan Dhan Yojana was supported by a paper by K.R. Srivastava which gave a glimpse of the burden rising on the banks and lack of availability of the scheme for poor and smaller section people of India. A study on the debt market in India was made. This study was backed by Rabi Narayan Kar’s paper. It gave a brief overview on the sstock markets in the country.

STATEMENT OF THE PROBLEM:-

How does the current regulatory framework facilitate the innovative regulations in the financial system and what are the drawbacks. Also, due to multiple regulators in India, there are varying regulatory requirements which often lead to confusion in the financial system.

OBJECTIVES OF STUDY:-

- To find out the innovations which have an adverse effect on the financial sector of India
- To determine the various reasons for regulatory inconsistencies.
- To ascertain appropriate deployment of authorities of the regulatory bodies in the financial system.

OPERATIONAL DEFINATIONS:-

Financial innovation: - Advances over time in the financial instruments and payment systems used in the lending and borrowing of fund. These changes, which include innovations in technology, risk transfer and credit and equity generation, have increased available credit for borrowers and given banks new and less costly ways to raise equity capital.

Regulatory Framework: - A Regulatory framework comprises a wide spectrum of government laws, ordinance, acts, legislation and regulations related to a countries economic development plans. IT is established by central and local governments and designed to apply it nationally and locally. It also includes administrative procedure; planning standards and regulations; and building standards.

Economic Growth: - The most common definition of economic growth is an increase in output produces over a period of time. It is an increase in an increase in what an economy can produce if it is using all its scarce resources. An increase in an economy's productive potential can be shown by an outward shift in the economy's production possibility frontier (PPF). The basic question arises in economic growth is what creates growth? The answer to this is all the addition or innovations done in any sector of the economic system such as technology, production methods, regulatory framework, etc leads to an economic growth of a country.

Research Methodology:-

Research methodology is a tool to systematically solve the research problem by collecting and analyzing data. The appropriate methodology for analyzing innovative reforms in regulatory framework will be qualitative method. The qualitative research for regulatory framework in India is supported by the following data collections:

Financial Sector Reforms

The term Financial Innovation is instrumented to describe the creation and marketing of new types of products and services in the different financial circumstances. Innovation is needed in the financial sector but strictly under regulatory framework which can ensure no individualistic and excessive behavior prevailing in market. Innovation of some intrusive derivatives can lead to a large amount of credit risk as in the case of 2008 crisis.

Reforms in financial markets are focused on removal of problems, introduction of new players, better pricing of financial assets, more transparency, etc. Reforms consider regulatory and legal changes, building of institutional infrastructure, refinement of market structure and technological updates. In the various financial market segments, reforms aim at creating liquidity and depth and an efficient price discovery process.

Wide ranging financial sector reforms in India were introduced as an integral part of the economic reforms initiated in the early 1990s. Financial sector reforms in India were grounded in the belief that competitive efficiency in the real sectors of the economy will not be realized to its full potential unless the financial sector was reformed as well. The main thrust of reforms in the financial sector was on the creation of efficient and stable financial institutions and markets. Reforms in respect of the banking as well as non-banking financial institutions focused on creating a deregulated environment and enabling free play of market forces while at the same time strengthening the prudential norms and the supervisory system. In the banking sector, the focus was on imparting operational flexibility and functional autonomy with a view to enhancing efficiency, productivity and profitability, imparting strength to the system and ensuring accountability and financial soundness. The restrictions on activities undertaken by the existing institutions were gradually relaxed and barriers to entry in the banking sector were removed.

One of the main causes of the economic crisis is said to be failure in regulations. Today, regulatory reforms cover more areas than in the past and with much greater intensity of supervision and oversight by international bodies has come to occupy center stage for ensuring the well-functioning financial system that is so vital for economic growth. The new regulations embodied in Basel III have much more requirements, particularly in terms of capital and liquidity. These rapidly evolving global standards have received support from all quarters.

It is said that the post-crisis reforms are driven by the need to fix what went wrong in the advanced economies and there will be a price to pay in terms of growth forgone in ensuring a more stable and resilient financial system. The questions raised are whether these regulations need to be applied in their entirety to emerging markets whose financial systems hardly have the features of the financial systems in the advanced economies which led to the crisis, and that the attendant slowdown in growth in emerging economies may be a disproportionate price to pay given that these are structurally transforming economies where poverty and inequality are extremely vital, much more than for advanced economies. For the regulatory reforms to be efficient without hampering a future economic recovery, therefore, policymakers are urged to assess their impact on crucial drivers of economic growth like trade finance, long-term financing and credit availability to small and medium-sized enterprises (SMEs), to adapt the regulations where necessary to mitigate their negative impact, and to take additional measures to promote economic growth.

