The role of Banking and Financial Services industry in economic recovery

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Abstract

The current economic crisis sweeping the world is different in character from previous crises. It is marked out by its depth and likely prolonged duration, its global reach and influence, and by the structural implications it has for the world’s financial systems and investment regimes. It has also come at an important time in the evolution of the global economy and is likely to accelerate some processes of change which are already in train. It will give rise to profound hardship in many parts of the world, with uncertain consequences at this point. The uncertain nature of the crisis adds to its challenge, and gives rise to a need for leadership internationally, nationally, and locally.

Financial service industry

Financial services industry is the emerging sector in the domestic as well as world economy. The introduction of new financial products brought with them complex dealing procedures and inherent risk. Essentially, the dealing staff should be conversant with the rules and regulations in order to ensure compliance.

Financial Services are the economic services provided by the finance industry, which encompasses a broad range of organizations that manage money, including credit unions, banks, credit card companies, insurance companies, accountancy companies, consumer finance companies, stock brokerages, investment funds and some government sponsored enterprises.

Financial services refer to services provided by the finance industry and it encompasses a broad range of organisations that deal with the management of money. It is an umbrella category that encompasses a variety of services, including banks, insurance companies, asset management companies, credit card companies, consumer finance companies, stock brokerages, investment funds and government sponsored enterprises. India has one of the most developed financial services markets in the developing world. Top companies from the United Kingdom and the United States among others are already active in India’s financial markets. Some of the big names are: Merrill Lynch, Oppenheimer, J.P. Morgan, Morgan Stanley, Grindlays, Standard Chartered, Hong Kong and Shanghai Banking Corporation among others. Local financial Institutions such as the Industrial Development Bank of India (IDBI), Industrial Credit and Investment Corporation of India (ICICI), Industrial Finance Corporation of India, Unit Trust of India and the Shipping Credit and Investment Corporation of India have raised billions through the most sophisticated financial instruments including Deep Discount Bonds. The two segments that constitute the major part of the Indian financial services industry are Banking and Life Insurance.
Commercial banking services

A commercial bank is what is commonly referred to as simply a bank. The term commercial is used to distinguish it from an investment bank a type of financial services entity which, instead of lending money directly to a business, helps businesses raise money from other firms in the form of bonds or stock.

The primary operations of banks service include:

- Keeping money safe while also allowing withdrawals when needed
- Issuance of chequebooks so that bills can be paid and other kinds of payments can be delivered by post
- Provide personal loans, commercial loans, and mortgage loans (typically loans to purchase a home, property or business)
- Issuance of credit cards and processing of credit card transactions and billing
- Issuance of debit cards for use as a substitute for checks
- Allow financial transactions at branches or by using Automatic Teller Machines (ATMs)
- Provide wire transfers of funds and Electronic fund transfers between banks
- Facilitation of standing orders and direct debits, so payments for bills can be made automatically
- Provide overdraft agreements for the temporary advancement of the Bank's own money to meet monthly spending commitments of a customer in their current account.
- Provide internet banking system to facilitate the customers to view and operate their respective accounts through internet.
- Provide Charge card advances of the Bank's own money for customers wishing to settle credit advances monthly.
- Provide a check guaranteed by the Bank itself and prepaid by the customer, such as a cashier's check or certified check.
- Notary service for financial and other documents
- Accepting the deposits from customer and provide the credit facilities to them.
- Sell Investment products like Mutual funds etc.

Investment banking services

- **Capital markets services** – Underwriting debt and equity, assist company deals (advisory services, underwriting, mergers and acquisitions and advisory fees), and restructure debt into structured finance products.
- **Private banking** - Private banks provide banking services exclusively to high-net-worth individuals. Many financial services firms require a person or family to have a certain minimum net worth to qualify for private banking services. Private banks often provide more personal services, such as wealth management and tax planning, than normal retail banks.
- **Brokerage services** - Facilitating the buying and selling of financial securities between a buyer and a seller.

Foreign exchange services

Foreign exchange services are provided by many banks and specialist foreign
exchange brokers around the world. Foreign exchange services include:

- **Currency exchange** - Where clients can purchase and sell foreign currency banknotes.
- **Wire transfer** - Where clients can send funds to international banks abroad.
- **Remittance** - Where clients that are migrant workers send money back to their home country.

