UNIT 22 CONTEMPORARY ISSUES IN FINANCE

22.1 INTRODUCTION

Globalization of economy has created a lot of development in each and every disciple concerning human life. Globalization has also impacted the financial development weather its being financial market development or financial product development. Currently we see huge development in capital market and financial innovation understanding the relevance of such development is a paramount need. Understanding the technological development in financial product like bitcoins and other crypto currency is also important. How financial market evolved over the years and how it has impacted the Indian financial market is a matter of concern. This unit is designed keep in consideration the Indian financial system and the issues which are revolving around the financial system of India. This chapter provide an platform for students to investigate the forces shaping the contemporary financial system.

22.2 OBJECTIVES

After reading this unit, you would be able to;

- To understand the Indian financial system.

- To get insight of various contemporary issues of finance.
- To portray the different features of Indian Financial System.

22.3 CONTEMPORARY ISSUES IN FINANCE: AN OVERVIEW OF ORGANIZED FINANCIAL STRUCTURE AND SYSTEM IN INDIA

The crux of any Financials is dependent upon the system of any country is very important as it has tendency boosts savings and investments and thus helps in promoting economic development. Indian Financial System helps as a link between savers and borrowers, thus generating funds for investments. Indian Financial System is basically of two types that is formal and informal financial system.

Formal Financial system is a well organized and a developed financial system where major roles are played by Finance Ministry, the RBI and SEBI and other regulatory entities.

Whereas Informal system is managed by local lenders, brokers and other group of association which don't have a formal and a recognized body.

Indian Financial System is basically made of four major components which are financial services, financial institutions, financial markets and financial products.

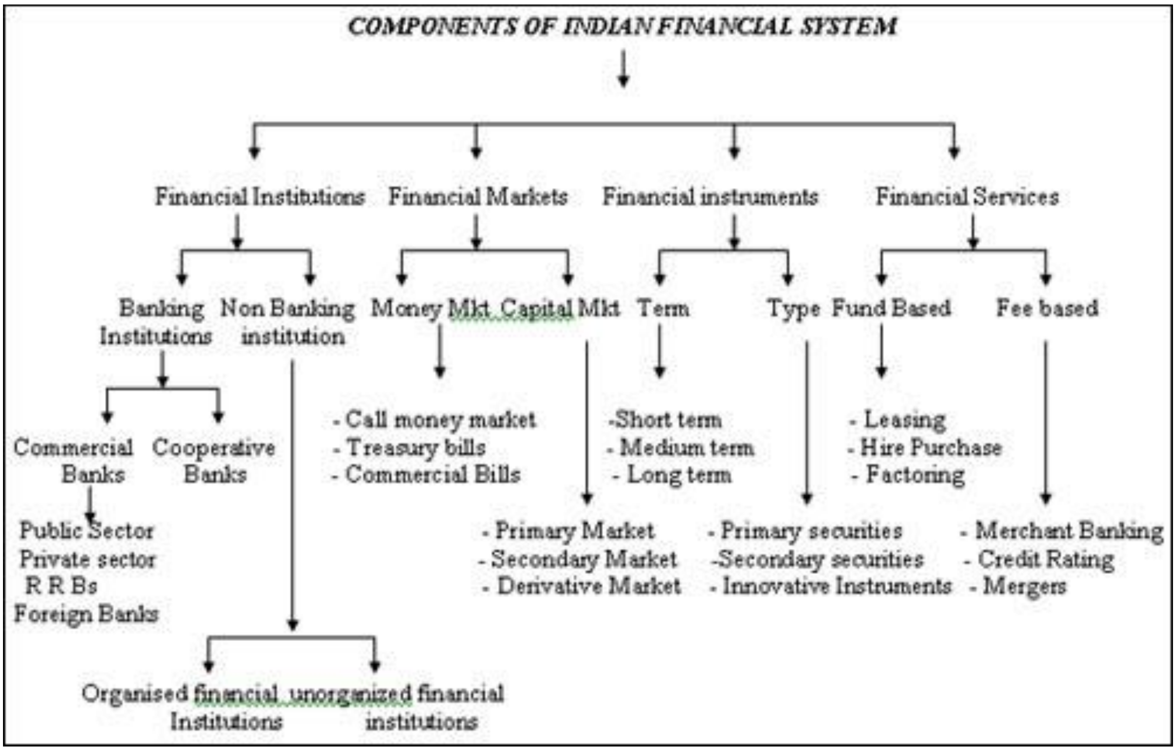

Fig 22.1 Overview of Indian Financial system:

Next section covers the details of constituents of Indian Financial System.