The regulation and supervision of the financial system in India is carried out by different regulatory authorities. The Reserve Bank of India regulates and supervises the major part of the financial system. The RBI has to supervise all the commercial banks, Urban Cooperative Banks (UCBs), some financial institutions and Non-Banking Finance Companies (NBFCs). Some of the financial institutions regulate or supervise other institutions in the financial sector, for example, Regional Rural Banks and the Co-operative banks are supervised by National Bank for Agriculture and Rural

Development (NABARD); and housing finance companies are supervised by National Housing Bank (NHB). Department of Company Affairs (DCA), Government of India regulates deposit taking activities of corporate, other than NBFCS registered under companies Act, but not those which are under separate statutes. The Registrar of Cooperatives of different states in the case of single state cooperatives and the Central Government in the case of multi-state cooperatives are joint regulators, with the RBI for UCBs, and with NABARD for rural cooperatives. Management control rests with the State/ Central Government. RBI and NABARD are concerned with the banking functions of the cooperatives. This "dual control‟ impacts the supervision and regulation of the cooperative banks. The capital market, mutual funds, and other capital market intermediaries are regulated by Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA) regulates the insurance sector; and the Pension Funds Regulatory and Development Authority (PFRDA) regulates the pension funds.

Due to the important role played by the financial sector, structural reforms in the financial system were introduced in India in the early 1990s. In the post-reform period, the focus of the regulatory and supervisory policies of the Reserve Bank of India (RBI) was to strengthen the Indian banking system in terms of capital adequacy, asset quality and risk management. The development of financial markets and systematic and timely introduction of new financial products also received significant attention under RBI's regulatory policies. A notable feature was that RBI had prescribed sound liquidity regulations along with capital regulations and had extensively used different policies. At the time of crisis, the banking system was well capitalized and did not have significant adverse effects.

Financial sector reforms are at the center stage of the economic liberalization that was initiated in India in mid-1991. This is partly because the economic reform process itself took place amidst two serious crises involving the financial sector:

- The balance of payments crisis that threatened the international credibility of the country and pushed it to the brink of default.

- The grave threat of insolvency confronting the banking system which had for years concealed its problems with the help of defective accounting policies.

Moreover, many of the deeper rooted problems of the Indian economy in the early nineties were also strongly related to the financial sector. There was large scale pre-emption of resources from the banking system by the government to finance its fiscal deficit and excessive structural and micro regulation that inhibited financial innovation and increase transaction costs. Also, there was relatively inadequate level of prudential regulation in the financial sector. India had poorly developed debt and money markets and outdated (often primitive) technological and institutional structures that made the capital markets and the rest of the financial system highly inefficient.

The Regulatory reform bill, 2013: The planning commission has sought out the views of public and stakeholders on the Draft Regulatory Reform Bill 2013. This bill will ensure the proper working of the regulators without interfering in their work. The bill also suggests an institutional framework for regulatory commissions and appellate tribunals.

Planning commission thinks that a law is needed to maintain convergence in the functioning of the regulators and consistency in the issues of determination of tariffs, enforcement of performance standards, and promoting investment, especially in selected sectors like infrastructure, electricity, telecom, Internet, airports, oil, gas and ports. The focus of the bill will be to ensure that the consumer’s interests are protected and the principles of competition are abided.

The bill specifies that draft Bill is designed to supplement existing sector-specific legislations. The draft bill will have overriding effects in cases of inconsistencies with other existing enactments. India has multiple regulators. Government has realized that it will be very difficult to form a super regulator due to implementation issues. As a result, super regulators in both finance and environment sectors are not formed. The government formed the Financial Sector Legislative Reforms Commission headed by the retired Supreme Court judge, B.N. Srikrishna. This commission has proposed a unified financial regulatory agency for markets, insurance, commodities and pension.

The RBI governor, Raghuram Rajan said that “Over regulation stifles the way industry functions and each regulator should work to meet the objectives with which it was created”. This suggests that the regulators function in a way that they are accountable for the markets and the people and a mechanism ensuring harmony among the regulators will help.

The RBI governor admits that there are multiple projects worth nearly Rs.2 trillion are delayed due to regulatory hurdles. Due to problems of overlapping jurisdictions, the regulations are not properly enforced and there is an inordinate delay. Often there are face-offs between the regulators like one between the RBI and Competition Commission of India (CCI) regarding the mergers in the banking sector. This creates a confusion whether the RBI should regulate the banking functions or thee CCI will deal with the area as it is also regarding the competition.