**Investment services**

- **Asset management** - The term usually given to describe companies which run collective investment funds. Also refers to services provided by others, generally registered with the Securities and Exchange Commission as Registered Investment Advisors. Investment banking financial services focus on creating capital through client investments.
- **Hedge fund management** - Hedge funds often employ the services of 2prime brokerage divisions at major investment banks to execute their trades.
- **Custody services** - The safe-keeping and processing of the world's securities trades and servicing the associated portfolios. Assets under custody in the world are approximately US$100 trillion.

**Regulation of financial services**

Ever since the Indian economy began opening up and liberalising, investors have suffered losses because financial regulators were unwilling, unable or poorly staffed to correct weaknesses in the institutions, systems and processes in Indian financial services.

Non-performing assets were the result of lending directed by government, on contact considerations, and a debtor-friendly definition of a non-performing asset. When NPAs were redefined, many 'good' loans suddenly became bad or non-performing.

**Implement changes in financial services sector**

The financial services sector could be in for exciting times, if proposals now on the table are anything to go by. Many changes are being proposed and if these get implemented, the sector is in for massive churn. Spoiler alert: some legal hurdles could still play spoilsport. First out of the gates is likely the issue of new bank licences. A range of new players is likely to get a shot at opening new banks. Banking is still considered a coveted business segment in India despite many risks.

**Financial services next engine of growth**

India has said its growth story, steered mainly by IT and telecom so far, will shift gear towards financial services to drive expansion. "It is our intention to make financial services the next growth engine for India," finance minister P Chidambaram said at ICICI Securities Investor Conference here on Thursday. As the economy becomes more open and trade intensity increases, big financial flows would be intermediated in the country.
Banking service industry

The banks’ role as financial intermediaries has a major bearing on how efficiently the economy allocates its resources between competing uses. In considering efficiency, we are interested in whether lending activity helps resources flow to their “best use” or whether some sectors get too little or too much credit relative to what is needed for the economy to perform at its best. We are also interested in whether lending and other financial activities are provided in a cost effective manner from the point of view of consumers and the degree to which the banks improve and innovate their financial products and services over time.

All else equal, a well-managed bank acting prudently and operating in a reasonably competitive market will be making credit available at an appropriate price to creditworthy borrowers. However, in concentrated banking systems dominated by a handful of large banks, competition may be lacking. Households and firms may end up paying more to access credit (and other bank services) than in a more competitive system.

The rapid eruption of the global financial crisis in the last quarter of 2008 has extensively affected both the global and Thai economies, leading to the deterioration in demand for exports as well as business and consumer confidence. As a result, there had been a drastic decline in credit outstanding of financial institutions since the start of 2008, induced by (1) heightened risk aversion of financial institutions and consequently a drop in loan supply, and (2) weakened demand for loans during the economic slowdown. Nevertheless, the November data suggest that there have been positive developments in the credit market, signaling tentative signs that the banks, deleveraging process may have come to an end:

1. The private credits provided by commercial banks expanded from the previous month in a wide range of sectors, including the business loans that had been falling since the beginning of the year. Household credits also continued to grow, with outstanding household credits in all categories already reaching their pre-crisis levels.

2. Despite leaving the reference loan rates unchanged since mid-2009, some commercial banks had recently been lending at a discount (as shown in chart 1), implying a higher degree of price competition in the loan market.

3. According to the latest survey taken in 2009 Q4, most senior loan officers were of the view that the demand for both business and household loans would continue to grow into the first quarter of 2010. They also expected the credit standards to be eased significantly.

4. Liquidity in the commercial bank system remains ample and sufficient to accommodate the expansion of demand for credits looking ahead.

The Indian economy will require additional banks, and expansion of existing banks to meet its credit needs.

Life Insurance

The Indian life insurance industry is estimated to grow at a compounded annual
growth rate (CAGR) of 14.1 per cent, and reach US$ 111.9 billion in 2015 from US$ 66.5 billion in 2011, according to a report by BRIC data. This would make India the third-largest market for life insurance in the world by 2015. India’s present position is at number 12, among top global markets for life insurance. Number of policies sold is expected to increase to 85.21 million in 2015 from 53.23 million in 2010.

