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Economic Institutions and Financial Advancement of India

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Abstract
Economic development is the primary objective of the majority of world nations. This truth is accepted almost without any controversy. Financial sector plays an indispensable role in the overall development of a country. The most important constituent of this sector is the financial institutions, which act as a conduit for the transfer of resources from net savers to net borrowers, that is, from those who spend less than their earnings to those who spend more than their earnings. The financial institutions have traditionally been the major source of long-term funds for the economy. These institutions provide a variety of financial products and services to fulfill the varied needs of the commercial sector, new enterprises, small and medium firms as well as to the industries established in backward areas. Thus, they have helped in reducing regional disparities by inducing widespread industrial development. The Government of India, in order to provide adequate supply of credit to various sectors of the economy, has evolved a well-developed structure of financial institutions in the country. These financial institutions can be broadly categorized into All India institutions and State level institutions, depending upon the geographical coverage of their operations. Financial Institutions plays a vital role in the development of developing countries because they can solve their problems of general poverty, unemployment, backwardness, low production, low productivity and low standard of living etc. by providing variety of financial instruments and securities. This paper covers the types of financial institutions pre and post Liberalization, their impact on industry, and opportunities for the country for the development.

Keywords: Economic Development, Financial Institutions, Liberalization,.

Introduction

Financial sector plays an indispensable role in the overall development of a country. The financial institutions have traditionally been the major source of long-term funds for the economy. These institutions provide a variety of financial products and services to fulfill the varied needs of the commercial sector. Besides, they provide assistance to new enterprises, small and medium firms as well as to the industries established in backward areas. Thus, they have helped in reducing regional disparities by inducing widespread industrial development.
The Government of India, in order to provide adequate supply of credit to various sectors of the economy, has evolved a well-developed structure of financial institutions in the country. These financial institutions can be broadly categorized into All India institutions and State level institutions, depending upon the geographical coverage of their operations. At the national level, they provide long and medium term loans at reasonable rates of interest. The State level institutions are mainly concerned with the development of medium and small scale enterprises, but they provide the same type of financial assistance as the national level institutions. The financial sector in India currently comprises financial institutions, financial markets and financial instruments. The various segments of the financial market in India are the credit market, the money market, the Government securities market, the foreign exchange market, the capital market and the insurance market. While the money. Government securities and foreign exchange Markets are regulated by the Reserve Bank; the capital market falls within the purview of Securities and Exchange Board of India (hereafter SEBI) and the insurance market is regulated by the Insurance Regulator y and Development Authority (IRDA). In order to develop these markets, both, the Reserve Bank of India (RBI), And SEBI have taken several measures over the years

Phases of Economic Development of India

The pre and post reform regime is analytically divided into four phases according to the changes in the business dimensions and environment.

- The **first phase** is the post-independence era of establishment of these financial institutions and its gradual development growth starts from 1948 up to 1974, which witnessed establishment of the apex development banks.
- The **second phase**, between 1974 and 1991, witnessed achieving of major land marks in the history of these financial intermediaries.
- The **third phase**, between 1991 and 2001, is the first decade of post liberalization globalization regime in which most of the development banks flourished by diversifying their business and all the development banks entered into secondary market to get advantage of cheap sources of funds and as a result the total market capitalization of these banks especially development banks increased.
- The **fourth phase**, from 2001 onwards, is the neo-liberal regime and the phase of new generation reforms that enabled the banks and development banks to corporatize themselves and finally all the development banks converted in full-fledged commercial banks that offered them high degree of operational flexibility.

The Environmental Changes in Development Banking up to 1991

Historically, low-cost funds were made available to Development Banks to ensure that the spread on their lending operations did not come under pressure. Development banks had access to soft window of Long Term Operation (LTO) Funds from RBI at concessional rates. They also had access to cheap funds from Multilateral and bilateral agencies duly guaranteed by the Government. They were also allowed to issue bonds, which qualified for SLR investment by banks. For deployment of funds, they faced little competition as the banking system mainly concentrated on working capital finance. With initiation of financial sector reforms, the operating environment for Development banks changed substantially. The supply of low-cost funds was withdrawn forcing Development banks to raise resources at market-related rates. On the other hand, they had to face competition in the areas of term finance from banks offering lower rates. The change in operating environment coupled with high accumulation of non-performing assets (NPAs) due to a combination of factors caused serious financial stress to the term-lending institutions.

Financial Institutions in India

Financial Institutions in India are divided in two categories. The first type refers to the regulatory institutions and the second type refers to the intermediaries.