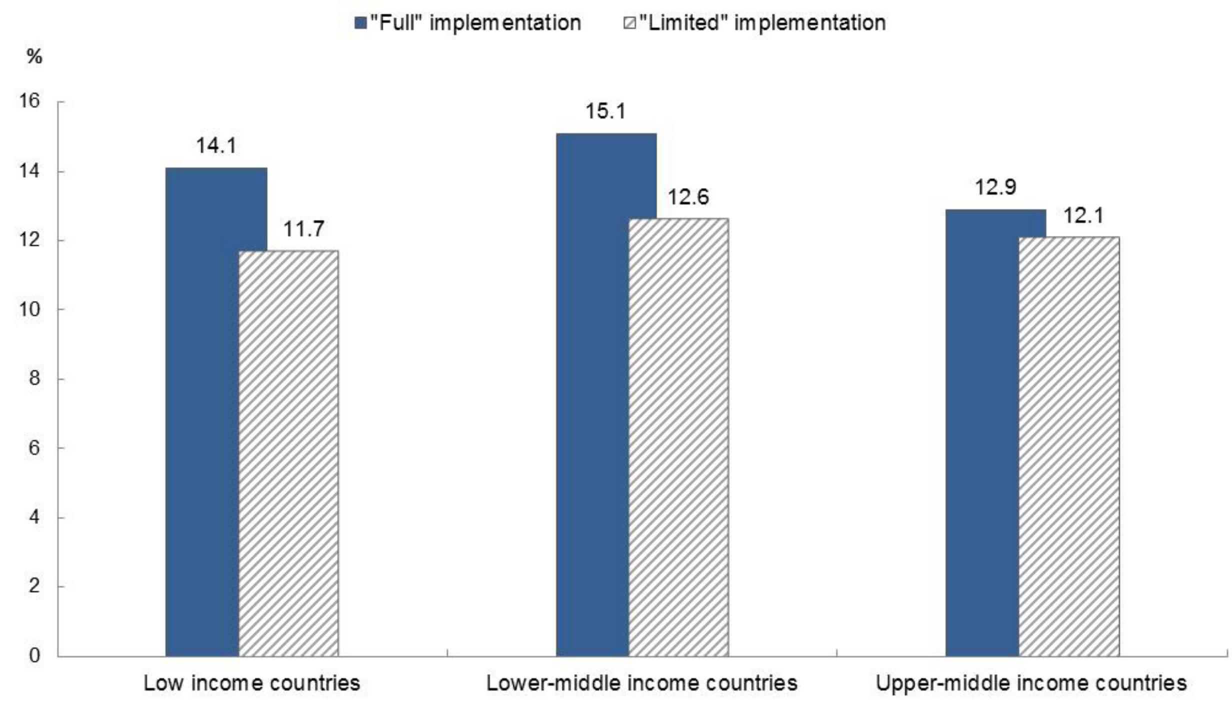
In the electricity sector, Central Electricity Regulation Commission and the CCI have been in a tangle over the issue of “abuse of dominance”. In November 2013, the Delhi High Court stayed the proceedings of CCI against three oil markets companies, Indian Oil Corporation Ltd (IOCL), Bharat Petroleum Corporation Ltd (BPCL) and Hindustan Petroleum Corporation Ltd (HPCL) on anti-competitive behavior in fixing petrol prices. And these companies have contended that the Petroleum and Natural Gas Regulatory Board (PNGRB) has the jurisdiction on this issue.

Trade Facilitation Agreement:-

World Trade Organization (WTO) has introduced a trade facilitation agreement to all its 160 members. The agreement was framed by considering the circumstances of Least Developing Countries (LDC) and developing countries. The basic provisions of the agreement are to lower the global trade barriers, decrease import tariffs and agriculture subsidies. TFA was an effort of developed countries to enter into the market of developing countries with the subsidized rate products. The WTO agreement limits the food subsidies to 10% of the total food grain production. WTO says it will determine the value of subsidies based on 1986 stock prices which is very less as compared to current stock prices. It was believed that the agreement could increase $1trillion of global GDP and will generate 21 million jobs by slashing and streamlining customers.

The last date for signing the agreement was decided to 31st July 2013, but India asked for some more time as the main concern of India is its food security and pilling of stocks. Signing the agreement may hamper the food security of India because of which India wants to add on concrete framework so that India’s food stock can be secured. India was strictly against some of the regulations of WTO, hence used its Veto power against the trade facilitation agreement because of which India has faced a very limited growth in its Corporate as well as financial sectors.

Implementation of TFA: Supposing that the agreement has been initiated the cost benefits for the lower income countries, middle income countries and upper income countries can be classified into two scenarios that is Full implementation and Limited implementation. According to OECD survey in the case of full implementation the potential cost reduction will be 14.1%, 15.1% and 12.9% respectively. In the case of limited implementation the cost benefits can be 11.7%, 12.6% and 12.1% respectively.