22.4 FINANCIAL INSTITUTIONS

Financial Institutions plays the role of collecting deposits from the depositor and passing them to the borrowers or investing them in bonds, share markets and other investment avenues. They act as intermediaries of financial markets and promote ease of financial transactions.

Financial Institutions are segregated into two categories;

Banking and Non-Banking financial Institutions: Banking Institutions plays the role of collecting deposits from the people in return for interest and distributing the money to customers in the form of loans. In India banks are segregated into Private Banks, Public Banks and Foreign banks further segregation is done on the basis regional and cooperative banks.

Example: Public Bank like SBI, Private bank like HDFC, Foreign Banks like HSBC.

Non Banking Financial Institutions: This includes those financial firms which cannot collect direct money from the customers instead they sell financial products to customers like mutual fund companies , insurance firms and other brokerage firms.

Financial institutions are further classified into:

Regulatory institutions: These are formed to keep a vigil on financial institutions like SEBI (Security exchange board of India), AMFI (Association of Mutual Fund Industries) etc.

Intermediaries are commercial banks like SBI, Bank of India etc which take money in the form of deposits and lend them to customers in the form of loans.

Non Intermediaries: This segment include those banks which lend money only to corporate or for agriculture business, they don’t take money from the individual consumers and don’t perform normal banking activities. Example like NABARD(National Bank for agriculture and rural development), SIDBI(Small industrial development bank of India) etc.

Commercial Banks in India are majorly of three types:

Public Banks: Public banks are those banks which are run by government and where government hold the major stakes. Reserve bank of India is the central authority for public banks, few example of Public banks are State bank of India, Bank of India, Punjab National Bank etc.

Private Banks: Private Banks are fully or partially managed and operated by private bodies and institutions here majority stakes are with private holders. Some of the example of Private Banks is ICICI bank, HDFC bank etc.

Foreign Banks: This segment includes those banks which have their head office in some other countries and they have branches all over the world like HSBC bank, Citi bank etc.

22.5 FINANCIAL MARKETS

Financial Market includes those segments where financial products are bought and sold like shares, Bonds, Treasure bills etc.

Financial Markets are broadly segregated into two segments:

Money Market and Capital Markets:

Money market deals in short term and highly liquid securities which have a maturity period of less than one year. This market deals in certificate of deposits, Notes, Commercial papers and T-bills.

Capital Market on the other hands deals with security having a maturity period of more than one year or which are not so highly liquid, here those securities are issued which can be traded. Capital markets helps in collecting funds for investment it includes primary market where new securities are traded and Secondary market where old securities are traded. Capital market is characterised by number of participants including standalone investors and corporatized investors namely mutual funds, pension funds, govt. funds, hedge funds and other institutional investors.

Bond Market: It is security having fixed rate of interest issued by corporates to raise funds from the market.

Stock Market: It represents a market place where trading of shares of listed entities takes place. It is secondary financial markets where trading of already issued securities takes place.

Forex Market: This market represents trading of currencies at global level takes place. This market is quite liquid in nature.

Derivative Market: Derivatives are securities whose price is determined by an underlying asset. It includes futures, forward and spot trading.

22.6FINANCIAL INSTRUMENTS

Financial Instruments includes those assets which are traded in markets. These are formed with the objective of generating capital. They function as a contract between lenders and borrowers. Financial Instruments can be traded in the form of cash, tradable security or it can be in the form of part ownership.

22.6.1 TYPES OF FINANCIAL INSTRUMENTS

Financial Instruments are divided basically into two types i.e. on the basis of term and type. Here term denotes short time period instruments less than one year, medium term instruments which have a longer maturity between one to five years and very long term instruments maturity of more than five years. Example of Short term is treasury bills, commercial papers etc and for long term is bonds, loans etc.