The regulators are assigned with the job of governing all the divisions of the Indian financial system. These regulatory institutions are responsible for maintaining the transparency and the national interest in the operations of the institutions under their supervision. The regulatory bodies of the financial institutions in India are as follows:

- ✓ Reserve Bank of India (RBI)
- ✓ Securities and Exchange Board of India (SEBI)
- ✓ Central Board of Direct Taxes (CBDT)
- ✓ Central Board of Excise & Customs

Apart from the Regulatory bodies, there are the Intermediaries that include the banking and non-banking financial institutions. Some of the specialized financial institutions in India are as follows**:**

- ✓ Unit Trust of India (UTI)
- ✓ Securities Trading Corporation of India Ltd. (STCI)
- ✓ Industrial Development Bank of India (IDBI)
- ✓ Industrial Reconstruction Bank of India (IRBI), now (Industrial Investment Bank of India)
- ✓ Export – Import Bank of India (EXIM Bank)
- ✓ Small Industries Development Bank of India (SIDBI)
- ✓ National Bank for Agriculture and Rural Development (NABARD)
- ✓ Life Insurance Corporation of India (LIC)
- ✓ General Insurance Corporation of India (GIC)
- ✓ Shipping Credit and Investment Company of India Ltd. (SCICI)
- ✓ Housing and Urban Development Corporation Ltd. (HUDCO)
- ✓ National Housing Bank (NHB)

Four measures of financial sector development

It is hard to find 'an indicator' which can directly measure the development of the financial Sector. The four measures are explained as follows:

- ■ **Private credit** Private credit is a primary indicator of financial sector development. This is equal to the value of credits by financial intermediaries to the private sector divided by GDP. This measure includes all the credit issued to the private sector by all the financial institutions in addition to the traditional depository money banks.
- ■ **Liquid liabilities** liquid liabilities are another traditional measure of financial sector development. LLY is the liquid liabilities of the financial system and is currency plus demand and interest-bearing liabilities of financial intermediaries and nonbank financial intermediaries as a percentage of GDP. This is the broadest available indicator of financial intermediation, since it includes all three financial sectors (central bank, commercial bank and other financial institutions).
- ■ **Commercial bank assets vs. central bank assets this** measure is the ratio of the assets of commercial banks to the total assets of the banking sector (i.e. commercial banks plus central bank assets) and it measures the degree to which commercial banks or the central bank allocates society's savings. The importance of this variable lies in the role that commercial financial intermediaries are likely to play in identifying profitable investments, monitoring managers, facilitating risk management, and mobilizing savings in relation to central banks**.**

- **The stock market capitalization to GDP ratio:** the stock market capitalization to GDP ratio which equals the value of listed shares divided by GDP.. This indicator is influenced by findings of various stock market studies indicating that:
- Stock market liquidity has a large causal impact on economic growth;
- Stock market liquidity influences growth as agents may have greater incentives to expand resources; and
- Stock markets can influence risk diversification**.**

Financial Institution in India Current scenario

The Financial Institutions in India mainly comprises of the Central Bank which is better known as the Reserve Bank of India, the commercial banks, the credit rating agencies, the securities and exchange board of India, insurance companies and the specialized financial institutions in India.

- **Reserve Bank of India**
- The Reserve Bank of India was established in the year 1935 with a view to organize the financial frame work and facilitate fiscal stability in India.
- The bank acts as the regulatory authority with regard to the functioning of the various commercial bank and the other financial institutions in India.
- The bank formulates different rates and policies for the overall improvement of the banking sector. It issue currency notes and offers aids to the central and institutions governments.

- **Commercial Banks in India**
- The commercial banks in India are categorized into foreign banks, private banks and the public sector banks.
- The commercial banks indulge in varied activities such as acceptance of deposits, acting as trustees, offering loans for the different purposes and are even allowed to collect taxes on behalf of the institutions and central government.

- **Credit Rating Agencies in India**

  The credit rating agencies in India were mainly formed to assess the condition of the financial sector and to find out avenues for more improvement. The credit rating agencies offer various services as:
- Operation Up gradation
- Training to Employees
- Scrutinize New Projects and find out the weak sections in it
- Rate different sectors

The two most important credit rating agencies in India are**:**

1. CRISIL
2. ICRA

- **Securities and Exchange Board of India**
- The securities and exchange board of India, also referred to as SEBI was founded in the year 1992 in order to protect the interests of the investors and to facilitate the functioning of the market intermediaries.
- They supervise market conditions, register institutions and indulge in risk management.

- **Insurance Companies in India**
- The insurance companies offer protection against losses. They deal in life insurance, marine insurance, and vehicle insurance and so on.
- The insurance companies collect the little saving of the investors and then reinvest those savings in the market.
- The insurance companies are collaborating with different foreign insurance companies after the liberalization process. This step has been incorporated to expand the Indian Insurance market and make it competitive**.**

- **Specialized Financial Institutions in India**

The specialized financial institutions in India are government undertakings that were set up to provide assistance to the different sectors and thereby cause overall development of the Indian economy.

