The Emerging Issues to India's Financial System

*Dr. V. Thamodaran

*Assistant Professor, Dept. of Business Administration

Abstract

India's financial sector has become much more diversified, with capital markets playing an increasingly important role. These markets have been substantially deregulated and, recent changes notwithstanding, many restrictions on capital flows have been eased, especially with respect to equity inflows. As well, the health of the public banks, which initially had very weak balance sheets, has been restored. While India's regulatory, supervisory and financial policy authorities have made progress, they are likely to face challenges related to several aspects characterising the country's financial system, including its banking sector and its capital markets. This paper has dealt with discussed on some issues that are related to Indian financial system.

Financial System in India

A financial system is the system that covers financial transactions and the exchange of money between investors, lender and borrowers. A financial system can be defined at the global, regional or firm specific level. Financial systems are made of intricate and complex models that portray financial services, institutions and markets that link depositors with investors

The financial system is characterized by the presence of integrated, organized and regulated financial markets, and institutions that meet the short term and long term financial needs of both the household and corporate sector. Both financial markets and financial institutions play an important role in the financial system by rendering various financial services to the community.

The Indian financial sector today is significantly different from what it used to be a few decades back, in the 1970s and 1980s. The Indian financial system of the pre-reform period essentially catered to the needs of planned development in a mixed-economy framework where the Government sector had a predominant role in economic activity. Financial markets were segmented and underdeveloped coupled with paucity of instruments. Second, there existed a complex structure of interest rates arising from economic and social concerns of providing directed and concessional credit to certain sectors, ensuing "cross subsidization" among borrowers. To maintain spreads of banking sector, regulation of both deposit and lending were affected. This resulted not only in distorting the interest rate mechanism, but also adversely affected the viability and profitability of banks. The lack of recognition of the importance of transparency, accountability and prudential norms in the operations of the banking system led also to a rising burden of non-performing assets.

The Current Financial Regulatory System

Financial regulators typically maintain an "arm's length" approach to resource issues, perhaps lacking in the capacity or manpower to evaluate them. For instance, key regulators take the following stands on natural resource issues.

Reserve Bank of India (RBI): Regulations forbid granting loans to private companies "purely for land acquisition." Special Economic Zones must be treated on par with commercial real estate projects, and hence require higher reserves. ¢ Securities and Exchange Board of India

(SEBI): Only a general requirement to disclose risk to investors is imposed. ¢ Private rating agencies sometimes seek to take regulatory compliances into account, but not always.

Role/ Functions of Financial System:

A Financial System Performs the Following Functions:

* It serves as a link between savers and investors. It helps in utilizing the mobilized savings of scattered savers in more efficient and effective manner. It channelises flow of saving into productive investment.

* It assists in the selection of the projects to be financed and also reviews the performance of such projects periodically.

* It provides payment mechanism for exchange of goods and services.

* It provides a mechanism for the transfer of resources across geographic boundaries.

* It provides a mechanism for managing and controlling the risk involved in mobilizing savings and allocating credit.

* It promotes the process of capital formation by bringing together the supply of saving and the demand for investible funds.

* It helps in lowering the cost of transaction and increase returns. Reduce cost motives people to save more.

* It provides you detailed information to the operators/ players in the market such as individuals, business houses, Governments etc.

Major Financial Problems of India

There are many problems in India and it is true that more of them are related to finance problems and economic problems. Indian financial management has great role in world's economy being the tenth largest economy in the world by GDP. We are now going through at least three kinds of finance problems in the India. These are:-

