Financial Services: A Key to Economic Growth of India

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Investor has been attracted to India mainly on account of its robust economic growth of over 8% for the major part of the last decade. Given that the country possesses demographic advantage, is consumption driven and a developing economy which has witnessed healthy economic growth, foreign investors see potential in the country. Indian growth story is not too great at the moment. The country economy has been witness to a downturn in recent years with growth falling to 4.5% in 2012-13. Hence, more importantly in order to make India a global financial centre we need to first recuperate confidence of the foreign investors and reassure them about India's growth story. For foreign investors to continue favoring the country India would need to record higher economic growth rates.

In order to revive the Indian economy a numbers of steps need to be initiated-

a. Revive investment in the economy by ensuring that plans get translated into action.

- Investments/ projects in the country are known to be delayed/stalled/ abandoned owing to want of numerous clearances and permissions, resulting in cost over runs. Investments totaling Rs. 8,450 bn were dropped in 2012-13 alone. Government needs to play an active role by providing the essential/necessary framework for investments.
- Stating that the slowdown in Indian GDP growth is due to the sluggish investment cycle, India has the potential to become the emerging market once investments revive. Hence, in order to revive growth, the economic priority must change to creating investment demand rather than creating consumption. The investment – led growth will drive the consumption demand while the consumption led- growth will not necessarily lead to investment growth. Hence, there is a need to ensure that plans need to get translated into action with faster clearance/ approvals of planned investments projects by the government. Thus, all that is required to be done is to unlock the Rs.10 lakh crore worth projects, which are awaiting government clearances.

b. Keep the fiscal in order which is a prerequisite for growth kicking off

- Relatively high social expenditure has limited the amount of capital investments undertaken by the government.
- The share of capital expenditure in total expenditure has declined from 23% 2004-05 to 12% in 2012-13 and 14% in 2013-14. Lower capital expenditure impacts future economic growth prospects of the country
- Hence, there is a need to plan the fiscal expenditure with a more growth oriented approach.

c. Open the economy to FDI: retail, insurance and Provident Funds potential segments

- During the financial crisis 2008/09, our fiscal deficit was just 3.5% but the world was in crisis. India had an opportunity to set up manufacturing and increase investment. However, investors are shying away from India with regulations becoming increasingly difficult and inconsistent feeling that the survival in this market is tuff. Besides, the FDI caps across various sectors also constrain the flow of funds into the economy.

d. Concentrate on improving supply chains in agriculture to ensure that agricultural production remains robust which will ensure that inflation is manageable.

- Supply chain/structural inadequacies are the major impediment impacting agriculture. This was highlighted this fiscal as despite having a favorable monsoons and good production the country faced very high food inflation (nearly 19% in Nov'13).

e. Give specific incentives to revive manufacturing so that this sector which has been stagnating in last two years picks up. Here we need to emphasize that SMEs are to be targeted given their contribution to GDP, exports and employment.

- For SMEs access to finance at favorable rates

- Tax incentives
- Provide infrastructure- power, roads connectivity, etc.

e. Have a transparent policy for foreign investors: no retro taxation.

- Investment policies should be clear and transparent
- There should be no going back on policies. This discourages potential investors. E.g.: retrospective taxation: Vodafone

Once we get the house in order, we need to ensure that investors see India as a sound financial hub-

1. Clean up balance sheets of banks and create size.-

- Gross non-performing assets, (NPAs) have increased from 2.94% as of 31st Mar'12 to 3.42% 31st March 2013. In absolute terms they increased from Rs.1,371 bn to Rs.1,838.5 bn. Would cross 4% this year.
- Number of corporate debt restructuring cases up to 31st Dec'13 stood at 443 aggregate amounting to Rs.89,298 crs. as against in 363 cases against Dec'12 aggregate Rs21,1978 cr.
- We must think of expanding the size of banks and make them globally competitive. Bank mergers the clue here.

2. Revive debt market-

- Corporate bond market is illiquid.
- Low participation. Get in insurance and pensions.
- Only higher rated bonds are traded in the market.
- Rationalize stamp duty across states.

3. Reinvigorate the stock market

- FII that drive market. Retail participation lower and domestic institutional investors.
- Lower cost of disclosures and ensure transparency.
- Strict insider trading laws.

4. Focus on building derivative market in bonds and commodities.

- The commodities derivative market in the country sees various bans imposed from time to time. This coupled with low financial literacy inhibits thedevelopment of this segment. Likewise for bonds to participation is low. Suitable products and knowledge dissemination needed to build these markets.
- Brought in IRFs, need to make them work.