Source: OECD website

Financial inclusion:

It is the process of providing financial products and services to the society, especially the weaker and poor people, at an appropriate cost and transparency by mainstream institutions. The present government has already started the “Pradhanmantri Jan Dhan Yojana”, a scheme for opening savings bank account for people who don’t have a bank account to encourage financial inclusion in the country. This will help the people to connect to the Indian economy and reap the benefits through the bank account. The person who opens an account within 100 days of the commencement of the scheme will get an insurance cover which may be up to Rs.100000. The account holder will also get a debit card under the “RuPay” scheme.

The account holders will be eligible for an overdraft of Rs.1500 after operating the account regularly for six months and will be eligible for higher amounts after repayment of the liability. The amount of loan or overdraft will be decided by the banks. This scheme will provide financial stability to the people who are currently not connected to the economy. On the inauguration day, i.e., 28th August 2014, around 1.5 crore bank accounts were opened across the country.

Many poor people don’t have an identity card as Adhaar card as a residential proof. These people will not be benefited by this scheme. Also, the banks have to get initial amount of Rs.2000 in each Jan Dhan account which is giving additional burden to the banks. The PM Jan Dhan Yojana have large operational costs which are said to be difficult to recover as the banks don’t know the exact amount of benefits they will make through this scheme. For the banks, the costs are rising without any guaranteed revenue in the near future through this scheme. They can see a big hole in their balance sheets.

Stock market in India:

Stock market in India is one of the best places in the world to invest. Mostly, the trading is done in two major exchanges, Bombay stock exchange (BSE) and National stock exchange (NSE). BSE was established in 1875 and NSE in 1992. Both the exchanges have similar working process, trading mechanism, trading hours etc. Almost all the significant firms are listed in both the exchanges. Both of the exchanges are competitors in the field of reduced costs, market efficiency and innovation. The two indices are Sensex and Nifty. Stock markets are said to be the growth of the economy.

Findings and Analysis:-

- **Unconformity of regulations: -** Major parts of Indian financial system suffers the problem of unconformity due to many and repeated norms and regulations enforced by multiple regulators.

- **Project hindrances due to legislative overlapping: -** Many important innovative projects are kept on hold due to conflicts of regulatory bodies. India is facing a tremendous downfall due to the quarrel between the regulatory bodies. Overlapping of legislative reforms creates a hindrance in the completion of various welfare projects in the financial system.

- **Resistance to change: -** India is reluctant to change its regulatory policy. Regulatory framework is not flexible which can adopt the new innovative techniques which can result in higher economic growth. India has created a trade barrier in order to resist itself from change.

- **Regulatory bodies reducing competition: -** Regulatory bodies works to decrease the competition in market. Competition leads towards an economic growth as more and more money starts circulating in the market, but Indian regulatory framework is designed in such a way that competition in the market does not increase.

- **Increasing burdens on financial institutions due to regulations: -** Regulations of Regulatory bodies enforces reforms on all the financial institutions which creates tensed circumstances in them. It becomes very difficult for financial institution under the pressure enforced by regulatory bodies. Some high worth institutions sustained the pressure where as low worth institution collapsed for the same.

CONCLUSION:

The present day financial system in the country and around the globe has undergone a lot of changes. It is characterized by stiff competition and regulatory interventions. Indian financial system is divided into various sectors and each one is regulated by a different regulatory body. Each of the regulators is given its jurisdiction. But, in some cases, there arises confusion on the legislative rights and the power of authority to make decisions. Projects of around INR 3 trillion are still under the review of some regulators and thus are stopped totally due to the snail-paced work of these regulators.

The competition in the Indian economy is affected due to some regulatory steps taken by the authorities and thus the consumers are unable to get the best from the financial system. Some of the financial institutions are suffering from losses due to tight regulatory regimes followed in the country.

There is a need to change. The regulatory bodies should have harmony in their work and the jurisdiction of regulations should be mapped perfectly. The regulations are too old for the modern markets. Some reforms are necessary for the betterment of the financial system. Changes, though, are not very easy to implement. Even small changes would be very difficult to be implemented. Due to complex structure of regulations, it will not be easy to bring in dynamic reforms and change the complete scenario.

The motive of a regulator is to ensure transparency and to give the consumers a safe financial environment. Customers expect a regulator to be unbiased and independent. Regulators in India should thrive for betterment and there is a huge scope for some regulatory reforms which can change the face of the financial system and can bring in a new era of better and clearer regulatory policies for the system which will ultimately lead towards economic growth.

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