Financial instruments are further classified into cash instruments and derivatives instruments. Cash based instruments derive their value directly from the market whereas derivatives instruments derive their value from the underlying instruments. Financial Instruments are also segregated into debt and equity on the basis of liability which they carry with them.

Debt instruments denoted loan and they carry liability of payments whereas equity denotes shares and the liability of payments is not attached with ordinary shares.

Types of securities:

Primary Securities:

Primary securities are those securities which are issued for the first time by the companies or by the government. They can be in the form of shares or bonds and these securities derive their values directly on the basis of markets. These types of securities are trade in the primary markets or new issue markets. Here company sell securities directly to investors in the form of IPOs (Initial Public Offerings)

Secondary Securities: This includes those securities which are already in the market and are getting traded. These securities are sold by the investors and are traded in the secondary markets. Like shares which are already issued and getting traded in stock markets.

Derivatives Securities:

Derivatives are those securities which are traded and which derive their value from underlying instruments. There are different types of derivatives like forward, futures, options and swaps.

22.7FINANCIAL SERVICES

This included the services which are provided by the professionals for management, investments and providing assistance for other financial matters. This help in getting a better and sound aid in organizing financial issues.

There are basically two types of Financial Services

1) Fund based
2) Fees Based

Fund Based Services:

Leasing:

Large business requires heavy investment in the form of plant, machinery, building etc; businessmen often become apprehensive of making or blocking such heavy investments. So they resort to financial service like leasing and Hire purchase.

Leasing is a method where large equipments like machineries or even land are taken on rent in the form of lease by the owners. In lease there are two parties' lessor who is the owner of the product and lessee who uses it and the contract between the two is called the lease contact.

Characteristics of lease:

1) Person can use the product without actually buying them.
2) Lease is generally for long period of time
3) Leases are in the form of professional contract.
4) Leases are done in exchange of certain charges.
5) Ownership remains with the lessor.

Hire Purchase:

Hire purchase is the method of buying the product on payment of instalments and ownership of goods is not transferred until the buyer pays the last instalment.

Example: Mr X want to buy a photocopy machine worth Rs 100000 from Mr Y. Mr X makes a condition with Mr Y that he will buy the good on instalments of Rs 110000 for ten months and till the payment of full money ownership of good will rest with Mr Y but Mr X will use the good and on paying the last instalment i.e. tenth instalment good will get transfer to Mr X.

The benefit of Hire purchase is that goods can be bought without payment of whole amount in a single time and also if in any condition the buyer is not able to make the instalments he can return the goods as ownership is not transferred.

Difference between Hire Purchase and Leasing:

Ownership:

In hire purchase ownership is transferred on the payment of last instalments whereas in lease ownership remains with the lessor and lessee can only use it.

Rental Payments:

In lease the rent include only the cost of using the product whereas in hire purchase the cost includes both principles as well as interest.

Time of Contracts:

In leasing the contracts are of longer duration whereas in hire purchase contracts are of comparatively shorter durations.

Tax:In the lease agreement, the total lease rentals are shown as expenditure by the lessee. In hire purchase, the hirer claims the depreciation of asset as an expense.

Repairs and maintenance: Repairs and maintenance lies with the lessee whereas in hire purchase repairs and maintenance lies with the hirer.

Amount of Finance: In leasing there is no down payment whereas in hire purchase there is a down payment.

Factoring:

Factoring is a financial service where a company sells its bill receivables to third party for collection. Third party makes immediate payments to company after charging commission or fees.

Suppose Company ABC sells goods on credit to Mr X for Rs 20000 on the condition that Mr X will make payment after 2 month. Now due to some unwanted situation company require the payments one month before so in that case they will sell the bill to factoring or third party, this third party will make the payment to Company ABC on behalf of Mr X and later than this factoring company will collect the payment from Mr X.

There are three parties in factoring i.e. the one who sell the receivables, the factor and debtor.