Role of financial markets

A) Financial markets play a critical role in helping achieve one of the key goals –sustainable and inclusive economic growth. Not only do the financial markets support the economy, but the financial services firms operating within the sector play an extremely important role in contributing towards the output of the economy and create employment on a large scale. It is noteworthy that the importance of financial services in a modern economy means it is essential that financial structure and reforms support economic growth and in turn help to build a competitive financial system domestically as well as globally. In terms of growth across sectors i.e. primary, secondary and tertiary, a wide range of companies thrive on the financial services which –

- Help them raise money for investing in the growth and development of their businesses
- To take advantage of a wide range of products offered by the financial markets that help them to manage business risks such as fluctuating interest rates as well as exchange rates; and
- To access products/ services that enhances stability and efficiency of their financial management.
- In addition, banking, savings and investments, insurance, and debt and equity financing help to save money, guard against uncertainty, and build credit, while enabling business to start up, expand, increase efficiency and compete in

local and international markets. In India, the financial service sector contributes between 15% to 20% of the total gross domestic product. Despite their potential, to date the impact of large commercial banks on expanding economic opportunity has remained limited in the country, due to insufficient information, inappropriate products, inadequate infrastructure and inflexible regulatory environments has kept costs elevated and therefore prices, high, limiting companies markets to clients within the top tiers of the economic pyramid. Hence, India being one of the larger economies, undoubtedly there is a need to explore the potential for expanding the financial service sector and supporting growth in the country and become a global financial hub.

What is a global financial centre?

A global financial centre comprises of intense concentration of a wide variety of international financial businesses and transactions in one location.

What does it require to build up such a global financial centre?

In order to understand the requirements for establishing a global financial hub it is essential to identify how participants choose to place business in a financial centre. Participants seem to choose to place their transactions and their businesses based on a number of criterion. Some of the interesting points to note are-

- Any tax oriented approach faces major difficulties in attracting participants.
- A criterion which is strong and important today is the availability of skilled personnel. As an international financial centre grows staff gains skills and move jobs, the availability of skilled staff grows, thus enabling further growth of the international financial centre. Soon, aspiring financial services jobseekers begin their careers by moving to the international financial centre. Besides, these also have an impact on the operational cost.
- The second most important and competitive factor is the favorable 'regulatory environment'. Business is transacted where regulators permit.
- Access to international financial markets
- Availability of business infrastructure- The availability of business infrastructure ranked as the fourth most important competitive factor for international financial centers. The business infrastructure of a city comprises of several components including telecommunications and IT infrastructure as well as transport links. In addition basic infrastructure such as lack of electricity and water supplies may seem to prevent development financial services clusters.
- A fair business environment -It needs to be viewed as place of fair dealing and regulation for locals and overseas participants. It also requires being a liquid domestic economy.
- Access to clients- access to customers is actually more important than access to the markets.
- Role of government- level of support from the government to the concerns of the industry is an essential factor.
- Taxation Policy in the country
- Operational costs
- Access to professional services: From the point of view of large financial services firms, banks asset managers and insurance companies, having your accountants and lawyers on the doorstep is essential.
- Quality of life- there is a need to have an attractive living and working environment in terms of leisure facilities & culture, healthcare facilities, schools & colleges, transport system, residential property and personal tax regime.
- ***Credit ratings***

Role of Credit Rating Agencies-

CRAs form an integral part of the international financial landscape, whose function is designed to reduce information asymmetries between lenders and borrowers by determining the ability and willingness of potential borrowers to meet their debt servicing obligations. Eventually, CRAs lower cost of intermediation, thus supporting economic and development activities.

Presently, the scale and complexity of financial intermediation has grown, so too has the demand for information. CRAs are no longer primarily concerned with sovereign and corporate bonds, but also consulting on the design of complex assets. Their evaluations can make or break a deal or at least significantly influence the costs and risks of its financing.

B) Key initiatives of Gujarat State Government in development of financial services and boost economic activities

- The state of Gujarat has been the most proactive state in the country with a strong emphasis on infrastructure. The visionary idea of Gujarat Government of GIFT continues to attract interest of large banks globally. This will contribute to creation of employment opportunities for skilled professionals in the area of banking and finance. The initiative of GIFT also shows a positive approach on the FDI. The initiative has created interest of multiple nations, international & private, scheduled and private banks in the project and agrees to invest in the growing FS sector and GIFT as global financial hub. The growth of the industry in turn being dependent upon financial service sector, the GIFT initiative shall thus contribute to economic growth.
- Gujarat government introduced slew of incentives to infuse new life into the textile industry. It introduced interest subsidy for value-addition chain from ginning to spinning, weaving, processing, garment manufacturing and technology up-gradation, Refund of VAT on expansion of existing and new units in spinning and readymade garments; Power tariff concession for new cotton spinning and weaving units; Financial assistance to skill development centers for textile industry; Financial assistance for technology acquisition for value chain; and Support for energy and water conservation and environmental compliance in order to establish Gujarat's unique identity at national and international market. In turn the unit setting up facilities here would practically have zero interest cost when government subsidy is factored in.