- Board for Industrial & Financial Reconstruction
- Export-Import Bank Of India
- Small Industries Development Bank of India
- National Housing Bank

Apart from these, there are several other financial institutions that are existing in the country. These are the stock brokers and sub-brokers, portfolio managers, investment advisors, underwriters, foreign institutional investors and many more**.**

Role of Special Financial Institutions in Industrial Growth

- Special financial institutions often play a vital role in the industrial growth of developing nations like India. Such institutions are operating in many developed countries. Although some of these were in existence prior to World War-II, they are mostly a post-war phenomenon.
- Soon after independence, it was felt that fast industrial growth in the country cannot take place without cheapening and widening channels of industrial finance.
- A notable step towards this was the establishment of special financial institutions both at the national level and state level, national level special financial institutions set up by the Central Government includes the Industrial Finance Corporation of India, the Industrial Credit and Investment Corporation of India, national Industrial Development Corporation of India, the Industrial Development Bank of India and the Industrial Reconstruction Corporation of India. Such institutions at the state level include the State Financial Corporations and State Industrial Development Corporations.
- These institutions are, mainly financing agencies, providing medium and long- term capital, generally to

the private sector, although public sector is not excluded. Their operations also include conducting of market surveys, preparation of project report, provision of technical advice and management services, and establishment and management of industrial units.

- They help in the development of the capital market by providing direct financial assistance to industrial enterprises and by helping them to raise long-term loans from the market. They underwrite the new issues of industrial securities and also subscribe to them.
- They are working as an instrument of balanced economic development by focusing their efforts on less developed industries and backward regions of the country. They mobilize the resources of the country into the profitable channels taking in view the goal of balanced development of the country.
- They also provide guarantee of deferred payment against imports of capital goods and thus bring together local and foreign entrepreneurs. Generally speaking, they are multipurpose institutions in the sense of financing projects in the various sectors of the economy.

Challenges faced by Financial Institutions

1. Not making enough money. Despite all of the headlines about banking profitability, banks and financial institutions still are not making enough return on investment, or the return on equity, that shareholders require.
2. Consumer expectations. These days it's all about the customer experience, and many banks are feeling pressure because they are not delivering the level of service that consumers are demanding, especially in regards to technology.
3. Increasing competition from financial technology companies. Financial technology (FinTech) companies are usually start-up companies based on using software to provide financial services. The increasing popularity of FinTech companies is disrupting the way traditional banking has been done. This creates a big challenge for traditional banks because they are not able to adjust quickly to the changes – not just in technology, but also in operations, culture, and other facets of the industry.
4. Regulatory pressure. Regulatory requirements continue to increase, and banks need to spend a large part of their discretionary budget on being compliant, and on building systems and processes to keep up with the escalating requirements.

Role of Financial Institution in Economic Development

- The progress of Indian economic development from 1947 to the present provides further evidence that individuals do respond to incentives in their pursuit of self-survival and accumulation of wealth.
- Further, the nature of this response depends on the economic climate, particularly the role of the government. India's economy struggled as long as it was based in a system of government regulation with little interaction with economic forces outside the country.
- The economic reforms of the early 1990s set the stage for substantial improvements in the Indian economy. Further, its rate of inflation and fiscal deficit both decreased substantially. Improved exchange rate management led to improved financing of the current account deficit and higher foreign exchange reserves. Finally, India's GDP and per capita income both increased substantially from 1990-1991 to 1998-1999.
- Entrepreneurial efforts have been found to generate a wide range of economic benefits, including new businesses, new jobs, innovative products and services, and increased wealth for future community investment
- The government develops policies concerning educational and financial support.
- Government policies on taxing and regulation of business also are relevant, that such policies can either promote or hamper entrepreneurial efforts. And the government can certainly help to provide networking opportunities among new and experienced entrepreneurs.

Conclusion

The Indian economy provides a revealing contrast between how individuals react under a government-controlled environment and how they respond to a market-based environment. The evidence presented here suggests that recent market reforms encouraging individual enterprise have led to higher economic growth in that country. The reasoning here is not new, although it is refreshing to discover that this "tried-and-true" reasoning applies to developing as well as to developed nations. Specifically, reliance upon a free market, with its emphasis upon individual self-interest in survival and wealth accumulation, can yield a wide range of economic benefits. In India those benefits have included, among other things, increased economic growth, reduced inflation, a smaller fiscal deficit, and higher inflows of the foreign capital needed for investment. Among other things, India is poised to generate new business startups in the high technology area that can help it become a major competitor in the world economy. To pursue further the entrepreneurial approach to economic growth, India must now provide opportunities for (1) education directed specifically at developing entrepreneurial skills, (2) financing of entrepreneurial efforts, and (3) networking among potential entrepreneurs and their experienced counterparts. Obviously, the government can play a substantial role in helping to provide these types of opportunities. It can also provide the appropriate tax and regulatory policies and help the citizens of India to understand the link between entrepreneurial efforts and economic prosperity.

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