**Health Insurance**
In the non-life insurance industry, health insurance is the second largest segment in India; with players in both the public and private sectors playing an active role. The industry is concentrated around 4 major public sector companies namely, New India Assurance, United India Insurance, National Insurance and Oriental Insurance.

The Indian health insurance industry has seen major growth in the past 6 years. The Indian health insurance industry is expected to grow at a CAGR of 37.2% from FY’2011 - FY’2016; with surging medical costs, rising population and increased awareness among consumers in the country.

**Challenges in BFSI**
The banking and insurance industry is challenged by competitive pressures, changes in customer loyalty, stringent regulatory environment and entry of new players, all of which are pressuring the organizations to adopt new business models, streamline operations and improve processes.

**Role of banking and finance industry in economic recovery**

The financial services industry plays a critical role in supporting UK businesses and enabling the UK's economy to grow. The products and services it offers are a significant part of the UK economy in their own right, and form one of our few world-class sectors.

The importance of financial services in a modern economy means it is essential that financial reforms support economic growth and help to build a competitive and resilient financial system that is free from taxpayer support and is co-ordinated internationally. The CBI's unique cross-sector voice speaks on behalf of the users of financial services as well as firms from across the financial services sector.

- There is growing optimism that both the world economy and the banking industry are recovering from the impact of the financial crisis.
- But the financial world has changed permanently, both in terms of the balance of power within the industry and how banks will be allowed to operate in future.
- Banks in emerging markets are now well capitalised and well funded and big enough to compete directly against their western counterparts in the global marketplace. They have greater potential for growth because of the relatively immature development of their domestic financial markets and their rapidly growing economies.
- But regulation will become an issue in the emerging markets just as it is in the more established western markets and may result in a return to more traditional business models.
- However, the regulatory environment will differ greatly from one country to
the next.

- The stronger role of national governments within banking means the future model for banking and corporate governance is likely to be a hybrid of a regulated free market approach and so-called ‘state capitalism’.
- A key challenge lies in the dichotomy that financial markets are increasingly global while regulators are predominantly national. Greater international cooperation will therefore be needed to improve the stability of the global financial system.
- The dominant role of the US dollar and of the US banks is set to give way to a world where other countries, their currencies, their capital markets and banks, all play a greatly enhanced role. This structural shift will offer both opportunities and threats.
- Perhaps the biggest lesson from the crisis is that banks all around the world have learnt that they must co-operate more.
- The financial crisis has demonstrated the need for banks to understand their business models together with the associated risks and to have confidence that performance indicators and executive incentives reinforce desired behaviours. Through their skills in providing high quality business information, management accountants should be at the forefront of meeting this need and thus contributing to the long-term sustainable success of their organisations.

**Banks and financial (in) stability – making the system safer**

Transforming short term deposits into longer term lending – one of the most important functions that banks perform for the rest of the economy – is also what makes financial systems prone to fragility. This process exposes banks to illiquidity or possibly insolvency given the possibility of bank runs from depositors and creditors, or deterioration in lending quality. Banks’ own practices and financial regulation have an important bearing in reducing or amplifying this risk. For example, banks have choices around how much debt they use to fund their lending (leverage), while the quality of that lending is influenced by a number of governance-related factors. These include the control that creditors and shareholders exert over bank managers, as well as the internal risk management systems of the bank. Regulations also set boundaries on what banks are able to do. Given the interconnections between a bank and the rest of the economy, the effects of a bank in stress or failure can potentially spill over to the wider financial and economic system when financial savings cannot be accessed, the credit intermediation process is disrupted or the transactional role via the payments and settlement systems is undermined. The extent of such contagion will depend on the “systemic importance” of the bank, which will be roughly related to its size, the nature of its exposures, inter linkages with other banks and so forth. Governments are naturally reluctant to see such important institutions fail since economic crises that are accompanied by major banking crises are typically far worse than usual business cycle slowdowns. However, as we have seen from the experience of Ireland and Iceland, supporting stressed banks can create major fiscal problems, particularly if the banking system is very large relative to the size of the economy. A banking crisis can evolve into a sovereign debt crisis, which itself can have cross-border contagion effects.

**References**