Types of Factoring:

Resource and Non resource factoring

Resource factoring: In recourse factoring factor provide full payment to the client irrespective the amount they receive from the debtor. They provide guarantee for non payment of debt.

Non resource factoring: In Non recourse factoring bad debt are not covered if payments are not received from the debtors than in that case such receivables are returned back to the company.

Fee Based Services:

Merchant banking:

Merchant banking is different from retail banking operations. It is basically providing wholesome banking and consultancy services to business firms. It involves managing their financials as well as taking strategic decision making for them. Merchant bankers are not only lenders but they also undertake activities like underwriting, registrar of issues, restructuring of business, executing business memorandums etc.

Merchant banking was first introduced by Grindlays banks in 1967.

These bankers are referred as Investment bankers in USA.. The notification of Ministry Of Finance in India defines Merchant Banker as "any person who is engaged in the business of issue management either by making arrangements regarding selling, buying, or subscribing to the securities as manager, consultant, adviser in relation to such an issue management".

Below mentioned are the major services offered by Merchant Bankers;

- Programme Management
- Debt Restructuring
- IPO management
- Managers, Consultants or Advisers to the Issue
- Underwriting of Public Issue
- Portfolio Management
- Financial Restructuring
- Off shore business management
- Non-resident financial services
- Loan Syndication
- Corporate Counselling and advisory services
- Placement and distribution

Credit Ratings:

- A Credit Rating Agency is a company that assigns ratings to the debtors according to their ability to pay back the debt in timely manner.
- These agencies provide highly essential risk assessment reports and analytical solutions and assign a definitive credit score to both individuals as well as organizations. These reports are considered important for getting the loan.
- Following are the Credit Rating Agencies of India:
- Credit Information Bureau India Limited (CIBIL)
- Credit Rating Information Services of India Limited (CRISIL)
- Investment Information and Credit Rating Agency of India (ICRA)
- Credit Analysis & Research Limited (CARE)
- Onida Individual Credit Rating Agency of India (ONICRA)
- Small and Medium Enterprises Rating Agency of India Limited (SMERA)
- Brickwork Ratings India Private Limited
- Equifax Credit Information Services Private Limited (ECIS)
- Experian India

Mergers:

Merger means when two companies are merged into one. Financial firms provide all kind of financial assistance to firms in their merger talks like the conditions of mergers, formalities related to mergers and also some time the cost specifics related to mergers.

22.8MAJOR CONTEMPORARY ISSUES IN FINANCE

Banking and the financial system is going through a great transformation, a lot of changes are taking place in the financial system with the advent of technology and globalization. Banking sector has also seen a great transformation after the banking sector reforms of 1990. List of certain contemporary issues which are prevailing in the current financial system are summarized below:

1) Banking Sector reforms: Post 90 and pre 90 has seen a great transformation in the banking sectors reforms, like asset classification and income recognition norms, interest deregulation, lowering of statutory liquidity ratio and cash reserve ratio as recommended by Narshimham committee. The period saw banks moving beyond brick and mortar branches to adopt innovative delivery channels including internet banking, ATMs, call centres, kiosks, Business Correspondents (BCs), etc. New products such as retail banking gained prominence. Banks have sought to grow, not just in terms of balance sheet size, but also in terms of greater penetration of banking services to the hitherto unbanked segments of the population. It is reasonable to say that banks have succeeded in rising up to the challenges posed by the unique needs of a transforming economy and have, in no small measure, contributed to the nation's economic progress

2) Globalization: Globalization and integration of economies have also affected the financial markets as market becomes more prone to financial crisis and competition from world markets.

3) Increased level of default loans: Increased competition and frequent distribution of loans created the problem of high nonperforming assets which is creating a dent on the performance of banks in the longer run.

4) Financial Crisis: As economies are linked and any disturbance in one economy affect the others financial system, thus financial system are more prone to contagious effect of financial crisis for example Greek financial crisis, U.S subprime crisis.

5) Technological Advancement: Banking and financial sector is going through a technological advancement phase like digitalization of Indian banking system and use of online portal for payments thus up gradation of banking system is required.