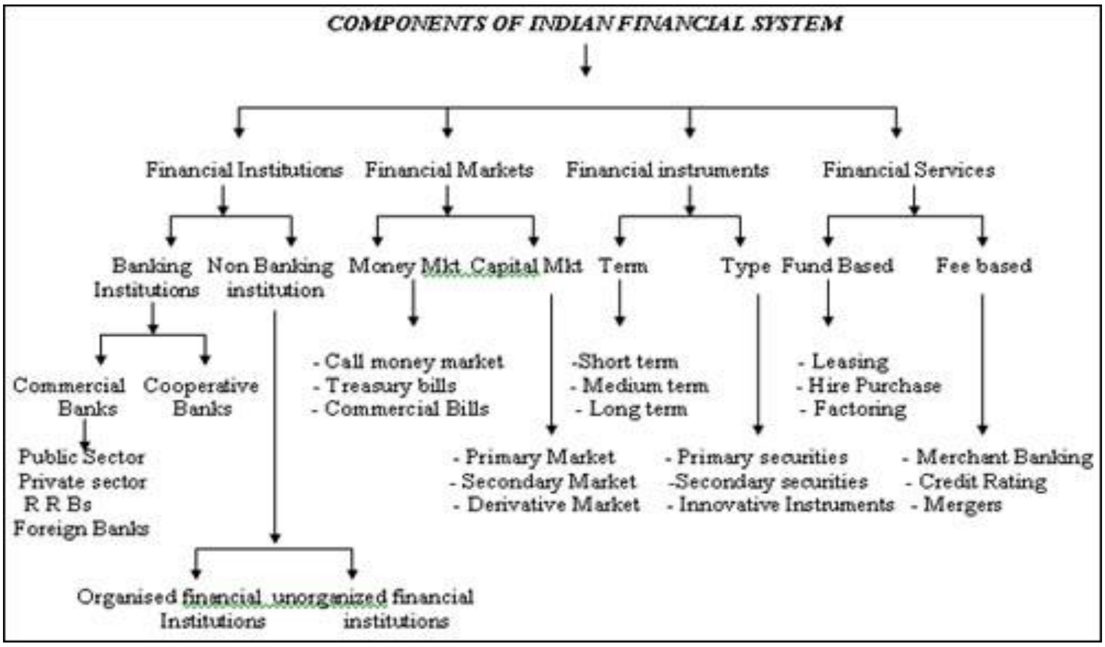
1. Many of people of under 45 years lowball their pension requirement. Not only lowball, but are very far-off from the correct estimate. They mostly generalize from their parent's necessity, even when they understand that they lead a very different kind of lifestyle. After retirement they get financial problems.

2. Indian people are being extravagant imitating the western developed countries. You can find this at many time in various example. They flushed out wine worth of million when India win world cup. This is a simple and fresh example. It causes of financial problems to others.

3. Unemployment is also one of major financial problems in India. Here in a family if one or two members are earner and rest are simply depend on his/her/them then it creates a big problem. This kind of financial problem affect whole financial system of a country.

A Strategy for Change

In recent years, a series of expert committees developed a consensus around a strategy for change. The reforms proposed by these committees require legislative changes, leading India's Ministry of Finance to set up the Financial Sector Legislative Reforms Commission to rewrite the laws. After two years of deliberations and consultation, the commission submitted the proposed Indian Financial Code. This draft law is a new, modern, coherent, and consistent framework based on the rule of law, independence, accountability, and an overriding objective of consumer protection. It replaces most existing Indian financial law. It outlines the powers of agencies that regulate the financial sector while recognizing that for those regulators to be effective, they must have clear objectives and be held accountable for achieving those objectives.



Any attempts at building a government agency must begin with a set of hypotheses about the problem in the world that this agency is required to solve. Alongside this market-failure perspective, there is value in looking at reform from the perspective of public choice theory, which views bureaucrats and politicians as self-interested. The Indian financial sector has witnessed tremendous improvement in its performance as compared to other emerging market economies. Substantial cost-efficiency and profitability has been achieved in the post reform period.

Other segments of financial market, particularly, Indian stock market is also comparable to the international stock markets in terms of turnover ratio. Presently, India has third largest investor base in the world. Indian Stock market trading and settlement system are of world class. India has one of the world's lowest transaction costs based on screen-based transactions, paperless trading and a T+2 settlements cycle.

Conclusion:

The Indian financial system has undergone structural transformation over the past decade. The financial sector has acquired strength, efficiency and stability by the combined effect of competition, regulatory measures, and policy environment. In this environment, leaders are biased toward decisions that keep them in a comfortable position. In the capital market, the progress of reforms has been impressive during the nineties. However, certain refinements are needed to bring the Indian markets on par with the major international markets.

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