6) Moving toward Universal Banking: We are slowly moving toward the concept of small number of large banks rather than from large numbers of smaller banks. This concept will not only reduce the default and underperforming banks but will also strengthen the capital base of banking structure.

7) Strengthening of Regulatory framework: Financial markets in India have evolved, as has the regulatory framework for them, historically in the context of a primarily bank-dominated financial system. It was only after the financial reform process was initiated in the early nineties and the regulation of banks started getting aligned to the international best practices that gradually different market elements were introduced as part of the market development agenda. This agenda focused, first and foremost, on putting in place the requisite market microstructure in terms of institutions, technology, market participants and appropriate regulations

8) Goods and service Tax: Financial market is going through the phase of GST implementation. Good and service tax is an indirect tax which is designed to reduce the cascading effects of different types of indirect tax. Its proper implementation and fixing adequate tax rate is a prime issue for the economy.

9) Financial Market cyber crimes: Financial market is always prone to cyber fraud like online theft, ransom attack so safeguarding the financial sector and preventing such attacks is a revolving issue for the financial sector.

10) Inflation and its affect on financial market: Economic conditions and rising inflation is also one of the issue from which financial sector is suffering so combating inflation and macro issues is also one of the issues of financial markets.

11) Introduction of Crypto Currency like Bitcoins,Ethereum etc. These are crypto currency which are made through complex computer networks and are used are payment only at recognized medium.

12) Microfinance and crowd funding: Microfinance is a very important aspect of financial inclusion. It involves lending micro credit services to poor section of the society who are distanced from traditional banking services. Microfinance service providers are categorised as non banking financial corporates who operates limited banking services to bottom of the society in affordable manner by providing loans through self help groups and is actively involved in raising the living conditions by infusing the some characteristic of earning their livelihood.

    Peer-to-peer lending over the e-medium is another advancing trend in the financial sector, to which the fundamentals of microcredit have also been suffixed in addressing poverty as well as various non-poverty-related dogmas. Such efforts include platform based, a term describing the collective effort of individuals who network and pool their resources to support charities initiated by other people or organizations. The rules for crowd funding are still being evaluated, and the Securities Exchange Commission is taking due considerations in formalising a plan for it.

Check Your Progress-A

Q1. What are the major services provide by Merchant Bankers?

Q2. Why Micro finance is important for an economy?

Q3. What is Crowd Funding?

22.9 SUMMARY

Thus what we can learn from this unit is that first our financial system depend upon financial institutions, financial products, and financial services, secondly with increased competitions and globalization we have seen a lot a changes in our financial system like changes in our banking system for example expansion of branches, increased use of ATM online mode of transaction, introduction of new norms like bankruptcy laws ,amendments in banking Act, introduction of new branches and introduction of private banks.

We have also witnessed a huge surge in both financial products and services like introduction of innovative products and services, increased in insurance and other investment avenues. We have also witnessed huge development both in the development of capital and financial markets. Apart from this other issue like financial inclusion; digitalization and consumer financial awareness is also one of the emerging issues of Indian financial market.

22.10 GLOSSARY

Stock Market: It represents a market place where trading of shares of listed entities takes place. It is secondary financial markets where trading of already issued securities takes place.

Forex Market: This market represents trading of currencies at global level takes place. This market is quite liquid in nature.

Derivative Market: Derivatives are securities whose price is determined by an underlying asset. It includes futures, forward and spot trading.

Cryptocurrency: A cryptocurrency (or crypto currency) is a digital asset designed to work as a medium of exchange

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9. R P Rustagi-Financial Management (Galgotia, 2000, 2nd revised Ed.)
10. Lumen Boundless Finance (Trends and Issues in Finance)

22.13 TERMINAL QUESTIONS

Q1. Evaluate the emerging contemporary issue of finance in detail.

Q2. Discuss the financial system of India in detail covering all the aspects of Indian Financial System.

Q3. Pen down the difference between leasing and hire purchase

Q4. What do you understand by the term factoring and forfeiting.

Q5. Define the concept of Merchant banking with practical Example

Q6. Write a short note on Goods and Service Tax.